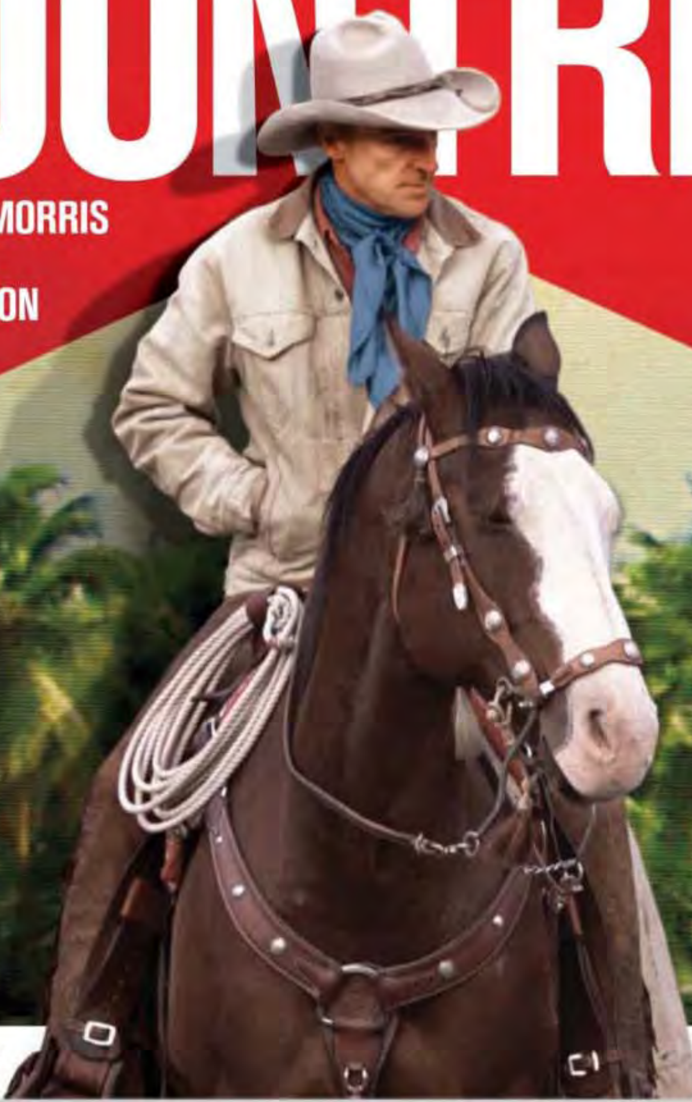
DIGITAL HEALTH BEHIND THE HYPE

BusinessWeek

MARLBORO COUNTRIES

WHERE PHILIP MORRIS IS CHASING ITS NEXT GENERATION OF SMOKERS



CORPORATE TAXES: WHO PAYS THE LEAST?

The McGraw-Hill Companies

MAY 4, 2009 | BUSINESSWEEK.COM

THE NEW 2010 LINCOLN

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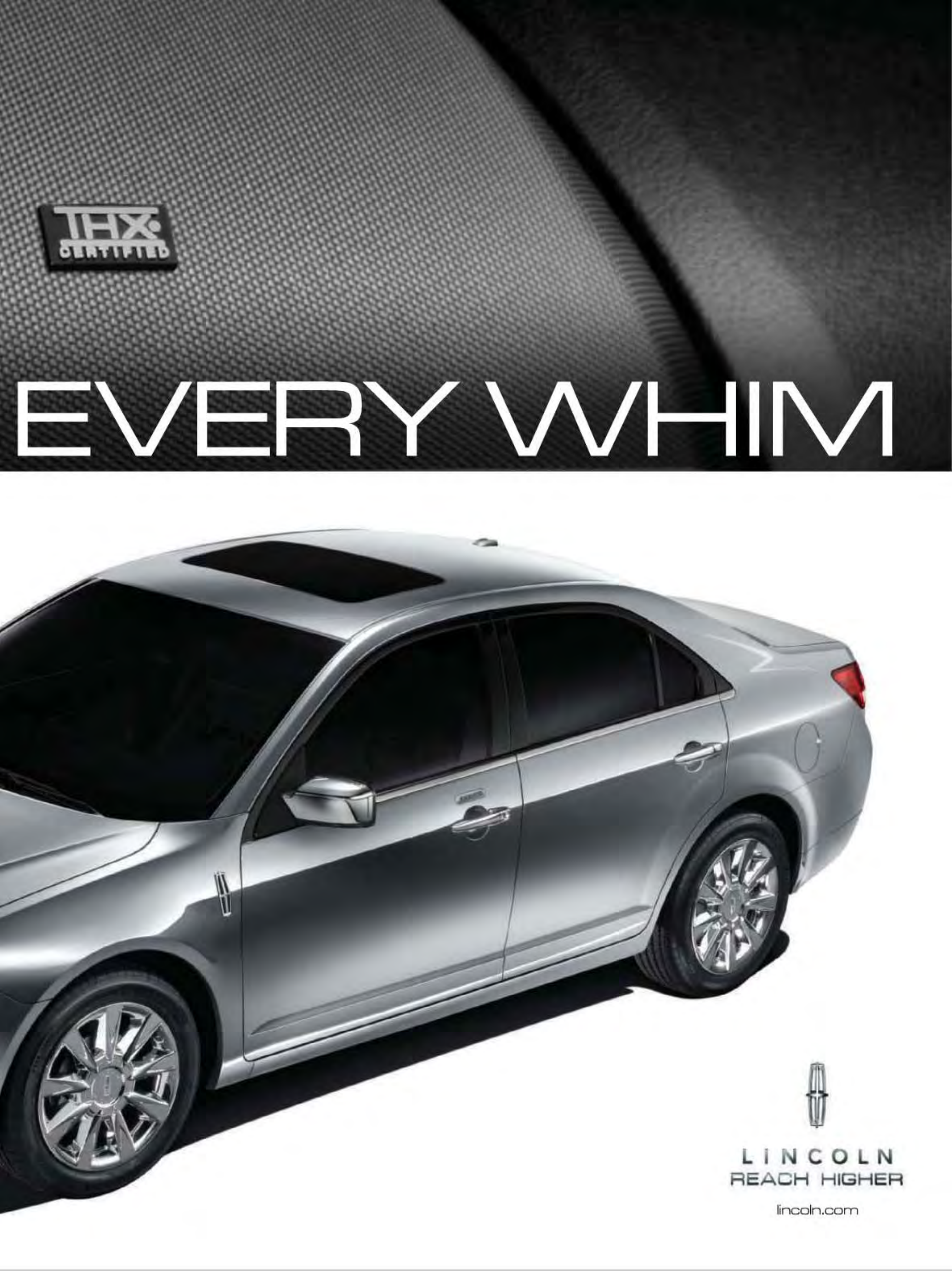
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LINCOLN
REACH HIGHER
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PHILIP MORRIS UNBOUND

Under CEO Camilleri, the tobacco giant is racing to find new smokers across the globe before restrictions spread.

BW PAGE 038

(COVER) ILLUSTRATION BY VIKTOR KOEN; (ABOVE) ILLUSTRATION BY HELLOVON

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THE BUSINESS WEEK

EDITED BY HARRY MAURER & CRISTINA LINDBLAD

Geithner, in congressional testimony, said most banks are well capitalized

SMOKE AND MIRRORS FROM THE BANKS?

Look at us, we're making money! On the eve of the release of "stress test" results, big banks such as **Bank of America, Citigroup,** and **JPMorgan Chase** have been trumpeting first-quarter numbers that roundly beat Wall Street expectations. At first investors seemed persuaded, but by Apr. 20, when BofA reported a $4.2 billion profit, the Street began to focus on the trading gains and accounting moves behind some banks' results, and the Dow dropped 3.5%. **Treasury Secretary Timothy Geithner** told Congress on Apr. 21 that the "vast majority" of U.S. banks have more capital than they need. He added, however, that before Treasury lets any given bank repay its TARP bailout cash, it will take the health of the overall financial system into account.

| BW | PAGE 017 "BofA CEO Ken Lewis: Man on a Hot Seat"

A DRY EARNINGS SEASON

Predictably, the first quarter wasn't kind to many other corporate bellwethers, though some did better than expected. **General Electric** saw earnings drop 35%, largely because of its struggling financial unit—but analysts had predicted worse. **IBM** and **United Technologies** turned in profit declines, with UTC dropping 28% and Big Blue just 1%; both maintained their forecasts for the rest of the year. Not so **Caterpillar,** deep in the ditch of the construction slump. It lost $112 million and slashed its 2009 profit outlook in half. And with airlines canceling or postponing jet orders, **Boeing** posted a 50% earnings plunge and also cut its forecast for the year.

76.9%

Year-on-year increase in mortgage applications for the week ended Apr. 17.

Data: Mortgage Bankers Assn.

(GEITHNER) WIN MCNAMEE/GETTY IMAGES; (ELLISON) KIMBERLY WHITE/BLOOMBERG

ONE NASTY SLUMP

Just to put your 401(k) losses in perspective, the **International Monetary Fund** predicts that by the end of 2010, worldwide losses on bad loans and securitized assets will total $4.1 trillion. The estimate is the first by the fund to include loans and securities originating in Europe and Japan. Banks may absorb 61% of the punishment, with insurers, pension funds, and other financial entities eating the rest.

International Monetary Fund

SUN FINDS A HOME

Larry Ellison loves to buy companies, but analysts say this merger may be his most challenging yet. The **Oracle** CEO swooped in after **IBM's** acquisition talks with **Sun Microsystems** broke off, and on Apr. 20 announced a deal to buy the troubled hardware company for $7.4 billion. The attraction for Ellison? Sun's popular **Java** programming language and other software, but he also plans to keep the hardware business.

BW PAGE 024 "Oracle Faces Its Toughest Deal Yet"

Ellison snapped up Sun

CAR CZAR BLUES

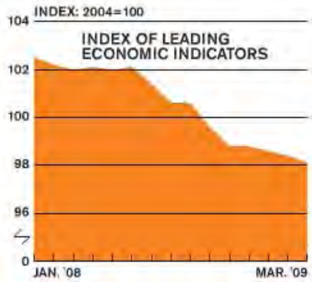
Could the widening investigation into pension fund corruption in New York State engulf **President Barack Obama's** "car czar," **Steven Rattner?** Neither Rattner nor **Quadrangle,** the private equity firm he founded, have been accused of wrongdoing. But the firm is one of several mentioned by the **SEC** and **New York Attorney General Andrew Cuomo** as having paid middlemen to win pension fund investments—a practice Cuomo barred on Apr. 22. On the same day, New York City's comptroller said Cuomo is also investigating whether the city's pension funds "were intentionally misled or deceived" by Quadrangle because it failed to disclose such payments. The firm said it's cooperating with the inquiry.

ECO-FRIENDLY GROWTH

Green products sure aren't withering away in the recession. Sales at U.S. natural-food stores jumped 10.9% in 2008, to $4.2 billion, and while growth started to slacken in the fourth quarter, it still surpassed 7% in December, which beats results at some of the best-performing grocery retailers like **Costco** and **Wal-Mart.** Meanwhile, packaged-good companies have launched 458 green products such as cleaners, toilet paper, and diapers so far this year—despite the premium prices

006 NEWS YOU NEED TO KNOW

WHERE'S THE BOTTOM?



Data: The Conference Board

usually slapped on them. At that pace, the number of eco-launches will triple in 2009. Experts say it's more evidence of green going mainstream.
Advertising Age

YAHOO! CHOPS SOME MORE

Cost-cutting—the phrase is well loved by investors. That helps explain why Yahoo stock rose a bit on Apr. 21 despite a 78% fall in first-quarter profits, to $118 million on sales of $1.16 billion. The number met the Street's expectations, and the 78% tumble resulted mostly from a one-time gain a year ago on a stake in China's **Alibaba.** The Net icon announced plans to ax 5% of its staff, about 675 people, on top of 1,600 job cuts in December. But Yahoo left largely unanswered how it would restore revenue growth beyond waiting for recovery.
"Yahoo's Bartz Starts Strong" businessweek.com/magazine

PEPSI LOOKS FOR FIZZ

A decade ago, **PepsiCo** spun off bottling operations to remove them from its balance sheet. So why is **CEO Indra Nooyi** offering $6 billion to buy its two largest bottlers, **Pepsi Bottling Group** and **PepsiAmericas,** a deal announced on Apr. 20? Because soda sales are drying up, and the move, if successful, could help Pepsi cut more than $200 million in annual costs. It would also give Pepsi 80% of its North American distribution network, which the company says will make it more nimble. Earnings and revenue slid 1% in the first quarter vs. a year ago.
"Pepsi Ups the Ante on the Bottle Front" businessweek.com/magazine

GLAXO ADDS STIEFEL

The cash-rich pharma business has a serious case of mega-merger fever. But **GlaxoSmithKline CEO Andrew Witty** is sticking to smaller deals to diversify the British company away from higher-risk prescription drugs. On Apr. 20, Witty inked his fifth and biggest acquisition since taking the top job last June. GSK agreed to pay up to $3.6 billion for **Stiefel Laboratories,** the world's largest dermatology business, whose top-selling drugs include acne treatment **Duac.** The combined company will boast $1.5 billion in revenues and an 8% share of worldwide skin-care prescriptions.

E-SPIONAGE CONTINUES

On Apr. 21, *The Wall Street Journal* reported that computer spies in recent months have infiltrated the **Defense Dept.'s Joint Strike Fighter** project as well as the **Air Force's** air traffic control system. Rising digital intrusions (some of them first detailed in a series of *BusinessWeek* stories in 2008) into U.S. government and corporate computers are leading the Pentagon to create a new command that will improve its offensive and defensive cyber capabilities. Congress is pondering legislation aimed at beefing up security on private-sector networks.

BusinessWeek's Apr. 21, 2008, issue broke the story of rising cyber-espionage

DRAMA IN DETROIT

The first dénouement approaches: Washington officials, **Chrysler,** and executives work-

DANIEL ACKER/BLOOMBERG

Pepsi's Nooyi is offering $6 billion to buy its two biggest North American bottlers


Departures from 22 North American gateways.
Connections to over 170 European destinations.
Making the world seem ever smaller.
All for this one moment.
Daddy
Love
Amy

JEFF KOWALSKY/BLOOMBERG NEWS

Building Chrysler minivans: A Chapter 11 filing is looking more likely

ing with debt-holding banks said on Apr. 20 that it's looking more likely the carmaker will enter Chapter 11 bankruptcy by Apr. 30. That's the deadline the White House set for banks and unions to make big concessions in order for Chrysler to win more federal loans. The Administration, though, may still help the company emerge from bankruptcy as part of a deal that would merge it with **Fiat. General Motors,** meanwhile, facing a June 1 deadline, said it won't make a $1 billion bond payment due on that date. It will either swap debt for equity by then—or rely on court protection in bankruptcy to slash what it owes.

YOUNG, RICH, AND CHINESE

Never mind the global downturn, China continues to mint millionaires at a rapid clip. By 2015 the Middle Kingdom will have more than 4 million wealthy households, up from just 1.6 million in 2008, says a new study. Also, China's rich are younger than their peers in the U.S. and Japan—by a full 20 years on average. Some 80% of them are 45 or younger. And while one-third of the moneyed elite now live in the four largest metropolises, most of the new millionaires will come from smaller cities. That has major implications for companies aiming to market goods and services to China's upper crust: They'll have to range farther into the interior and the north of the country to chase after them.

McKinsey & Co.

A DEATH AT FREDDIE MAC

Amid **SEC** and **Justice Dept.** investigations of accounting and disclosure matters at Freddie Mac, acting **Chief Financial Officer David Kellerman** was found dead in his suburban Washington home on Apr. 22. Kellerman, who had been at Freddie for 16 years, rising to controller and principal accounting officer, was given the CFO job in a September management shakeup around the time the government assumed control and began infusing billions into the teetering mortgage giant. At press time, police were investigating whether the 41-year-old Kellerman took his own life.

TURKEY LURES TOURISTS

Luckily for Turkey, the "staycation" trend hasn't caught on everywhere. The Apr. 12 edition of *BusinessWeek Turkey* reports that the tourism sector is expecting the number of international visitors to hold more or less steady this year at around 25 million. One thing Turkey has going for it—besides beaches, Roman ruins, and the Hagia Sofia—is the weak lira, which makes the country a more attractive destination for Europeans. One downside: Germany and Austria are doing more to keep travelers at home this year, by promoting family tourism packages and other local attractions.

THE GOOD NEWS IN A SHRINKING GDP

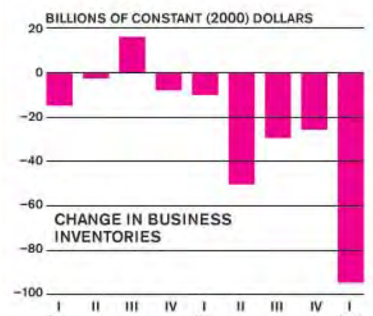
The upcoming report on the economy will likely show a massive clearing out of business inventories, bringing stocks in line with demand and setting the stage for new growth

Quarterly reports on real gross domestic product usually say more about where we've been than where we're going. Washington's data on first-quarter GDP, due on Apr. 29, will certainly have some bad news about growth last quarter, but it may well offer some good news about the second half. That's because several monthly reports imply that businesses have been slashing production at a much faster rate than overall demand has dropped off. As a result, the GDP data will most likely show a supersized liquidation of business inventories that is laying the groundwork for a stabilization in GDP.

Inventory adjustments—and the production cutbacks that accompany them—always play a major role in a business cycle. In past downturns, reducing excessive stockpiles amid weaker demand has typically accounted for about two-thirds of the drop-off in GDP, with falling demand making up the rest. This inventory purge also sets up the economy's natural snapback in a recovery. As inventories come into better balance with sales, companies start ordering again, and production stops falling, setting the stage for renewed growth.

The latest report will likely show that process is already well advanced. Economists expect first-quarter GDP to have declined at about a 5% annual rate, following the fourth quarter's 6.3% drop. They believe about half of that contraction reflects shrinking inventories. Several economists are looking for an inventory decrease close to $100 billion, after adjusting for inflation, which would be the largest quarterly liquidation on record (chart).

ECONOMISTS EXPECT A RECORD LIQUIDATION



*Average forecast of economists
Data: Bureau of Economic Analysis, *BusinessWeek*

One reason for the outsize shrinkage in stockpiles: The decline in overall demand appears to have been much less severe than in the fourth quarter. Both home building and capital spending by businesses are expected to post steep drops, but the surprise stabilization in consumer spending and a narrower trade deficit provided some offset. Consumer spending appears to have grown about 1% after huge declines in the second half of 2008.

Moreover, as the contraction in demand eased, the plunge in manufacturing output continued to intensify, helping to speed up the inventory adjustment. Factory production plummeted at a 22.4% annual rate in the first quarter after falling 18% in the fourth quarter. In particular, output of consumer goods declined almost 15% last quarter, even though spending on these items appears to have grown about 3%. That disparity implies an enormous drawdown of inventories. Plus, another big liquidation is likely this quarter as production cuts continue while demand gets support from Washington's stimulus package.

Nascent progress in bringing stockpiles into better alignment with demand shows up in the ratio of business inventories to sales. This gauge turned down in February after increasing steadily and sharply since the middle of last year. Most of that rise occurred because of the sudden decline in sales, which dropped 16% in the second half of last year. But since December, stockpiles have fallen 2½ times faster than sales, and the ongoing liquidation will continue to push the ratio lower in coming months.

One area where the inventory adjustment will drag on for a while is machinery and high-tech gear, reflecting huge cutbacks in capital spending. Equipment outlays sank at a 28.1% annual rate in the fourth quarter, the largest drop in 50 years, and first-quarter spending is expected to have posted a similar fall. In February manufacturers' ratio of inventories to sales for machinery and electronic equipment was the highest in 15 years. Factories are slashing production, and the cutbacks in high-tech gear far surpass even those during the tech bust in 2000.

Nevertheless, the traditional inventory cycle is starting to turn. Inventories will most likely have exerted their greatest drag on growth in the first quarter. Heavy cuts now will clear the way for at least a modest resumption in GDP growth in the second half, as businesses lift output to a level that's in better balance with sales. | BW |

BRAD TRENT; CHART BY LAUREL DAUNIS-ALLEN/BW

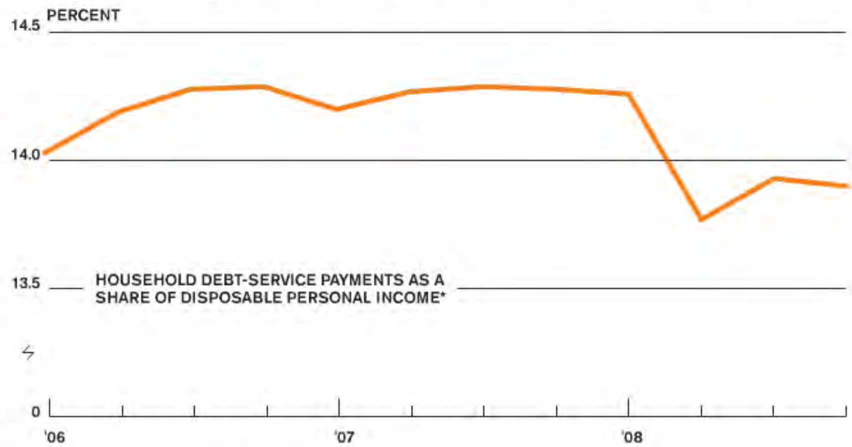
NUMBERS

HOUSEHOLDS BORROW LESS, BUT THEIR DEBT BARELY DROPS

By Tara Kalwarski/Charts by Laurel Daunis-Allen

Alarmed by the recession, U.S. households are scaling back on debt. The credit extended to consumers has shrunk since late 2008. Two top issuers experienced year-over-year declines in unpaid balances on credit cards. But the share of aftertax income going to service debt hasn't fallen much because income growth has also weakened.

Debt remains proportionately high: The ratio of debt payments to income has dipped only slightly as unemployment pushed down disposable income.



Data: Federal Reserve *Seasonally adjusted

UNPAID BALANCES

Credit-card debt at these five top issuers exceeded $604 billion last year.

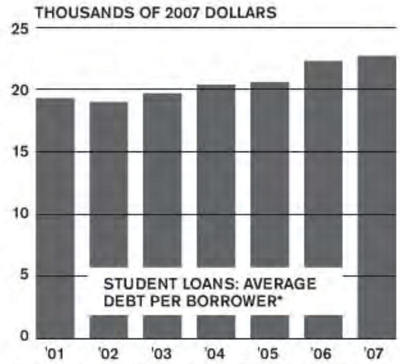
Data: *Nilson Report* *Based on outstandings, or the unpaid balances on all credit cards **Reflects acquisition of Washington Mutual

74%

Share of consumer credit held by commercial banks and finance companies as of February—about $1.4 trillion. Of the rest, credit unions and savings institutions had $323 billion; the federal government and Sallie Mae held some $120 billion; and nonfinancial businesses, including auto finance companies, had loaned $52 billion.

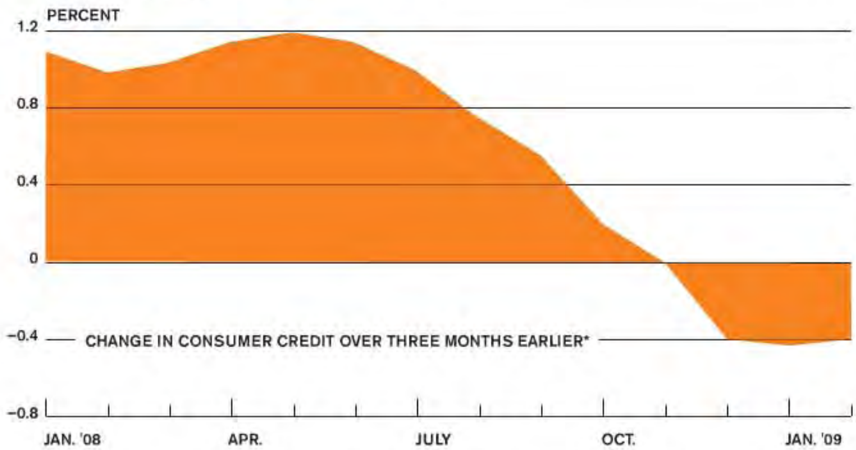
Data: Federal Reserve

College bills: The average student loan burden is up 18% since 2001.



*Includes both federal and nonfederal loans taken out to attend four-year post-secondary institutions
Data: The College Board

A modest retrenchment: Since the end of 2008 consumers have managed to cut back slightly on how much they owe.



Data: Federal Reserve *Calculated using seasonally adjusted, three-month average of consumer debt, excluding mortgages

†Excludes American Express cards issued by banks such as JPMorgan Chase and Citigroup

AN UNWELCOME DELIVERY

Domino's Pizza has become the latest company to learn how quickly a brand can be tainted in a Web 2.0 world—and how important it is to monitor social media. On Apr. 13 a prank video made by two Domino's employees in North Carolina hit YouTube. In it, one of the pair sticks cheese up his nose and "sneezes" into a sandwich he's making—using that cheese. After Domino's learned (from a blogger) about the video, it issued a statement and created a Twitter account to answer questions. And in a YouTube message, Domino's USA President Patrick Doyle conveyed his outrage, announcing the impending arrest of the workers (who said they never delivered the befouled food), a scrubdown of the outlet, and extra vigilance in hiring.

But such responses may be too little, too late these days. Doyle's apology didn't come until 48 hours after the gross-out video was posted, at which point it had racked up nearly a million views—and lots of play on other social media sites. Twitter had been abuzz with questions about Domino's silence. On LinkedIn, users created a forum on what the company should do. ("Develop a new store model with visible/viewable food prep areas," suggested one PR professional.)

Then there's the question of how to counter such a visceral image. According to University of Pennsylvania psychology professor Paul Rozin, who studies disgust, words aren't enough. "Disgust is powerful," he says, and not easily neutralized by reason. While regular patrons who have positive associations with Domino's may be less affected than others, Rozin says, the company can't do much to dispel the offending image—short of showing "pictures of attractive people eating Domino's pizza next to waterfalls."

If there's a lesson here, experts say, it's that companies must have an active presence on the Web—to monitor their brands continuously, perhaps enlisting loyal customers to help deal immediately with any damage. Domino's, says Scott Goodson, CEO of Web-savvy ad shop StrawberryFrog, "had to stand up to the video all by themselves." Pizza Hut just announced it is seeking a Twitter-based intern to monitor its reputation online. And Domino's own Twitter account now has more than 1,000 followers. The company hadn't wanted to "jump in without a strategy," says spokesman Tim McIntyre. But "we were kind of pushed."

—Ben Levisohn and Ellen Gibson

RICHARD DOWNS

ANALYZE THIS

By now, just about every manager has gotten the message about the importance of delivering timely, candid feedback. But very little is said about the art of receiving it.

Constructive criticism is a crucial tool in gloomy economic times. Frankly, I rarely meet individuals who are really good at giving others an appraisal. But—no surprise, here—for most of us it's still easier to give this kind of feedback than to get it.

I'm often asked by boards of directors to gather and deliver feedback to CEOs, whose positions tend to isolate them. The best of them embrace the experience, because they're starved for this kind of information. Others, and not just those in the corner office, aren't capable of digesting or ultimately using the critical comments they hear about their performance or behavior.

Granted, sometimes the problem is with the way such critiques are delivered (more on that later). But in my experience, the biggest obstacle to absorbing feedback is a recipient's narcissism. We all have this trait in varying doses. But for some it's a serious problem, one that makes them feel inappropriately wounded or humiliated by any criticism. Their reaction is to get angry or dismissive—or to employ other defenses. One CEO I worked with always agreed instantly with any negative feedback I conveyed, implying that he was so self-aware he wasn't being told anything new. By brushing me off, he successfully deflected the criticisms, but also missed an opportunity to learn from them.

Another defense can be to reject criticism because of the way it's delivered. I don't condone obnoxiously conveyed feedback. But I believe it can contain a germ of truth. And a harshly expressed assessment may also be a sign that a colleague or boss has been long frustrated by an individual's refusal to hear anything negative.

It may seem counterintuitive, but one the best ways to ease the sting of criticism is to ask for it on a regular basis. Think of it as preemptive action—a strategy that will help you learn, in doses you can handle, how you are experienced by others. It's a healthy way to gain a sense of control over being critiqued.

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.

UPTURN AHEAD?

File under Good News That Could Turn Bad: An index developed decades ago by the independent Economic Cycle Research Institute suggests the economy may recover before yearend. The growth rate of the Weekly Leading Index—composed of forward-looking indicators for sales, jobs, income, and output—has improved by a third from its Dec. 5, 2008, low of roughly -30%. While the rate is still negative, says Lakshman Achuthan, the institute's managing director, the uptick "has us forecasting an economic upturn." In 16 of the last 17 U.S. downturns, a climb like this one was followed by recovery in about four months, Achuthan says. The exception: In 1930, after months of climbing, a similar index used by the institute went south, and so did the economy—into the Great Depression. *–Tara Kalwarski*

CLAWING BACK

*Measured by the percentage change in index value over one year earlier

Data: Economic Cycle Research Institute

ILLUSTRATION BY RICHARD DOWNS; CHART BY DAVID FOSTER

FACETIME | MARIA BARTIROMO

BofA CEO KEN LEWIS: MAN ON A HOT SEAT

April is turning out to be a cruel month for Bank of America Chief Executive Ken Lewis. Despite BofA reporting a \$4.2 billion first-quarter profit on Apr. 20, investors drove the bank's stock down 24%—a drop that contributed mightily to a 289.6-point decline in the Dow at the close. The following day, the state treasurer of Connecticut called on Lewis to resign; on Apr. 23 he and other credit-card chieftains will be jawboned at the White House by President Obama about high interest rates and predatory practices; and on Apr. 29 he must face shareholders at BofA's annual meeting. Next month might not be that great, either: The government reports the results of its bank stress tests on May 4. I talked with Lewis twice this week, for CNBC on Monday and then again the next day for *BusinessWeek*.

(TOP) BRAD TRENT; (BOTTOM) JENNIFER S. ALTMAN

MARIA BARTIROMO
Consumer credit was obviously a sour note for the quarter, with losses of \$1.8 billion. How bad are BofA's credit problems ahead?

KENNETH LEWIS
They're so tied to levels of unemployment that you can almost look at that and look at future bankruptcies and come up with what you think they might be. So we don't see consumer credit losses peaking until sometime early in 2010 because we expect unemployment levels to continue to increase to that point. We do not, however, think that unemployment will get to 10%. We think it will still be in single digits, around 9%.

Do you feel you will need to raise more capital in the coming months?
I don't think so, and we will look to sell certain assets,

including, as we have announced, First Republic. But we'll look real hard at nonstrategic assets to make sure that we can build capital in ways other than raising it through common equity offerings or a conversion of TARP. We're now in talks with regulators about that, and so we'll have a clearer view of what we need to do after discussions with them. But at the moment, our internal stress tests do not indicate that we would need more equity, particularly given that we'll be focused on our asset sales.

"WE WOULD HAVE DONE A LOT WORSE HAD WE NOT HAD MERRILL LYNCH. ... THE BRIGHT SPOTS FOR THE FIRST QUARTER WERE MERRILL AND COUNTRYWIDE"

Would it have been better for the government to just do the stress test and not tell the public because now there are all these expectations?
In hindsight, making it public and then causing all these expectations probably was not the way to do it.

What other sales might be on the horizon as you continue to recapitalize and raise new money—Columbia Asset Management, BlackRock, U.S. Trust, the prime brokerage business, the 401(k) business?
I think we'll just step back and see what is strategic and what isn't. And the fortunate thing is when you acquire something as large as Merrill Lynch, you have chances to do that.

A service workers' union ad: The SEIU has an ulterior motive, Lewis says

How would BofA have done if it had not been pressured to complete the Merrill acquisition?
Merrill made over $3 billion in the first quarter, so we would have done a lot worse had we not had Merrill Lynch. In fact, the bright spots for the first quarter were Merrill and Countrywide.

What are you planning to tell shareholders who may complain about the stock drop, about the acquisitions, and about this tumultuous period?
I'm going to tell the stockholders that even first-quarter results show the strategic benefits of our recent acquisitions, and that can only get better. These are going to be proven to be wise decisions.

What are your thoughts on the suggestion in *The New York Times* this week that the government could convert preferred stock into common stock and become big shareholders in BofA and other banks?
Certainly that's a possibility. I think to the extent that we have any choice, we want no part of any government money and would like to pay it back as soon as possible.

It seems as though the regulators are making it tougher for banks to pay back the money.
They have a national objective of making sure the banks have enough money to lend, and they don't want what I call a head fake—where you pay back the money and then need it again.

What is the lending environment right now?
There is a dramatic decline in demand, with even some sociological implications—consumers wanting to save and not spend. I don't know if that's permanent or not.

Denise Nappier, the Connecticut state treasurer, who controls a $20 billion retirement fund, has called for you to step down. The Service Employees International Union has mounted a campaign against you, in part because BofA is said to be actively lobbying against the Employee Free Choice Act, which would eliminate the secret ballot in union elections.
First of all, the SEIU would like to unionize Bank of America, and so I think they have an ulterior motive. And then second, I was told that the state of Connecticut owns 1.4 million shares [actually it owns 3.2 million shares of BofA]. I own around 5 million, so I'm going to outvote her.

You know, I've got to tell you, I was in Texas at an economic forum yesterday, and your name came up, and a lot of people feel that you have been muzzled, that you are coming across much more shy and demure than you ever have been. Is this a result of pressure from lawmakers and regulators?
No. I think just weariness, Maria. BW

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

Business Exchange

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

Memo to Ken Lewis
Some investors are calling for the head of Bank of America CEO Ken Lewis. Public relations consultant Paul Pendergrass, in a Mar. 25 *New York Times* story, offers Lewis advice on how to keep his job. Among his suggestions: "Get a Ruthless Speech Coach. You are saying many of the right things, but they can't be heard over all that screaming your body language is doing."

To read the full blog post, go to **http://bx.businessweek.com/bank-of-america/reference/**

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026 Bob Nardelli's wrong turns
027 Haircut now, avoid bankruptcies?
028 Option ARM—and your left leg
029 All aboard for high-speed rail

Anti-American graffiti on the wall of the former U.S. Embassy in Tehran

HASAN SARBAKHSHIAN/AP PHOTO

IN IRAN, BUSINESS AWAITS A THAW

Easing tensions could bring foreign investment, allowing companies there to scale up

By Stanley Reed

TEHRAN

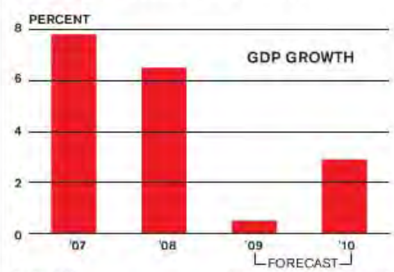
Nestled in rocky hills about 40 minutes from Tehran, Pardis Technology Park is supposed to be Iran's answer to Silicon Valley. But these days, Pardis is deserted and forlorn, with many buildings standing unfinished, their exposed girders rusting. Foreign companies are reluctant to invest in the Islamic Republic, and domestic outfits are cash-strapped.

Both foreigners and locals may find a new reason to move in. President Barack Obama has indicated a willingness to ease tensions with Tehran, and many Iranian businesspeople hope their leaders will engage with him. A relaxing of U.S. economic sanctions "would be a seismic shift," says Ramin Rabii, chairman of Turquoise Partners, a fund manager that invests in Iran.

Americans and other Western companies might benefit, too. Iran, after all, has 66 million people, good schools, and a diversified industrial base—with a pent-up appetite for computers, planes, aircraft parts, and knowhow for the crucial oil and gas industry. And many Iranians like the prospect of working with U.S. companies rather than the Europeans that have been the only game in recent years. "Iranian officials believe Americans are more straightforward in business deals," says Narsi Ghorban, managing director of Narkangan Gas to Liquid, a Tehran energy company. "They get what they want and give you your due."

If businesspeople do come to Tehran, a sprawling city built on steep hills that lead up to snow-capped mountains, they will find some conditions improved. Mobile telephones from other countries finally work, and several private hotels have sprung up. Since the 1979 revolution, social life has never been more liberal. Boys and girls hold hands in public, women show some hair outside their scarves, and checkpoints where police once searched cars for alcohol have all but disappeared. But there's still enough fear of the regime that many people decline to be interviewed.

SPUTTERING IRAN



Data: EIU

Fiscal year from Mar. 21

While President Mahmoud Ahmadinejad continues to make belligerent noises about Israel and the West, others in Tehran have hinted that they're ready for a change. In a Mar. 21 speech, Supreme Leader Ali Khamenei trotted out standard anti-American rhetoric but also indicated a willingness to talk. And Ahmadinejad's probable opponent in the June presidential election, former Prime Minister Mir Hossein Moussavi, favors negotiations with the U.S. "Obama has prompted Iranians to have an open debate about the relationship they want to have with the U.S.," says Gary Sick, an Iran specialist at Columbia University in New York. "This is something that hasn't been seen in 30 years."

Most Iranian executives seem to be rooting for Moussavi. Although he is an old-guard leftist, businesspeople hope he would lead a reform-minded

KAVEH KAZEMI/GETTY IMAGES

administration that could ease Iran's isolation. "Ahmadinejad has done serious damage to Iran's reputation and the reputation of Iranian business," says Mohammad Reza Behzadian, a former head of the Tehran Chamber of Commerce who runs Tondar Middle East, a trading company in Tehran.

There are, of course, countless stumbling blocks to improved ties. Iran continues to pursue a nuclear program opposed by the West. And Tehran is prone to antagonistic actions such as the Apr. 18 sentencing of Iranian-American journalist Roxana Saberi to eight years in prison on what seem to be trumped-up charges of spying for Washington. But there may be openings for cooperation and confidence-building on Afghanistan, where both Tehran and Washington deplore Taliban influence, and on Iraq, where Iran's help could ease a U.S. withdrawal.

Iran has much to gain. Facing pressure from Washington, major European banks have stopped doing business in the country. So Iranians must pay exorbitant rates for trade financing from second- and third-tier banks in Europe, the Middle East, and Asia. Some Iranians work around the restrictions by setting up subsidiaries in the United Arab Emirates and playing cat-and-mouse with American inspectors. But such solutions are expensive, adding billions of dollars to Iran's soaring import bill—$57 billion for the year that ended in March. "It's a challenge finding banks that we can trust," says Parviz Aghili, CEO of Karafarin Bank in Tehran.

Sanctions also restrict the development of Iran's vital energy reserves. Tehran wants to boost oil production capacity by 25%, to 5 million barrels a day, but with little foreign help and aging fields in rapid decline, it's tough even to maintain current output. That's one reason Iranian oil officials are quick to say they want American help. "We don't have any problems with U.S. investment," says M.A. Khatibi Tabatabaei, Iran's representative on OPEC's board of governors.

Renault Pars boss Kerebel says getting business done in Iran takes persistence

Ahmadinejad's erratic policies make things worse. The populist President has spent freely on everything from loans to small businesses of questionable viability to imported food and cash handouts for the poor. And he has pressured banks to shovel out easy credit, leading to a real estate boom. But worried that oil earnings will start to peter out, the central bank has tightened up, starving factories of capital and prompting a sharp fall in property prices.

OIL SQUEEZE

Last year, when oil prices surged, the Iranian economy could shrug off its problems. With oil's steep decline and the global financial crunch, though, some fear social unrest. Many factories are months behind on salaries, says Ali Reza Mahjoub, a member of Parliament and head of Workers' House, a labor group. He estimates that unemployment, officially 12.5%, is really closer to 17%. As financing dries up, building is grinding to a halt, says developer Amir-Mohamad Mazaheri. "This is a very dangerous situation," he says, puffing on a cigarette in a new tower in North Tehran. "There will be 3-4 million construction workers looking to any activity to support themselves."

Businesses of all sizes are hurting. Mehdi Farahani makes shoes in a small workshop in central Tehran with his brother and cousin. The 32-year-old says business has fallen by two-thirds, spurring him to lay off half of his 20 workers. Over a lunch of deep-fried trout, rice, and Pepsi in a packed hole-in-the-wall restaurant, he blames the government for doing little to protect small businesses from cheap Chinese imports. "Life in Tehran is becoming very difficult," he says.

Even with sanctions in place, savvy foreigners have managed to make a mark in Iran—though it takes persistence. Renault, for instance, has a $200 million joint venture to build the Logan compact. But late payments from the Iranians and difficulties training enough suppliers to meet a requirement of 60% local content have slowed progress, Renault says. The venture, Renault Pars, has cut its output target for the Logan by 25%, to 150,000 cars per year. "You need a lot of time and energy," says Renault Pars chief Jean-Michel Kerebel. "What takes five hours in Europe could take five days here." | BW |

—With Babak Pirouz in Tehran

The island already buys a lot of U.S. goods: $710 million in fruit, grain, poultry, and more last year

SVEN CREUTZMANN/GETTY IMAGES

CUBA: HOW TO BOOST TRADE

Even without lifting the embargo, Obama could encourage more commerce

By Steve Levine

As President Barack Obama seeks to ease tensions with Cuba, he risks a standoff with Congress over Washington's 47-year-old trade embargo on the island. While the White House on Apr. 13 made some travel easier and said U.S. telecom companies may invest in Cuba, Obama could do much more if he wants. The notion that the embargo makes trade with Cuba impossible "is a fallacy," says Jake Colvin, an analyst at the National Foreign Trade Council, a lobbying group for U.S. exporters. In fact, the President can authorize nearly any U.S. company to operate in Cuba.

Obama, of course, would face strong opposition from conservatives and some Cuban Americans if he loosens trade too much without reciprocal steps from Havana. Yet Cuba buys a lot of American goods already: $710 million in grain, fruit, poultry, and other products last year. And it would likely buy far more if it could. "An opening with the U.S. fits into Castro's economic calculus," says Julia E. Sweig, a Cuba expert at the Council on Foreign Relations.

A big stumbling block to doing business in Cuba is credit. American banks are barred from financing trade with Cuba, so Havana must pay cash for U.S. imports. A good start, Colvin says, would be simply to let companies give Cuba 90 days to pay for goods rather than requiring cash up front. Later, Obama might let American banks get involved, though the embargo specifically bars financing trade in certain products, says Anya Landau French, a researcher at the Lexington Institute, a think tank.

Obama could also let Cuba sell products in the U.S. to earn money to buy more American goods. And he might take the Apr. 13 measures further. The White House said it would allow more frequent money transfers and travel to the island—but only by Cuban Americans. Even with the embargo, Obama could allow anyone to visit for cultural and humanitarian purposes, though not tourism, French says, adding: "There's no reason the U.S. should be restricting its own people's travel."

In many industries, U.S. companies will be playing catch-up. Europeans, Canadians, and others have long been in Cuba. Nonetheless, American business is excited about the possibilities. Caterpillar, for instance, is hoping to export its bulldozers, road graders, and other construction vehicles to the island. "Cuba doesn't need to rebuild its infrastructure. It needs to build an infrastructure," says Bill Lane, Cat's top lobbyist. "There will be demand for almost every product Caterpillar produces." | BW |

ORACLE FACES ITS TOUGHEST DEAL YET

With his purchase of Sun, CEO Ellison is wading into the treacherous computer hardware market

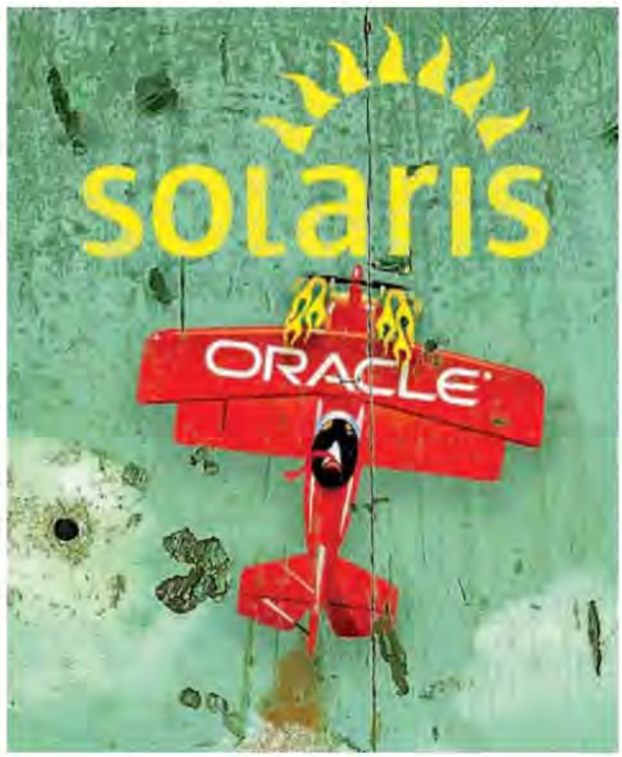
By Steve Hamm

Is Larry Ellison getting in over his head?

Since 2005 the Oracle CEO has spent more than $30 billion on 55 acquisitions. All were software outfits. He'd buy a company, fold the products and some engineers into Oracle, and discard the rest—a formula that helped lift operating margins to industry-leading levels. Now, with his $7.4 billion deal for Sun Microsystems, he's venturing into unknown territory. Sun is primarily a computer hardware company, a market wracked by the recession. That may make this Ellison's riskiest deal yet. "I think hubris is running wild at Oracle," says George F. Colony, CEO of researcher Forrester Research. "It will be extremely hard for them to play in this business."

Oracle is the world's leading maker of database software and the No. 2 player in the market for corporate software applications. It's buying Sun primarily for its popular Java programing language, Solaris operating system, and other software. But hardware and related sales account for 80% of Sun's revenues. Although rumors are circulating that Oracle will sell the hardware business, executives say it's central to their plans.

The idea is to focus Sun's server business on a small but promising segment of the market: "computer appliances" preloaded with Oracle software. The software package could, for instance, provide a company with all the software needed to run its business. That way, companies don't have to spend time and money pulling together the different technologies themselves. Oracle says revenue growth will come primarily from



additional software sales the company lands as a result of the combination, not from server sales. And officials say this merger won't be harder to pull off than its other deals. "We have a track record of integrating acquisitions very rapidly, and this time will be no different," says President Safra A. Catz.

Problem is, the hardware business is a very different beast than software. While Oracle dominates the database industry, the server market, which accounted for nearly half of Sun's $13 billion in revenues last fiscal year, is hypercompetitive: IBM, Hewlett-Packard, and Dell all rank far ahead of Sun in a business where scale matters. And corporate customers switch from one server supplier to another with relative ease. With software, they make long-term commitments to a product.

Adding to the difficulty, the server market seems to be deteriorating with each passing day. IBM, which reported first-quarter results on Apr. 20, said its computer sales had declined by 22%. Overall, analysts expect the market to shrink as much as 15% this year.

Oracle is confident it can squeeze $1.5 billion of operating profits out of Sun in the first year after the acquisition is closed, and $2 billion in the second. But that may be tough. Unlike with its software mergers, Oracle will need to keep a significant number of Sun's managers, marketers, and salespeople, since its own staff doesn't have hardware expertise. Analysts estimate Oracle will need to cut 10,000 people from Sun's staff of 30,000 to make its profit targets—but that will be hard without slicing into muscle.

Ultimately, Oracle may decide it's better to sell the hardware business than run it. Cowen & Co. analyst Peter Goldmacher says even if Oracle slashes Sun's sales, general, and administrative expenses by 22% to 32% and hits its profit goal, hardware will be a drag on the profitability of the software business. "Their margins will take a big hit," he says. |BW|

–With Aaron Ricadela

55

The number of software company acquisitions Oracle has closed since 2005

ACME ILLUSTRATORS

026

BOB NARDELLI'S WRONG TURNS

The former GE star was disappointing at Home Depot and may soon have to step down at Chrysler

COMMENTARY

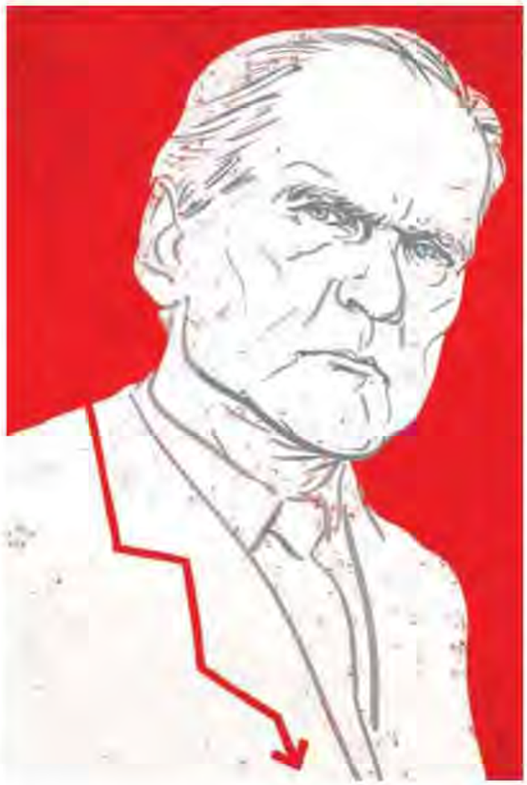
By David Welch

When Cerberus Capital Management hired Robert L. Nardelli to fix Chrysler in 2007, the private equity shop and majority owner figured an outsider like Nardelli would show those Detroit guys how to run a car company. After all, he had learned his stuff at General Electric, a company that reputedly bred the best managers in the world.

It hasn't worked out quite the way Cerberus planned. Nardelli may not be Chrysler's chief much longer—either because the company is liquidated or because Fiat gets a controlling stake and puts its own man in the job. Nardelli's exit would mark the second time he has been bounced as CEO since leaving GE in 2000. Three years ago, Home Depot gave him the shove, too.

It may be tempting to see Nardelli's missteps as an indictment of the Jack Welch school of management. But other Welch acolytes have fared better since leaving GE, among them W. James McNerney Jr. at Boeing. Nardelli has proved himself a manager who can slash costs. But since leaving GE he hasn't demonstrated compelling strategic vision.

Of course, fixing Chrysler would have tested any executive. The company was losing money well before the economy imploded. Daimler, the former owner, cut spending on new models, and Nardelli's bosses at Cerberus declined to invest more money. Chrysler argues that Nardelli had some



successes, such as forcing executives to get more disciplined about spending and pushing for quality improvements.

All the same, some of the choices he made hurt more than they helped. Nardelli's default position is to cut costs. That's an understandable instinct when a company is hemorrhaging money. But Nardelli's cuts haven't always served strategic ends. At Home Depot, he replaced many veteran hardware guys and retired tradesmen with twentysomethings making less money. The cuts gave profits a short-term pop, but lackluster service drove away loyal customers.

At Chrysler, Nardelli cut costs partly by robbing from tomorrow: He slashed capital spending for new models

At Chrysler, Nardelli cut costs partly by robbing from tomorrow. Car companies are nowhere if they don't have new products in the pipeline. But he cut capital spending for new models from more than $3 billion in 2007 to $2.3 billion for the next two years. When the feds showed up to assess Chrysler's viability, they noted that Nardelli's team planned only four new models for the next five years. They also pointed out that Chrysler had dedicated half as many engineers to a given vehicle project as General Motors. Nardelli could have cut more production to find a breakeven point rather than axing engineers and crimping product development.

FIGHTS WITH MANAGERS

Nardelli tends to ram through his ideas. At Home Depot he acquired a wholesale business, despite objections from his executives that it would shift focus from the retail stores. Several key people left, and Home Depot later sold the company. At Chrysler, Nardelli tangled with managers and engineers, including veteran Mike Donoughe, who didn't agree with some of the boss's plans. When Nardelli fired him, Donoughe joined Tesla Motors, the Silicon Valley electric-car company. A Chrysler spokesperson says Nardelli held "fireside chats" with managers and showed them "deep respect."

One of the great ironies of Nardelli's tenure is that though he billed himself as the plucky outsider waging war on Detroit myopia, his strategy differed only in degree from what the car guys have been doing for years: restructuring. Like his predecessors, he wasn't able to wring concessions from the unions fast enough. Instead, he saved money by paring white-collar ranks. His legacy is a Chrysler so hollowed out it may no longer be viable as a standalone company. **|BW|**

KYLE T. WEBSTER

TAKE A HAIRCUT NOW, AVOID BANKRUPTCY?

Bondholders are forgiving some debt to mitigate future losses, and companies are scrambling to cut deals

Harrah's CEO Loveman (R) has cut costs, but he risks alienating customers

By Christopher Palmeri

Harrah's Entertainment is having a little luck. The wounded casino giant has persuaded bondholders to forgive some of its debt, twice now. In the latest deal, on Apr. 9, investors agreed to exchange \$5.9 billion in loans for roughly \$3.7 billion in cash and new debt, taking a 37% cut on their principal. The upshot for Harrah's: lower interest payments and a less onerous debt load. "This gives them breathing room," says Chris Snow, an analyst at research firm CreditSights.

Dozens of companies that binged on debt when credit was flowing like cocktails on a casino floor are begging lenders to take a hit, and some bondholders are agreeing. Companies exchanged \$36 billion of debt for a lesser amount in 2008, according to credit rating agency Moody's. The total debt traded for new this year could top that number. Other highly leveraged private companies such as Freescale Semiconductor and Chrysler have or are renegotiating with investors. Public companies in troubled industries, including automakers Ford Motor and General Motors, are doing the same.

By cutting their debt, companies have a better chance of surviving the recession and emerging from this crisis as viable entities. "They're buying an option, hoping the economy will recover," says Jason W. Reese, CEO of investment firm Imperial Capital.

Bondholders are betting that it's better to take a haircut today than risk a company filing for Chapter 11 later. When borrowers go bust, the creditors are less likely to recoup their money. In bankruptcy, bondholders typically recover 5¢ to 42¢ on the dollar. "It's a game of chicken," says Jason A. Bauer, an analyst at investment firm T. Rowe Price, which participated in the first Harrah's debt exchange. "If it goes into bankruptcy, your return could be zero."

Buyout giants TPG and Apollo Global Management took Harrah's private for \$30 billion back in January 2008, one of the largest private equity deals ever made. The company's debt load doubled as a result, leaving Harrah's with an interest bill of \$2.1 billion a year just as America's love affair with gambling began to fade.

Now, CEO Gary W. Loveman is slashing costs to conserve cash. He halted construction on the Margaritaville Casino in Tunica, Miss., and postponed a plan to rename the company Caesars Entertainment.

Still, the casino chain faces major uncertainties. The cost-cutting, for example, may alienate customers. To save money Harrah's reduced the number of cashier windows where players exchange chips and replaced them with machines. Dealers at Harrah's, whose hours and benefits are being cut, took out ads criticizing the CEO's \$39 million pay. Says a Harrah's spokesman: "We are confident the steps we've taken won't affect the long-term success of our business."

Harrah's may have history on its side. A University of Chicago study found that highly leveraged companies that ran into trouble after the last buyout boom in the late 1980s, including RJR Nabisco, did well after cutting their debt. Says Joshua Lerner, a professor at Harvard Business School: "When you look at these firms three or four years later, there is little harm." |BW|

DEBT FORGIVENESS

Bondholders are giving distressed borrowers a break

COMPANY	AMOUNT EXCHANGED	PRICE ON THE DOLLAR
Ford Motor	\$9.9 billion	40¢
Harrah's Entertainment	\$5.9 billion	63¢
Freescale Semiconductor	\$2.8 billion	32¢
Six Flags	\$870 million	27¢

Data: Company reports

MARTIN FUENTES/*LAS VEGAS REVIEW JOURNAL*/RAPPORT SYNDICATION; PATRICKMCMULLAN.COM

OPTION ARM —AND YOUR LEFT LEG

"Flexible" loans for small business owners could lead to both bankruptcies and home foreclosures

By Mara Der Hovanesian

Entrepreneur Michael Bissell worries about losing his business, his house, or both. His 10-year-old Web design firm in Portland, Ore., is struggling as customers fall behind on their bills. To cover salary and other expenses, Bissell tapped into his home last year for extra cash, relying on his exotic mortgage, which gives him the option to pay less than the monthly interest and principal for a while. But that source of money is running dry: The payment on his home loan will soon jump significantly. "I have no padding," says Bissell.

Small business owners are at the epicenter of two dangerous forces: the housing bust and the recession. During the boom, many entrepreneurs pulled money out of their homes to start businesses or fund existing operations. Some, like Bissell, relied on an especially pernicious type of loan, the option adjustable-rate mortgage, which allowed borrowers to determine the size of their monthly payment. When the businesses ran into trouble, many homeowners started paying the minimum, tacking the extra interest and principal onto the loan.

Many mortgages are resetting and triggering higher payments—either because the terms of the loans dictate such a reset or the balances far exceed the value of the underlying homes. That's leaving entrepreneurs scrambling to come up with more money as their businesses are suffering—a double whammy on a fragile economy. Borrowers with option ARMs can't easily refinance, since they often owe more on the loans than their homes are worth. And loans for small businesses have all but dried up. "Small business [owners] are hurting, and they're scared," says Chad Moutray, chief economist in the U.S. Small Business Administration's Office of Advocacy.

In the era of easy credit, mortgage brokers targeted small business owners, marketing option ARMs as cash-management tools. An executive at now-defunct lender GreenPoint Mortgage called such loans "a low-cost and low-hassle way for small business owners to finance ... growth" in a trade publication back in 2004. Bill Challas, a broker at LG Loan Group, saw entrepreneurs as ready buyers: "If you could pay $1,000 less a month on a loan, wouldn't you?"

-4.5%

The drop in small business loans in the last two years of the boom*

Data: Small Business Administration
*2005-06

CALIFORNIA NIGHTMARE

Statistics are scarce because lenders don't break down loan volume by types of borrowers. But sales of option ARMs to all homeowners, according to research firm First American CoreLogic, soared more than 75%, to $255 billion, from 2005 to 2007—the height of the housing frenzy. Small business loans backed by the government dropped 4.5% in the last two years of the boom.

The problem is acute in California, where small businesses account for more than 50% of employment. Homeowners in the state are liable for 60% of all the outstanding option ARMs nationwide, according to Credit Suisse. Officials are trying to forestall a wave of business failures. Preston DuFauchard, commissioner of California's Corporations Dept., is pressing large lenders to modify the loans. "California small businesses are at risk, since they were targeted for these toxic mortgages," says Samuel D. Bornstein, a professor at Kean University in Union, N.J.

Such efforts come too late for Pamela Plouffe of Pine Mountain Club, Calif. She refinanced her home in 2003, extracting $50,000 to buy an apparel business. Last year her monthly mortgage payment jumped from $900 to $1,700 as customers dwindled. The bank foreclosed in October. Says Plouffe, 53: "I've got to start over." BW

–With John Tozzi

Plouffe, who refinanced to buy a clothing business, lost her home

MAX S. GERBER

A digital simulation by the California High Speed Rail Authority

CLEARING THE TRACK FOR HIGH-SPEED RAIL

Federal funding may finally help some long-dormant projects, such as California's, chug out of the station

By Pete Engardio

It may be old hat in Europe and Asia to rocket through the landscape on a 200-plus-mile-an-hour train. But in America, all that promoters of high-speed passenger rail service have to show for three decades of effort are dusty feasibility studies stretching from Florida to California.

Yet by committing $13 billion in stimulus and budget funds to high-speed train travel to reduce traffic congestion and cut pollution, the Obama Administration is giving these projects a critical boost. A priority is a line that would whiz passengers 520 miles from Anaheim to San Francisco in less than three hours and upgrades of Amtrak service in New England and the Midwest to reach speeds of up to 150 mph. "This is the first time a U.S. Administration has put this high on the agenda and is putting serious money behind it," says G. Lindsay Simmons, a Washington attorney representing the French National Railway, which aspires to manage U.S. transit systems.

Dozens of potential investors, most of them foreign, are interested but wary. They remember all the previous setbacks that undid once-promising projects in places such as Texas and Florida. They're also keenly aware that U.S. government analysts concede that it's impossible to run these hugely expensive networks profitably. That means an eternity of subsidies—and the unending wrath of Republican budget hawks who have repeatedly attacked Amtrak's budget. "We believe deeply that high-speed rail will come to the U.S.," says Yannick Legay, high-speed project policy manager for Alstom, creator of France's fabled TGV, or *train à grande vitesse*. "But we're still at the beginning of the story."

LaHood: A national high-speed rail network is three decades away

Despite their caution, executives from Alstom have made three marketing trips to California in recent months to showcase the company's latest technology, which can hit 357 mph in tests. Bullet-train operator Central Japan Railway has formed a 10-person division to develop strategies to bid on U.S. contracts. Foreign manufacturers such as Bombardier, Kawasaki, and Siemens, which now assemble transit cars in the U.S., would gladly do the same with high-speed trains to land business.

"AS GOOD AS IT GETS"

California is the big test. Voters in November authorized the state to float $9.9 billion in bonds to start construction of the first $33 billion phase. Billions more are expected from Washington. "You can never have 100% certainty that a deal will happen, but this is as good as it gets," says David Crane, economic adviser to Governor Arnold Schwarzenegger.

If, however, projects like California's don't begin before the next shift in poltical power, federal funding could again be in jeopardy. Support also must be maintained for the long haul. U.S. Transportation Secretary Ray LaHood notes that the interstate highway system, launched in the 1950s, wasn't finished until the early '90s. "We are talking another three decades," he says, "before a national high-speed network becomes a reality." **BW**

—With Andy Reinhardt in London, Kenji Hall in Tokyo, and bureau reports

HIGH-SPEED PROJECTS

ROUTE	TOP SPEED	COST (BILLIONS)
Anaheim-San Francisco	220 mph	$33
Washington-Boston*	150 mph	3.8
Anaheim-Las Vegas	311 mph	12.8
Dallas-Houston-San Antonio	220 mph	12-18

*Upgrade of Acela Line
Data: U.S. GAO, Texas High-Speed Rail & Transportation

(RIGHT) JAY MALLIN/BLOOMBERG NEWS

THE DUBIOUS PROMISE OF DIGITAL MEDICINE

By Chad Terhune, Keith Epstein, and Catherine Arnst
Illustration by Yarek Waszul

Why huge spending on electronic records won't produce quick improvements in efficiency or care

Neal Patterson likens the current scramble in health information technology to the 19th century land rush that opened his native Oklahoma to homesteaders. Cerner, the large medical vendor Patterson heads, is jockeying for new business spurred by a $19.6 billion federal initiative to computerize a health system buried in paper. "It's a beautiful opportunity for us," the CEO says.

The billions in taxpayer funds—part of the $787 billion economic stimulus—also have energized tech titans General Electric, Intel, and IBM, all of which are challenging Cerner and other traditional medical suppliers. Microsoft and Google aim to put medical records in the hands of patients via the Web. Wal-Mart is teaming with computer maker Dell and digital vendor eClinicalWorks to sell information technology to doctors through Sam's Club stores.

Under the federal stimulus program enacted in February, hospitals can seek several million dollars apiece for tech purchases over the next five years. Individual physicians can receive up to $44,000. These carrots should encourage the proliferation of technology that will computerize physician orders, automate dispensing of drugs, and digitally store patient records. If providers participate broadly, those files are supposed to be accessible no matter where a consumer goes for treatment. President Barack Obama says the changes will improve care, eliminate errors, and eventually save billions of dollars a year. There's also a stick: The federal government will cut Medicare reimbursement for hospitals and medical practices that don't go electronic by 2015.

The incentives are working. R. Andrew Eckert, CEO of tech provider Eclipsys, says one client, a 250-bed hospital that shelved a software order in the fall after losing $50 million in the stock market, has reinstated the order. The move is "100% due to the stimulus," says Eckert (who won't name the hospital). Brandon Savage, chief medical officer at GE's health unit, says his company's technology will leapfrog the competition by not just replacing paper but also guiding doctors to the best, least-costly treatments.

In Washington, where partisan bickering over how to revive the economy flares on several fronts, sweet consensus reigns on health-tech spending. Congressional Republicans sound just as enthusiastic as the White House. Encouraged by former House Speaker Newt Gingrich, now an influential industry consultant, lawmakers cheer electronic records as a business-based remedy for much that ails medical care.

HIGH COST, QUESTIONABLE QUALITY

That rare agreement, however, is obscuring the checkered history of computerized medical files and drowning out legitimate questions about their effectiveness. Cerner, based in Kansas City, Mo., and other industry leaders are pushing expensive systems with serious shortcomings, some doctors say. The high cost and questionable quality of products currently on the market are important reasons why barely 1 in 50 hospitals has a comprehensive electronic records system, according to a study published in March in the *New England Journal of Medicine*. Only 17% of physicians use any type of electronic records.

Hospitals and medical practices that plugged in early have experienced pricey setbacks and serious computer errors. Suddenly dumping more money on hospitals, which will then funnel the cash to tech vendors, won't necessarily improve the situation, say many doctors and administrators.

Studies have shown that some large networks, such as the Veterans Administration and the Kaiser Permanente system, based in Oakland, Calif., have used electronic records to help cut costs and improve care. But so far there's little conclusive evidence that computerizing all of medicine will yield significant savings. And improvements to patient care may be modest. An analysis of four years of Medicare data published in March in the scholarly journal *Health Affairs* found only marginal improvement in patient safety due to electronic records—specifically, the avoidance of two infections a year at the average U.S. hospital. "Health IT's true value remains uncertain," wrote Stephen Parente and Jeffrey McCullough, researchers at the University of Minnesota.

Part of the problem stems from a fundamental tension. Info tech companies want to sell mass-produced software. But officials at large hospitals say such systems, once installed, require time-consuming and costly customization. The alterations often make it difficult for different hospitals and medical offices to share data—a key goal. Meantime, the health IT industry has successfully lobbied against government oversight.

"Most big health IT projects have been clear disasters," says Dr. David Kibbe, senior technology adviser to the American Academy of Family Physicians. "This [digital push] is a microcosm for health-care reform. ... Will the narrow special interests win out over the public good?"

OVERLOOKING RED FLAGS

Britain's experience shows that technology alone doesn't offer an automatic advantage. An $18.6 billion initiative to digitize Britain's government-run health system is four years behind schedule because of software snafus and vendor troubles. Few British doctors have been able to use electronic records, and there's little proof that they have saved money or helped patients. "There is a belief that technology solves all of our problems," says Ross Koppel, a sociologist at the University of Pennsylvania School of Medicine. "[But] more data does not equate to better medical care."

Administration officials insist they are proceeding cautiously and will learn from any missteps. But red flags raised by doctors and researchers haven't gotten much attention in Washington, in part because the health-tech industry has forged strong ties to the President, his top medical advisers, and Republican heavyweights such as Gingrich (page 35).

Nancy-Ann DeParle, the new White House health-reform czar, recently stepped down after eight years as a member of Cerner's board of directors. A former administrator of Medicare and Medicaid during the Clinton Administration, DeParle worked from 2006 through 2008 as a managing director at CCMP Capital Advisors, a private equity firm that invests in health-care businesses. She has sold shares in Cerner for about $950,000 and is disposing of investments related to CCMP, according to the White House.

DeParle declined to comment. Obama spokeswoman Linda Douglass says DeParle will delegate any decisions related to Cerner to a subordinate. "She is not going to be involved in implementing health IT," Douglass adds. Cerner CEO Patterson says DeParle's ascension won't benefit his company, which had $1.7 billion in revenue in 2008. "I think that actually works to our disadvantage," he argues. "I'm not sure I'll even be able to talk with her now."

Glen Tullman, CEO of Allscripts-Misys Healthcare Solutions, a big Chicago vendor to doctors, became acquainted with Obama when he ran for the Senate in 2004. The pair worked out at the same Chicago gym and occasionally played basketball. At that time, Tullman gave Obama a personal demonstration of his company's software at Allscripts' headquarters and went on to serve on Obama's Presidential campaign finance committee. "I feel fortunate that before he became President we had the opportunity to help him better understand the value of electronic health records as a necessary condition to fixing health care," Tullman says.

Shortly after the stimulus became law two months ago, Tullman and Gingrich hosted a Webcast for thousands of hospital officials and doctors promoting the financial incentives. Since then, Tullman has worked with a client, the University of South Florida Health system in Tampa, to seek $15 million in stimulus money to hire 130 e-health "ambassadors" who would pass out free samples of Allscripts' prescribing software to physicians. If the funding comes through, the $50,000-a-year representatives would receive a two-week training course from Allscripts, though the marketers otherwise are supposed to be independent of the company.

"This is all about getting doctors moving and considering an electronic health record," Tullman says. "The market is so big, we will get our fair share." U.S. Representative Kathy Castor, a Tampa Democrat, is helping. She has brought the Allscripts proposal to the attention of officials at the U.S. Health & Human Services Dept. whose job it is to dole out the tech incentives. Castor says the program will create good jobs during a recession.

POLITICAL GENEROSITY

Health technology companies and their executives gave more than $5 million to campaigns in 2007-08, mostly to Democrats

DONOR	ALLSCRIPTS	CERNER	EPIC SYSTEMS	GE	McKESSON	SIEMENS
TOTAL	$119,146	$128,112	$203,191	$3,637,894*	$726,761*	$409,788*
% TO DEMS	100%	35%	98%	61%	44%	60%

Data: Center for Responsive Politics analysis of Federal Election Commission data

*Includes donations unrelated to health technology

STEFAN HESTER

Cerner CEO Patterson says the company's software makes medicine safer

Allscripts' rivals want their share, too. Lobbyists for McKesson, a large medical supplier based in San Francisco that already generates $3 billion a year in health technology sales, are distributing a position paper to members of Congress and Administration officials that could help steer stimulus dollars toward the company. The document, reviewed by *BusinessWeek*, addresses the definition of "meaningful use" of electronic records. That is the standard Congress set for hospitals and doctors seeking incentive money; it is now up to the Obama Administration to refine the term. The McKesson paper urges a requirement that recipients "build on existing technologies"—language that could favor products of McKesson and other established vendors.

Dr. David Blumenthal, the new head of health tech at HHS, will play a big role in fine-tuning this language. Formerly director of the Institute for Health Policy at Harvard Medical School, he declined to comment. HHS spokesman Nicholas Papas says: "Health IT has the potential to save the federal government more than $12 billion over 10 years, improve the quality of care, and make our health-care system more efficient. We have work to do to achieve this potential... and we will ensure that everyone has a seat at the table." McKesson says it's just trying to speed the process. "Our big message is: 'Please do this quickly. Uncertainty creates a slowdown,'" says Ann Richardson Berkey, senior vice-president for government strategy.

There are potential benefits to patients and taxpayers if the promise of electronic medical records can be fulfilled (page 36). In theory, a computer screen can supplant reams of paper and offer instant access to patient histories, dangerous drug interactions, and allergies. Treatment of diabetes, cancer, and other illnesses can be tracked more effectively.

SPIKES IN PHARMACY ERRORS

Geisinger Health System in Danville, Pa., wanted all that when it spent $35 million to purchase and install software from Epic Systems, a large vendor in Verona, Wis. But in June 2005, during a pilot run of a computerized order-entry system at Geisinger's flagship medical center, errors began appearing at a rate of several a week in the hospital's psychiatric unit. "The pharmacy would interpret an order as one drug at one dosage, and the patients were ordered the wrong medications at different dosages," recalls Jean Adams, a nurse in charge of the IT team. Fortunately, astute staffers discovered the problem after a few weeks and began verifying the computer drug orders using the phone. Full implementation of the Epic system was put on hold. Adams says Geisinger traced the trouble to incompatibility between a common pharmacy database and Epic's system.

Epic CEO Judith Faulkner says the episode at Geisinger, and similar incidents at other hospitals, taught her company that physician orders and pharmacy records cannot use distinct technologies. "It doesn't work when you mix and match vendors," Faulkner says. "It has to be one system, or it can be dangerous for patients."

To resolve its problem, Geisinger spent an additional $2 million on fixes that took 18 months, according to Dr. James M. Walker, the hospital chain's chief health information officer. An internist and former minister, Walker is one of health technology's best-known advocates. Tech boosters frequently cite Geisinger as an illustration of IT's sunny future. But Walker concedes that the stimulus-fueled rush to adopt existing technology could cause other providers to suffer through expensive fixes with potentially harmful consequences for patients. Vendors such as Epic, Walker says, sell relatively rudimentary electronic tools and expect hospitals and doctors to assure accuracy and safety. "This can be very tricky," Walker adds. "A lot of us are trying to say: 'Look, let's slow down.' "

NO WAY TO REPORT PROBLEMS

The Joint Commission, a nonprofit group that inspects and accredits 15,000 health-care organizations, has expressed similar caution. The commission, based in Oakbrook Terrace, Ill., issued a warning in December about problems with complex health-tech systems. It cited one U.S. pharmaceutical database that found 43,372 medication mistakes, or about 25% of the total reported in 2006, involved computer technology. The problems included flaws in data entry, inadequate software, and confusing screens.

Koppel, the researcher at Penn, has sounded some of the loudest alarms. In 2005 he published a study in *The Journal of the American Medical Association* that examined an Eclipsys system at the university's academic hospital. He found that use of computers introduced 22 new types of medication errors. His goal was to discover why young medical interns make so many errors. He hypothesized that long hours were to blame. To his surprise, the problems stemmed mostly from software installed to prevent mistakes.

Eclipsys CEO Eckert says Koppel's study examined a technology that has been updated. "The industry has grown up," he says. "There are months of testing by the client and us before someone activates a system."

When health technology fails for one medical provider, there is no central mechanism for reporting problems to others who use it. The federal government collects and disseminates this kind of information on drugs and medical devices. But tech contracts routinely bar medical providers from disclosing systemic flaws. Koppel contends this is unethical and risky: "We need to collect what we know and head off [any potential] tragedy."

Companies counter that confidentiality agreements protect their proprietary technology and that privacy laws prevent disclosure of patient and physician information without consent. "To the extent we are required to report information, or are allowed to, we would, of course, like to do that," says Allscripts CEO Tullman. He compares the skeptics of health info tech to doctors who questioned the introduction of the stethoscope in the 19th century: "There have been Luddites in every industry."

Disputes over health-tech failures are often resolved in private, making them difficult to sort out. Seattle Children's Hospital sued Eclipsys in 2002, claiming the company missed installation deadlines and failed to fix software errors. This resulted in "sizeable cost overruns and delays," the suit alleged. Eclipsys and the hospital reached a confidential settlement in 2003. A spokeswoman for Eclipsys says "isolated problems in Seattle don't reflect our company's overall success. Every vendor in the industry has had accounts with implementation issues."

"That was a bad marriage," says Dr. Mark Del Beccaro, chief medical information officer at Seattle Children's Hospital. "It taught us to get a better prenuptial agreement next time." The hospital turned to Cerner for a new system, but Del Beccaro soon became troubled by incidents of children suffering medication overdoses despite alerts from the Cerner software. He asked the doctors involved whether they had seen the alerts onscreen. "They told me, 'I get so many alerts, I click through [them],' " Del Beccaro says. "They do become mind-numbing."

"Alert fatigue" is a common concern at hospitals. The Joint Commission, in its December bulletin, warned about doctors and nurses overriding them and impairing patient safety. At Seattle Children's, Del Beccaro says, it took considerable effort to reduce online warnings. "There are definitely times Cerner could be more responsive to our problems, but we are pretty happy with them," he says.

Children's National Medical Center in Washington, D.C., has had a similar experience. In 2006 doctors and nurses there say they discovered an eightfold increase in dosage errors for high-risk medications. They attributed the trend to a Cerner system installed six months earlier. The mistakes were caught, and no patients were harmed, according to the center. But the hospital reverted to a process using paper notes. "I felt betrayed by a system I was supposed to trust," says Cherise Aldridge, a neonatal intensive-care nurse.

For three years, Cerner has resisted making adjustments to its software, which cost the Children's Center $30 million, says Linda Talley, the hospital's director of nursing systems. Today nurses use the Cerner network in combination with one assembled by the hospital's tech department. Nurses retype drug dosages, babies' weights, and other information from the Cerner computer into the homemade system to double-check how

STEPHEN VOSS

DIGITAL HEALTH'S HEAD CHEERLEADER

Newt Gingrich's for-profit firm is at the forefront of the push to computerize patient records

By Keith Epstein

Newt Gingrich, a polarizing Republican icon during his time as House Speaker in the 1990s, still gets his licks in. As a pundit on Fox News, he attacks President Barack Obama for giving Treasury Secretary Timothy F. Geithner "dictatorial" power. He collects speaking fees of up to $50,000 to rail against the federal financial bailout. But on one topic—moving medicine from paper records to digital—Gingrich, 65, has evolved into a harbinger of harmony.

Years before most others in Washington, he preached that computerizing hospital charts and patient histories would save lives and money. Now his for-profit Center for Health Transformation, operating from book-filled offices on K Street in the heart of Washington's lobbying district, advises GE, IBM, and Microsoft. His 94 clients, which also include hospitals and insurers, pay up to $200,000 apiece annually to get Gingrich's guidance. Lately he has been advising on how to grab some of the $19.6 billion in federal stimulus money.

Some 94 clients pay as much as $200,000 apiece annually for Gingrich's advice

Backed by a staff of 23, Newt, as everyone calls him, says he doesn't promote one client over another. He isn't a registered lobbyist. "What we market is soup," he explains. "We're not marketing Campbell's."

Gingrich opens doors on Capitol Hill, pairs potential business partners, and finds hospital customers for tech vendors. He proffers policy prescriptions in speeches and writes newspaper opinion pieces with Democratic senators such as John Kerry (D-Mass.), the former Presidential candidate. Privately he consults with senior Obama Administration health-care officials, such as Andrea Palm, a former aide to Hillary Clinton in the 1990s who now serves as Deputy Assistant Secretary for Legislation at the Health & Human Services Dept. Gingrich and the department's new overseer of health technology, David Blumenthal, have been e-mailing.

Gingrich says his organization, which he started in 2003, promotes "real-life solutions" gleaned from "collaboration with leaders." Mentioning GE and Siemens, he says: "Some of the vendors are ... more aware of the potential for dramatic change. Others are so busy trying to make this quarter's sales goal that they're not doing much strategic thinking." He politely declines to identify the latter.

David Merritt, a Gingrich top lieutenant and a former adviser to Presidential candidate John McCain (R-Ariz.), says many of the center's clients these days have an identical question: "How do I get the money [from the stimulus program]?"

much medicine to administer. This time-consuming process has brought the dosage-error rate back down, says Talley. But she warns that other hospitals use the Cerner system without a backstop like the one her institution cobbled together.

Dick Flanigan, a senior vice-president at Cerner, says the company responds swiftly to requests for improvements and is "absolutely focused on making systems as safe and effective as possible." There are divergent opinions as to which technology works best, he adds. Cerner has developed a more expensive system that uses bar codes for medication and is capable of better integrating a wide array of data, he says. "We are flexible on this, and at times we incorporate what is done by the client." CEO Patterson adds that hospitals "are much safer [with Cerner technology] than without it."

The company faced more questions over its technology at the University of Pittsburgh Medical Center (UPMC). In 2005 researchers there found that at the university's Children's Hospital, patient deaths more than doubled, to 6.6% of intensive-care admissions, in the five months following the installation of a computerized order-entry system. The research on child patient deaths at the University of Pittsburgh found a "direct association between [computerized records] and increased mortality," according to an article published in December 2005 in the medical journal *Pediatrics*. Digital technology slowed treatment in several ways, the researchers concluded. One example: Doctors and nurses in the intensive-care unit were accustomed to ordering medications and tests while a sick child was en route to the hospital. The Cerner system required that orders be submitted only when the patient arrived, costing crucial time. The authors of the *Pediatrics* article acknowledged that their work clashed with other studies showing that digitization decreases errors and shortens hospital stays.

G. Daniel Martich, chief medical information officer at UPMC, says the *Pediatrics* study was flawed. Factors other than the installation of computers, such as the centralization of pharmacy services, also disrupted care, he emphasizes. The problems identified in the 2005 paper have all been resolved, Martich adds. "There were workflow issues," he says. "We learned the hard way because we were pioneers." Over the long run, he says, technology has helped decrease mortality rates and cut medication errors in half at Children's Hospital since 2003.

CURSORY PRODUCT TESTING

Cerner CEO Patterson says the 2005 Pittsburgh study "certainly got our attention" and prompted an internal review. But that inquiry and others since have found no pattern of ill effects, he says. "We have more clients doing more orders than anybody," Patterson says. "If I had a systemic problem, you'd be reading about it on the front page."

The U.S. Food & Drug Administration has been considering

UPSETTING THE CASTE SYSTEM

A successful technology venture hits resistance

YAREK WASZUL

By Catherine Arnst

Partners HealthCare System, the largest hospital network in New England, provides a valuable lesson on digital medicine: When computerizing records, take into account physicians' pride.

Four years ago, Partners, which is based in Boston and includes the teaching hospitals Massachusetts General and Brigham & Women's, took a radical step. It required that the 4,500 doctors with admitting privileges install GE Healthcare electronic records systems in their offices that would be compatible with the hospital's own extensive network. Each physician had to pay about $25,000.

The strong-arm tactic worked—for the most part. Use of electronic records by doctors affiliated with Partners rose from 9% in 2003 to almost 100% today. But some 150 doctors cut their ties to the hospital rather than wire up.

According to Dr. Thomas H. Lee, who heads Partners' physician group, the main obstacle was not the price of the technology but the network's emphasis on tying all staff—specialists, primary care doctors, and nurse-practitioners—into a coordinated team. The move violated medicine's traditional caste structure, says Lee. "That doesn't always sit well with doctors who are used to being the top authority."

Partners even required doctors with their own computer systems to switch to the GE version. "I don't want doctors just to work better," Lee says. "I want them to work better with their colleagues."

Doctors are supposed to coordinate a patient's care in a way that happens in few places. A diabetic who needs to see a number of specialists no longer should have to worry about conflicting medications or redundant tests. Primary care doctors stay in the loop when patients enter the hospital for surgery.

No studies have yet been published to determine whether Partners has saved any money since going digital. Nor has the network determined whether care has improved. But it now has the data to carry out those studies, and it plans to do so soon.

whether to regulate health technology in the manner it oversees medication and implants. That decision now falls to the Obama Administration, which faces opposition from industry groups arguing that additional red tape would impede adoption of helpful technology.

Companies are lobbying the Administration to keep product-testing and standard-setting within the sole jurisdiction of a nonprofit body called the Certification Commission for Healthcare Information Technology. Founded in 2004 with industry money and grants from nonprofits, CCHIT now receives $7.5 million a year under a contract with the federal government. The other half of CCHIT's $15 million budget comes from fees paid by companies.

Mark Leavitt, chairman of CCHIT, is a former tech vendor. He sold his electronic health-records company to GE in 2002 and later became chief medical officer of the Healthcare Information & Management Systems Society, a trade group in Chicago. Seven of the CCHIT's 19 voting members work for vendors or for-profit tech consulting firms. "We try to strike a fair balance between medical providers and vendors," Leavitt says. "People need to trust what we do."

GE Healthcare's Savage says its product updates doctors on the best treatments

BOB STEFKO

But another commissioner at the CCHIT, Michael L. Kappel, the senior vice-president for government and industry relations at McKesson Technology Solutions, acknowledges that preserving purely private-sector oversight will be tough in the wake of the financial crisis. "I'm having a hard time with this issue because people read about these financial companies, and there is a feeling that government lacks enough regulation," Kappel says. But regulating health info tech "is a recipe for disaster," he adds. "I am very sensitive to criticism that [CCHIT] is vendor-dominated. That couldn't be further from the truth."

Blumenthal, the new Obama health-tech chief, declined to comment on CCHIT. But in an article published this month in the *New England Journal of Medicine*, he said the body needs to set stricter standards: "Many certified [electronic health records] are neither user-friendly nor designed to meet [the stimulus law's] ambitious goal of improving quality and efficiency in the health-care system."

Sharona Hoffman, a professor of law and bioethics at Case Western Reserve University in Cleveland, says CCHIT's product testing, typically completed in a single day, isn't rigorous enough. In an article last December in the *Harvard Journal of Law & Technology*, she and a co-author faulted the group for telling vendors the testing scenarios in advance and for not conducting ongoing monitoring. Without better oversight, she argues, hospitals and doctors probably will not spend their stimulus money wisely.

Barry Hendrix, a primary-care physician in Paragould, Ark., says he paid dearly for just such a mistake, wasting $100,000 on an electronic records system. "It was a complete disaster," he says of the equipment he bought from NextGen in 2005 and abandoned within months. The system generated patient notes with stray asterisks and other gibberish, he says, and it didn't work properly with NextGen's billing software. Hendrix says he couldn't get technical support from the company or its authorized reseller. NextGen, a unit of Quality Systems in Horsham, Pa., counters that Hendrix is a rare exception among thousands of loyal customers. It adds that it has terminated the reseller that served him.

Hendrix, however, has advice for doctors looking to go electronic: "Never believe a slick salesman." **BW**

Business Exchange

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Obama's Point Man on Health IT Weighs In

Businesses angling for a share of federal health-technology stimulus money will want to study an Apr. 9 *New England Journal of Medicine* article written by the new Obama Administration health info tech overseer, David Blumenthal. Overall, "Stimulating the Adoption of Health Information Technology" conveys a strong sense of caution. "Huge challenges await," Blumenthal writes.

To read the full *NEJM* piece, go to **http://bx.businessweek.com/health-information-technology/reference/**

Under Camilleri, sales jumped 13% in 2008, despite the worldwide recession

PHILIP MORRIS UNBOUND

By Nanette Byrnes and Frederik Balfour
Illustration by Hellovon

Freed from Altria, CEO Louis Camilleri is racing to boost global sales as tobacco restrictions spread

Louis C. Camilleri rarely shows his joy. But stepping into the role of CEO of the newly formed Philip Morris International (PMI) last March put him in a mood to celebrate. Gone from his life were the 129 active lawsuits of the U.S. business, which would remain under the banner of Altria Group, where he had been CEO for six years. Instead of worrying about the slow death of the U.S. tobacco industry—spiraling taxes, smoking bans, and antismoking ads featuring body bags and black lungs—he could focus on new places to sell cigarettes from a sleek new operating base overlooking Switzerland's Lake Geneva and the Alps of Savoie. "This is the job I always wanted," Camilleri, 54, told staff. "I just had to break up the company to get it."

Unbound from Altria, Camilleri has poured his energies into ramping up sales in overseas markets where smoking is still a growth industry and a tobacco exec isn't viewed as a social pariah. Over the past year he has launched seven new variations on Marlboro alone, including Marlboro Black Menthol in Japan and a super-slim variant in Russia and Eastern Europe. He inked a deal with Stockholm-based Swedish Match to market smokeless tobacco worldwide. His biggest coup: the August launch of Marlboro in China, home to a third of the world's 1 billion smokers, through a joint venture with China National Tobacco. That helped sales jump 13% in 2008, to $26 billion, while profits rose 14%, to $7 billion, despite a worldwide recession. "If these guys were in any other industry," notes analyst Christian Eddleman of Argus Research, "theirs would be pointed to as the way to execute a long-term strategy."

But the forces that dogged Camilleri in the U.S. increasingly threaten to cramp his freedom overseas. On the first anniversary of the Marlboro maker's split, Camilleri faces a complicated landscape, with rising anti-tobacco pressures and a familiar set of adversaries. He's racing to sell more cigarettes in more countries around the world. Just as Altria was spinning off PMI to get away from U.S. liabilities and other issues, billionaires Michael Bloomberg and Bill Gates pledged $500 million to fund antismoking campaigns in emerging markets. Meanwhile, governments in developing nations are gradually coming around to the view that tobacco use should be discouraged

ILLUSTRATION BASED ON PHOTO BY DANIEL ACKER/BLOOMBERG NEWS

THE GLOBAL TOBACCO BATTLE

Philip Morris International is counting on growth from the developing world, but is encountering an increasingly sophisticated public-health pushback, much of it financed by U.S. billionaires Michael Bloomberg and Bill Gates.

Schoolgirl Permatasari in Jakarta: "It's cool to smoke Marlboros"

UKRAINE
63.8% OF MEN SMOKE
$.83 AVERAGE MARLBORO PRICE

The average smoker consumes 2,526 cigarettes per year, the highest rate in the world. The recent economic downturn has prompted a hike in the excise tax, but the price per pack will remain low.

BRAZIL
20.3% OF MEN SMOKE
$1.51 AVERAGE MARLBORO PRICE

A top exporter of tobacco, the country has aggressive health warnings on packages that could become a model for others, including photos of advanced lung disease.

SOUTH AFRICA
25% OF MEN SMOKE
$2.22 AVERAGE MARLBORO PRICE

One of the most restrictive of the developing markets, bans all advertising of tobacco products and smoking in most businesses. Excise taxes are also up.

through smoking bans, tax hikes, and marketing restrictions. In a world connected by the Internet, Camilleri knows he can't escape being cast in a harsh light for selling what he concedes is "a very harmful product," one the World Health Organization says will kill 5.4 million people this year.

Such restrictions arguably make it more critical for Camilleri to strike fast. Marlboro is the only true international cigarette brand. But while it holds a 42% share in the U.S., PMI has less than 16% of the global market, so there's room to grow. Camilleri is unapologetic about hawking a product known to cause cancer. He's not trying to woo new smokers, he says, just encourage existing ones to switch to higher-quality cigarettes.

Born in Alexandria, Egypt, in 1955, a product of British boarding schools and the University of Lausanne, Camilleri joined Philip Morris in 1978. He's sold cigarettes ever since, spending the first 18 years of his career in overseas markets before coming to New York in 1996 as chief financial officer. As CEO, he sold off Miller Brewing in 2002, renamed the company Altria a year later, and spun off Kraft Foods in 2007, moves that many say were aimed at leaving behind the taint of tobacco. Camilleri, though, says he loves what he does: "It's a great job. It's a fun job as well." A longtime smoker himself, Camilleri has quit just once, three years ago when he had a cold. He took it up again after three months "for no real reason other than that I enjoy it." Quitting, he says, "wasn't that difficult."

With his boxy suit jacket and thick glasses, Camilleri comes off in his first interview since the split as more like a reserved accountant than one of the bad boys of Big Tobacco. Colleagues say he can often be found in his office, poring over dense reports for hours while smoking his signature Marlboro Ultra Lights—something he can't do in New York, where the city's smoking ban means he has to stand outside to light up. "He spends an enormous amount of time alone," observes one recently departed exec, adding that Camilleri seems to prefer sending back material with written comments to meeting with the person who wrote it. Board member Steven Wolf, former chief of US Airways, says Camilleri "knows market share in countries you and I have never heard of."

HOW TO PLAY IT 066

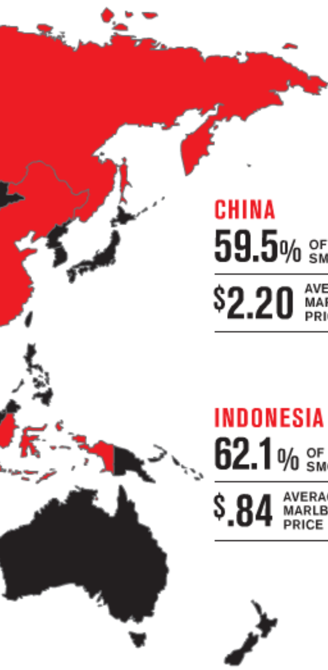
"SOCIALLY RESPONSIBLE"

Camilleri doesn't deny the moral challenges of selling cigarettes in the 21st century. PMI pays a premium to attract top talent, analysts say, and the CEO travels by corporate plane for security. Camilleri concedes that smoking causes disease and acknowledges growing pushback against his life's work.

PAUL HU/ASSIGNMENT ASIA, (MAP) DAVID FOSTER

RUSSIA
70.1% OF MEN SMOKE
$1.20 AVERAGE MARLBORO PRICE

Smoking is still allowed most places including trains, clubs, and restaurants. But average male life expectancy is under 60, in part from smoking, and the health minister is proposing a ban. Tobacco companies sit on regulatory parliamentary boards.



CHINA
59.5% OF MEN SMOKE
$2.20 AVERAGE MARLBORO PRICE

Home to a third of the world's smokers, 350 million people. Large cities including Beijing and Hong Kong have only recently put bans in place. Although tobacco accounts for 8% of government revenue, a recent study shows that 1.9% of GDP is being spent on dying smokers. The study also argues that a tax hike would bring down smoking and raise revenue.

INDONESIA
62.1% OF MEN SMOKE
$.84 AVERAGE MARLBORO PRICE

The most wide-open market for tobacco companies today. Cigarette makers can advertise on TV and sponsor sports teams and concerts.

Data: The Tobacco Atlas; Campaign for Tobacco-Free Kids; Bloomberg Initiative; Philip Morris International. Marlboro prices represent the most popular local pack, cigarette counts vary.

The tobacco chief claims to welcome curbs on advertising so long as they don't crimp his ability to market directly to adults. In his eyes, PMI cleaves to a higher moral standard than some competitors. The company doesn't mark its Formula One cars with the Marlboro logo, he notes, nor does it advertise on the back cover of magazines. Others do. "[We're] being very socially responsible in a rather controversial industry," he says.

What angers him is that none of this is acknowledged in public-health circles, that his company is left out of the tobacco debate while fast-food operators are allowed to comment on obesity issues. Critics focus on smoking rates. What about the dangers of counterfeit products and lost tax revenue if the industry is pushed underground? "If I shut down all the factories tomorrow," says Camilleri, "people aren't going to stop smoking." Instead of trying to "actually reduce the harm caused by smoking," he argues, activists are trying to "demonize the tobacco industry."

For a sense of why, head to Indonesia, where PMI has grown quickly in recent years. Unlike many parts of the world, the country has no laws restricting the sale of tobacco products to minors. And PMI's higher moral standards are hard to spot as its tobacco advertising is ubiquitous. In Jakarta, the Marlboro man rides his horse across giant billboards advertising Marlboro Mix 9, a machine-rolled cigarette with tobacco and cloves that mimics the popular local kretek cigarettes. Marlboro-sponsored kiosks dot street corners. Camilleri's local brands are hawked through nighttime TV ads, many of which equate smoking with romance and a life of adventure. PMI products are plastered on umbrellas, storefronts, and billboards on roads from the terraced rice paddies of Java to the jungles of Sumatra. As it did in the U.S., the company runs adult-only events like the "Marlboro X2 Red Racing Experience"—complete with young women in slim satin outfits twirling oversized white umbrellas boldly marked Marlboro. In 2007, PMI had $2.7 billion of sales in Indonesia and spent $220 million on marketing and related costs.

In a country of 237 million, where almost a third of the population is under 15, nearly 50 million people smoke. According to a recent study funded by the Bloomberg-Gates initiative, smoking rates are rising fastest among the young, with rates among Indonesian males age 15 to 19 up 139% between 1995 and 2004. Data tracker Euromonitor International predicts 10% more Indonesians will take up smoking by 2012.

Arista Nanda Permatasari, 16, shows why the market holds such potential. On a break from Jakarta's upscale High School No. 6, Arista runs to a brightly colored cart parked just outside the schoolyard to buy a pack of Marlboro Reds for 75¢. Tens of thousands of such vendors dot the country, many of whom also sell gum and sugary sodas. A little later, Arista, wearing knee socks, a baby-blue uniform, and braces, settles into a leatherette sofa at the nearby QNET café to gossip with friends, drawing deeply on a cigarette. "It's cool to smoke Marlboros," she explains. Kretek cigarettes, a mixture of two-thirds tobacco and one-third clove, are still the smoke of choice for most Indonesians, especially men, but machine-rolled Western cigarettes have an aura of glamour. Arista, who began smoking at 15 when her older sister gave her a Marlboro menthol, knows from anti-tobacco programs in her school that smoking is unhealthy. "I will try to stop," she says, "maybe when I'm 17."

Camilleri claims no prize in Arista. The divorced father of three, one of whom is still in high school, says if he had the chance to talk to Arista and her friends he'd "tell them exactly what I told my kids and continue to tell my kids: I don't think they should smoke." Camilleri says his kids don't smoke.

But to health advocates, much of what PMI does in Indonesia seems at odds with Camilleri's stated position. The company has invested heavily in promoting its local brands, which make up 84% of its Indonesian sales, through rock concerts and sponsored sports events. "We felt it was very important that we not lose our competitive edge in any way," Camilleri explains. While he says the company supports broad marketing restrictions, he's not about to let others profit from Indonesia's growing tobacco addiction. He doesn't want a repeat of Kazakhstan. A decade ago, PMI dropped TV ads, only to lose its No. 1 spot. "We put ourselves at a huge competitive disadvantage," he says. "That is something I'm not willing to repeat."

Without pause, he rattles off evidence of PMI's success in Indonesia: 360,000 retailers carrying its products, the 60,000 contract workers employed to make them. The company bought local kretek maker PT HM Sampoerna for $5.2 billion in 2005, which has since helped it grow from less than 10% of

Kania gets help from antismoking activists in the U.S.

the cigarette market to nearly 30%. PMI now makes its own Marlboro-branded kreteks along with regular cigarettes, and built a new $220 million factory outside Jakarta that opened last fall.

One person who's fighting Camilleri's aspirations in Indonesia is a law school graduate named Dina Kania. At 24, she has taken up the anti-tobacco cause through the Jakarta-based National Commission for Child Protection. Armed with an undisclosed amount of cash from the Bloomberg/Gates grants and training by U.S. activists, she's now trying to curb advertising while mobilizing public support for an advertising ban.

AN UPHILL BATTLE

The year Altria bought Sampoerna, Kania traveled to the company's annual meeting in a New Jersey facility to voice her worries to Camilleri. Over the years the meeting had become an endurance contest of sorts, with Camilleri taking question after question from activists, some covered head to toe in black chiffon to symbolize death. When Kania got to the microphone, he told her she should be glad his company was purchasing Sampoerna because it would behave ethically.

Four years later, Kania says just the opposite is true. She argues that PMI has increased competition and has infused cigarette marketing with youthful themes. "PMI is so creative and aggressive it makes the other companies do the same things," says Kania. "They raised the stakes."

Kania acknowledges that she's fighting an uphill battle—her own brother took up smoking at 15—but she can already point to at least one victory. In July, PMI was forced to pull all promotional materials for one of its Sampoerna brands out of an Alicia Keys concert in Jakarta after Kania brought it to the attention of Keys' handlers. The singer threatened to pull the plug on the event unless the cigarette maker backed out.

Kania and her counterparts around the globe get guidance from the anti-tobacco forces that spent decades whittling down the U.S. markets. Her mentor, Matthew L. Myers, has battled the industry for decades. He is administering much of the Bloomberg/Gates money through his Washington-based group, the Campaign for Tobacco-Free Kids. So far, they have made 178 grants worth $125 million in 38 countries. Unlike his wealthy benefactors, who decline to comment on individual company actions, Myers seems to relish the chance to face off anew against his old nemesis on the global stage, targeting the concerts as a blatant practice of a double standard. "Philip Morris has been diabolically brilliant in the way it markets Marlboro," says Myers. Its focus on emerging economies, he adds, "has the potential to be one of the most devastating actions impacting public health." While there have been some gains over the past year, with public smoking bans in such unlikely spots as Beijing and Amsterdam, it's hard to battle the prowess of PMI.

Camilleri brings decades of experience to the tobacco wars. To tap into markets like Russia, he's focused on bringing out new products that have a youthful air. The last thing he wants is for his marquee brand to become known as "Dad's smoke." He compares Marlboro to brands like Nike and Apple, which rely on peer influence: "One of the key consumer engagement theories is brand ambassadors, right? People associate themselves with [the attributes of] those individuals." New cigarettes, he adds, can have a halo effect that reinvigorates the "brand family."

If his product were anything other than cigarettes, Camilleri might be hailed as a role model in how to build a global business. He spent years courting Chinese ministers to strike his deal to distribute Chinese brands into foreign markets in exchange for the right to make Marlboros for the mainland market, and has built a powerhouse brand in Marlboro. Although the stock is down 26% since the split, analysts like Argus's Eddleman remain optimistic. "This is the way to build an international market," he says. "But there's always a whiff of brimstone when it comes to Philip Morris." BW

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Where There's Smoke, There's Profit

Global commerce in counterfeit cigarettes is thriving, thanks in part to the steep excise taxes some countries slap on tobacco. At the center of that trade is China, which by some estimates churns out 190 billion copycat smokes each year. *Caijing*, China's leading business magazine, shed new light on this shadowy industry in a December story that profiled the city of Yunxiao, where cigarette production takes place in homes, barns, and even caves.

To read the story, go to **http://bx.businessweek.com/china-manufacturing/reference/**

PAUL HU/ASSIGNMENT ASIA

The Nuclear Energy Renaissance

In partnership with *Platts*

Around the globe, policy makers seeking to meet the world's surging energy demand with a low-carbon, baseload power supply are taking a new look at nuclear energy. After nearly 20 years, there is once again great interest in the power of the atom.

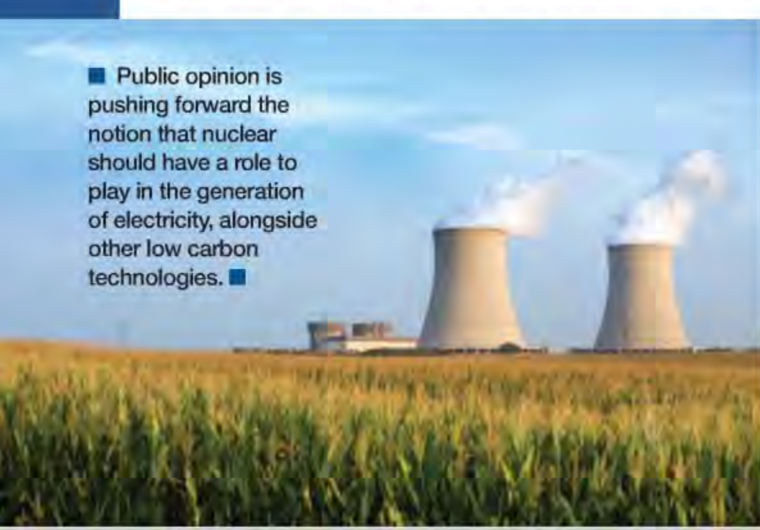
America needs cleaner energy that is reliable, abundant, and immediately available. But there aren't many choices that fit the bill now, *today*. Perhaps that's why both public and political support for nuclear energy is the strongest it's ever been.

So, what are the variables that changed the equation? First, global warming: Since the turn of the century, scientists and political leaders have come to a consensus in the belief that climate change is quite simply the biggest challenge facing humanity. Industry insiders see nuclear as an important weapon in the fight against warming.

"If this nation is truly serious about controlling global warming, nuclear power must maintain its 20 percent share of U.S. power generation," says J.M. Bernhard Jr., Chairman, President and CEO of The Shaw Group Inc., the $7 billion energy, environmental and infrastructure engineering and construction firm based in Baton Rouge, LA. "That will require the construction of 45 to 50 new nuclear plants by 2030, while maintaining the current fleet."

Second, energy supply has become a concern as geopolitics has left its mark on the psyche of energy consumers around the world. And third, energy demand is ever on the rise. The Energy Information Agency predicts a 30% increase in electricity use by the year 2030. The United States uses about 15 times more energy per person than does the typical developing country.

America is not alone in rethinking nuclear. Countries looking in atomic power include the United Kingdom, Italy, Finland, France and the Czech Republic. China and India are extremely serious about nuclear, and Russia, home to huge resources of oil and natural gas, is also very active. Whether large or small, resource rich or resource wanting, countries taking a new look at nuclear are doing so for essentially the same reasons: global warming, energy independence and energy security.



Public opinion is pushing forward the notion that nuclear should have a role to play in the generation of electricity, alongside other low carbon technologies.

Climate of Change

Public opinion is pushing forward the notion that nuclear should have a role to play in the generation of electricity, alongside other low carbon technologies. According to a recent Gallup poll, a record high 59% of Americans surveyed favor nuclear. When asked by the Nuclear Energy Institute (NEI) about their support for new nuclear power plants, 69% agreed that the U.S. should build more nuclear power plants in the future. In fact, a majority associated nuclear energy with energy independence & security, reliability, efficiency, clean air and affordability.

59%
of Americans surveyed favor nuclear. (Gallup Poll)

One of Nuclear's most respected advocates is Dr. Phillip Finck of the Idaho National Laboratory. With a doctorate in nuclear engineering from MIT and an MBA from the University of Chicago, Dr. Finck is uniquely qualified to grasp the political, technical and commercial implications of a national return to nuclear energy. "My vision and belief is that nuclear is one of the key tools we can use to help us with both the climate and energy independence issues," he says. "Think of it: With one solution, we lessen the amount of CO2 per unit of energy produced with the potential of replacing some of the energy we import. And, we also have another superb clean baseload power option at our disposal. To be able to replace dirty baseload with clean baseload is a tremendous advantage."

When asked about how renewable energy options might fit into the mix, Dr. Finck welcomes power options based on natural resources, while keeping in mind drawbacks. "Wind and solar have a natural intermittency that affect their use as part of the grid structure; they are more difficult to use as baseload power, but I believe strongly that we should use what we can. I see great advantages to using wind and solar in the mix. But the backbone of the system could easily be, and should be, nuclear."

The Powerful History of Nuclear

Throughout human history, heat has been the primary method for enjoying the benefits of energy. We've either used heat directly to warm our food, our shelter, or ourselves, or we've employed it in the creation of a secondary item, like electricity. Humans

have learned how to extract the power of tiny amounts of nuclear material to create electricity, but that process is new; very new when we think of how long humans have been harnessing the benefits of energy.

Congress created the Atomic Energy Commission in 1946. The goal in the 1950s was to show that nuclear was the future of energy, and that it could create electricity for commercial use while building an American industry. The first U.S. commercial generating plant powered by nuclear energy was built by Westinghouse Electric in Shippingport, PA in 1957. In fact, 40% of all the nuclear power plants operating in the world were either built by Westinghouse or licensees using Westinghouse designs. Today, America is home to nearly 25% of the 440-plus nuclear plants that operate in 31 countries. According to the Department of Energy, nuclear accounts for 12% of our generating capacity and 20% of our daily electricity.

The Employment of Logic

One item is often forgotten when calculating the benefits associated with a strong U.S. nuclear industry: jobs. In the midst of the greatest economic crisis in three generations, few industries can equal the economic benefits of a resurgent nuclear energy industry. According to the NEI, the average nuclear plant employs 1,600 people during construction. Plants often help create economic activity that generates 550 additional jobs locally, and produce about $430 million annually for goods, services and labor, through subsequent spending by the plant and its employees. Nuclear plants provide state and local tax revenue of more than $20 million, along with annual federal tax payments of $75 million.

By renewing its nuclear industry, the U.S. also protects its position as both a technological and commercial power. "This is a high-tech industry," says Dr. Finck of the Idaho National Laboratory. "A nuclear reactor costs several billion dollars, which means that with plants currently being talked about, this could be a several trillion dollar worldwide market."

Activity in the space supports Dr. Finck's assertion. Westinghouse, for one, has hired over 4,000 people globally in the last four years. The company is building four plants in China, and has been identified as technology provider for at least 14 new plants in the U.S., including six for which the company has signed contracts. Westinghouse also sees business growing in the

20%
of daily U.S. electricity comes from nuclear plants.

operating plant arena, which includes service, maintenance, and refueling, in the U.S. and around the world.

Westinghouse President and CEO Aris S. Candris says his company has had inquiries from no less than 40 countries regarding potential construction of new plants, driven in large part by the excitement over new plant designs that are even safer and more economical than the already well-performing operating fleet.

"The nuclear energy renaissance is clearly a reality," he says. "We are seeing support for nuclear energy throughout the world, and are particularly pleased that so many bright and enthusiastic young people now see nuclear power as both a growth and a green industry."

Planet Ready, Shovel Ready

If national goals are indeed about reducing our carbon footprint while increasing energy independence and creating jobs, few can argue with the advantages presented by advocates of nuclear energy. In the United States, Westinghouse and its partner The Shaw Group are building the infrastructure to provide the Westinghouse AP1000™ nuclear power plants around the world. The AP1000, with a generating capacity of 1,100 megawatts, employs naturally occurring safety systems such as gravity, natural circulation and condensation to further enhance the safety pedigree. Plus, the plant requires fewer pumps and motors, and less piping and wiring than traditional plants, reducing both construction and maintenance costs.

Mr. Bernhard of The Shaw Group is bullish on what Nuclear can contribute to the nation. "A nuclear renaissance will create an industry-driven jobs program unrivaled since the great infrastructure projects of FDR's Works Progress Administration. But unlike those Depression-era programs, the nuclear renaissance will be paid for with private capital and built by private citizens."

As pressure increases on the American energy ecosystem to deliver more power with less carbon, few choices are readily available. Ironically, the strongest contender is one that's been touted as the most future-forward for over half a century. Only time will tell how fast America, and the world, will choose to go back to the future of energy.

Written by Henry Gentenaar

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Alan Peterson,
President, Tradeshow & Conference Group
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052 Europe chases U.S. stimulus cash
054 You're fired—but stay in touch
056 Suzy Welch's new book, *10-10-10*
057 Taking the Ted out of Turner
059 Big chill at an outsourcing hot spot
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WHAT'S NEXT

DAVID POHL

ECONOMICS & POLICY

The Unequal Tax Burden on Companies

A close analysis of what S&P 500 corporations really pay reveals enormous disparities

By Nanette Byrnes

FPL Group, owner of Florida Power & Light, understands the value of alternative energy. By setting up everything from 1,500 acres of solar electric systems in California to wind farms across the U.S., the Juno Beach (Fla.) utility has avoided the need to build 12 new power plants. And those investments create another green benefit: tax breaks. Over the past four years, FPL has paid just \$88 million in taxes on earnings of nearly \$7 billion. FPL spokeswoman Jackie Anderson says the company is merely taking advantage of incentives to develop renewable resources.

No one likes to pay taxes. FPL paid more than $500,000 to Washington lobbyists last year to keep its tax breaks coming. That strategy seems to work, and corporate tax receipts have been on a steady decline—a trend that could change in the coming months. President Barack Obama's current budget contemplates ending the deferral of income tax on foreign corporate earnings, as well as other tax breaks. At the moment, most companies pay less than the official tax rate of 35%. A study published last summer by the General Accounting Office found that from 1998 to 2005, 55% of large U.S. companies had at least one year of paying no taxes at all.

TINY TAX BILLS

Some companies do a particularly good job of keeping the tax man at bay

COMPANY	TAX RATE	WHY THE TAB IS LOW
Range Resources	0.4%	Heavy drilling for oil and gas, plus losses from the late 1990s and early 2000s
Allegheny Energy	1.1%	Big losses in energy trading, gas-fired electricity, and natural gas retailing in the early 2000s
FPL Group	1.3%	Investments in renewable energy, including wind farms and solar
Broadcom	1.7%	Chipmaker gets a tax credit for R&D done in the U.S. It manufactures and sells in low-tax countries overseas
NVIDIA	2.2%	Semiconductor company's U.S. research garners it credits, as do stock options. Much of its sales are abroad, too

*Cash taxes divided by earnings before taxes excluding extraordinary items, four-year average 2005-2008

To get a real-world view of how corporate players fare under the complexities of the tax code, we had data tracker Capital IQ analyze the tax burdens of companies in the S&P 500-stock index. (Like *BusinessWeek*, Capital IQ is owned by The McGraw-Hill Companies.) Instead of simply adopting the tax rate that companies report on their income statements, Capital IQ looked at the cash taxes disclosed in footnotes and cash flow statements companies file with the SEC, the closest we can get to what they actually paid in taxes. (An interactive list of the 50 highest payers and 50 lowest payers is available at businessweek.com.) By dividing that figure by a company's pretax income (excluding extraordinary items) and averaging it over four years to minimize anomalies, we calculated what we consider to be the true tax rate.

The result is a list of players whose tax burdens ranged widely, from essentially nothing to almost 400%

COMPANY	TAX RATE	WHY THE TAB IS LOW
Xcel Energy	2.5%	Utility's rate may be affected by a settlement with the IRS over a controversial tax tactic
Akamai Technologies	2.9%	Losses from the dot-com bust are shielding current earnings but will last only a few more years
TECO Energy	3.0%	Energy company with operations in the U.S. and Guatemala had big losses in 2005
Boeing	3.2%	Airplane giant gets a tax break on sales made overseas and on research and charitable gifts
CMS Energy	3.5%	Owner of Michigan's largest power company is still working through old losses from bad investments

Data: Capital IQ, company reports, *BusinessWeek*

of pretax income a year. Troubled industries with weakening profits had the highest tax rates: The auto sector averaged 45.5%, banks paid 50.3%, and real estate companies paid 66.1%. The least-taxed industries were semiconductors, at 19.6%, often because of high expenses in the U.S. and high overseas income. Infrastructure investments helped to keep telecoms at a low 22.2%.

With a prolonged recession and a new Administration in Washington, tax deals could become sparser in the coming year. The new budget calls for the removal of deferred tax payments to oil companies with high drilling costs, for example. That helped Range Resources pay just 0.4% last year. CFO Roger Manny insists that ending deferments will hurt the cash flow of his company, discourage exploration across the industry, and lead to higher energy prices.

Of course, tax breaks never die without a fight. Tax lobbying has increased 47% over the past decade, according to the Center for Responsive Politics. Companies complain that the official U.S. rate is higher than every other industrialized nation's except Japan's. But fighting to keep tax rates low is hardly an American phenomenon. As Chas Roy-Chowdhury, head of global taxation at the Association of Chartered Certified Accountants, notes: "It's the same around the world." | BW |

–With Frederick F. Jespersen, Ellen Gibson, Brian Burnsed, Jane Sasseen, and Greg Spielberg

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Enel Green Power's Nevada geothermal plants will power 40,000 homes

GREEN BIZ

Europe's Rush to Grab U.S. Stimulus Cash

The Continent's renewable-energy giants have a head start on smaller American rivals

By Mark Scott

As the White House hammers out how to spend some $80 billion in stimulus money aimed at kick-starting investment in renewable energy, the race for a piece of the action is on. And while plenty of Americans are on the starting line, many winners are likely to come from across the Atlantic. "The stimulus package is a big incentive to invest," says Francesco Starace, president of Enel Green Power, a new subsidiary of Italian utility Enel.

The Europeans have a substantial head start. Iberdrola Renovables, a unit of Spanish energy company Iberdrola, is the world leader in renewable power and already No. 2 in U.S. wind generation (behind Florida's FPL Group). Portugal's EDP Renováveis is third in U.S. wind and a growing force globally. In manufacturing, Denmark's Vestas is the world's biggest wind-turbine maker, and Spain's Gamesa is No. 3, behind General Electric.

Although the details of the stimulus plan aren't yet finalized, developers will get tax credits or grants worth 30% of the cost of renewable-energy projects started by the end of 2010. That has the Europeans planning big investments for years to come. Iberdrola expects to spend $2 billion-plus annually in the U.S. through 2012, up from $400 million in 2007. EDP Renováveis says it will invest $5 billion in the U.S. over the same period, while Enel Green Power plans U.S. spending of $1.5 billion by 2013—a figure that could jump to $7.5 billion if financing costs fall. As much as $33 billion could be invested over the next two years, at least a third of it from Europe, estimates consultancy Emerging Energy Research.

$33 Billion

U.S. renewable-energy investment for 2009-10, at least one-third of which will come from Europe

Data: Emerging Energy Research

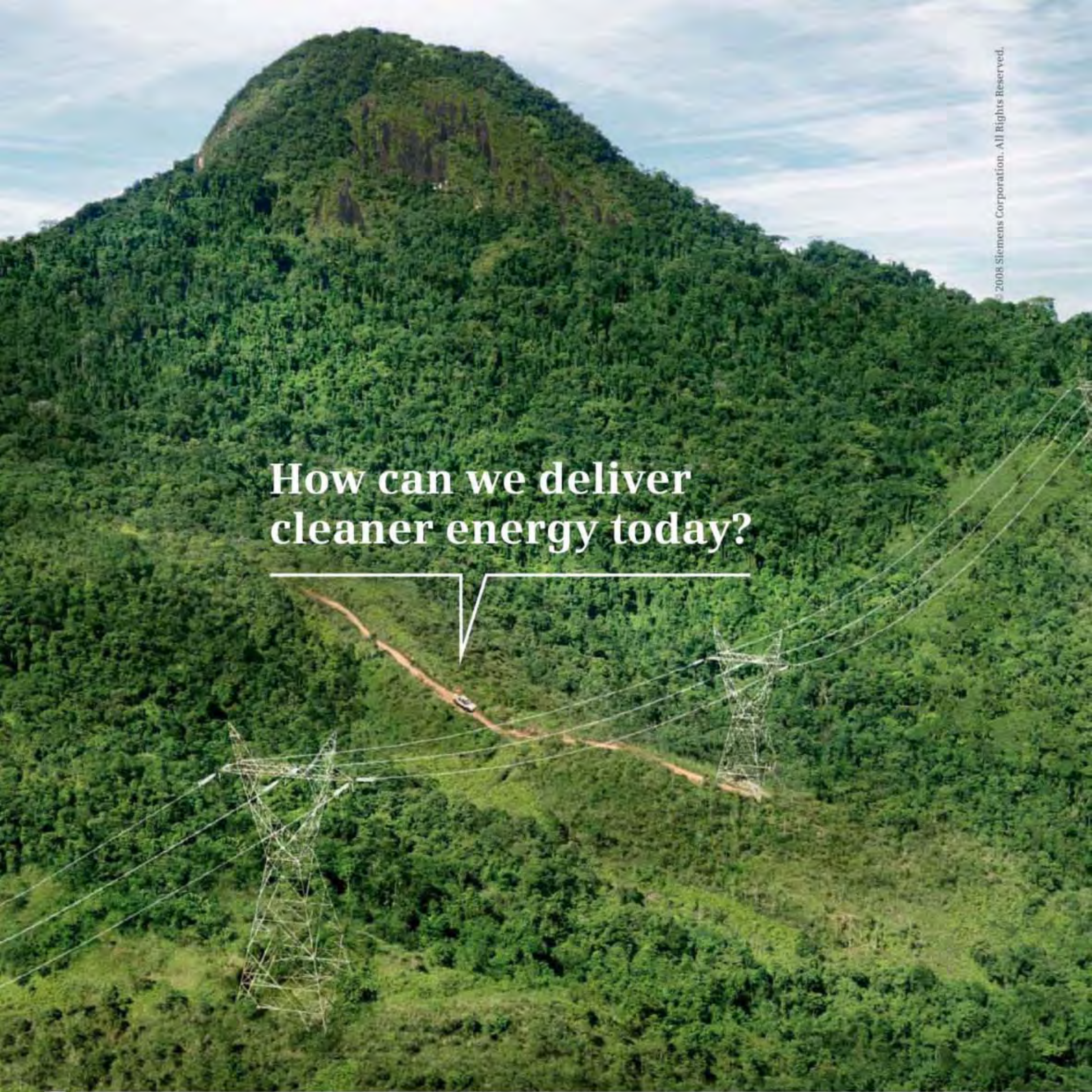
Some spending already under way may benefit from the incentives, too. Enel Green Power on Apr. 15 unveiled two geothermal plants in Nevada, built at a cost of some $200 million, which use the earth's heat to generate electricity for 40,000 homes. And on Apr. 17, Iberdrola opened a $400 million wind farm in Texas that will power 70,000 households. Both plan to file for stimulus money.

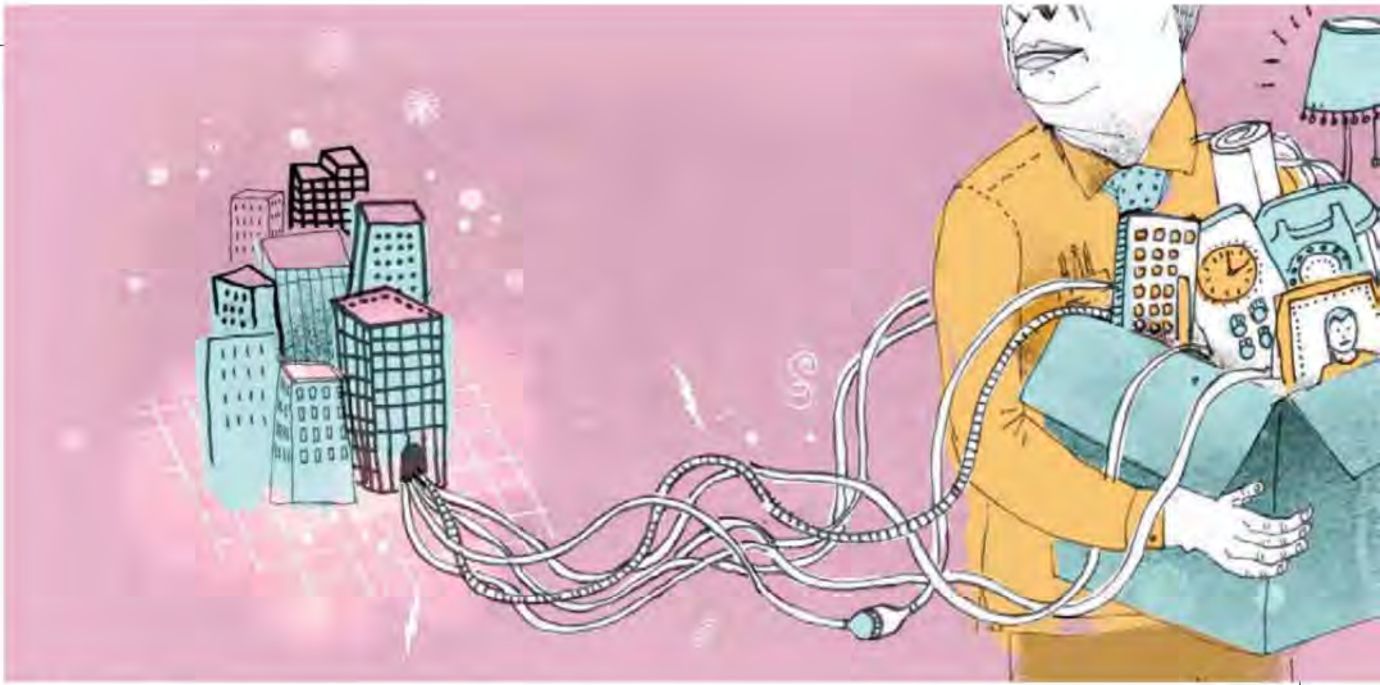
While there's sure to be opposition to funding Europeans, they will put plenty of Americans to work. Vestas, for instance, in November opened a $100 million turbine-blade factory in Windsor, Colo., creating 650 jobs in the town 60 miles north of Denver. The company plans to invest a further $1 billion by 2010 at three more plants across the state and on sales offices nationwide, employing an additional 4,000 people.

FUNDING EDGE

The Europeans are helping put some wind back into a sector that has been slowed by the credit crunch. Spending on clean energy projects in the U.S. fell 91% in the first quarter vs. the same period in 2008. Much of the investment had been funded by sales of tax credits for green energy, but as corporate profits have plunged, fewer companies need to buy them. Falling energy prices have also cut the incentive to invest in green technology.

One big advantage for the Europeans is their financial health. They tend to be subsidiaries of well-funded utilities, while American rivals are typically smaller. And the Europeans are sitting on a ton of cash. Iberdrola Renovables raised $5.9 billion in Spain's largest-ever initial public offering in 2007. Last year, EDP Renováveis pocketed $2.1 billion by selling a minority stake. Now, Enel plans to sell 40% of its shares in an offering analysts expect will fetch $4.5 billion. Says Rui Teixeira, chief financial officer at EDP Renováveis, "Our funding provides us with a competitive advantage." |BW|


How can we deliver
cleaner energy today?



JAMES GULLIVER HANCOCK

MANAGING

You're Fired—But Stay in Touch

More companies are creating Web sites where ex-employees can share leads and remain within reach

By Stephen Baker

As the global recession has deepened, human resources managers have adopted a term for the thousands of employees they're ushering out the door: "alumni." From Dow Chemical to JPMorgan Chase, companies are urging former employees to maintain ties as members of the broader corporate team, almost like grads of the same alma mater, even if they end up moving to competing companies.

The idea is to keep in touch with pros who might end up as business partners or even return as employees. For this, companies are steering them to alumni social networks. Much like Facebook or LinkedIn, they offer former employees and retirees a place to establish profiles and friend lists, share news and ideas with ex-colleagues, and participate on blogs and message boards. Unlike the big public social networks, the company sites feature industry news and job leads. They guide alums to reunions and company events—some even offer deals on health insurance.

Alumni networks follow a tenet of the knowledge economy: Personal connections transcend corporate boundaries. Already, office workers routinely Twitter and share Facebook status updates with long lists of "friends" that often include business rivals and former colleagues. With their alumni networks, corporations attempt to dissolve those boundaries themselves, establishing for each company a broad network of people who can keep in touch throughout their careers to benefit from each other's knowledge and contacts. Some companies mix alumni with current employees; others keep them apart. "We're interested in building lifelong relationships," says Caren Scoropanos, who heads two-year-old KPMG Connect, where some 17,000 alumni mingle online with 22,000 employees.

Software companies such as Seattle's Conenza and New York's SelectMinds build and manage alumni networks. The number of companies participating is rising fast. SelectMinds alone runs more than 60 networks, including those at IBM, Lockheed Martin, and KPMG. The company launched the service nine years ago as a recruiting tool, says SelectMinds CEO Anne Berkowitch. "We went to market with the idea that former employees were valuable. It was a time when companies couldn't hire fast enough."

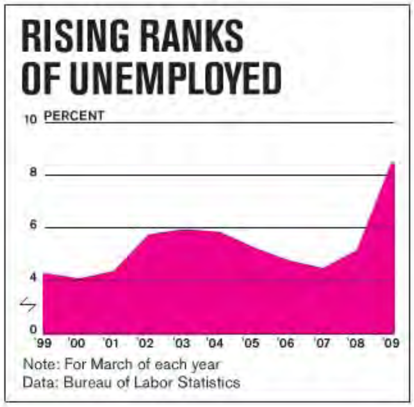
MAINTAINING GOOD GRACES

Today it's a far different story. Companies are sending centuries of experience out the door. And yet, if they keep ex-employees on alumni networks, they retain a link to that knowledge. In the best cases, former employees might have nice things to say about the company—becoming, in HR parlance, "brand ambassadors." And when the economy recovers, companies will be in touch with qualified workers who can be recruited to come back.

Such cases are called "boomerangs."

Of course, not everyone who leaves a company is an eager brand ambassador. Some are angry after being laid off or fired. The risk is that alumni networks could give them a forum for venting. Yet the way it works out, say alums and company execs, the disgruntled tend to air grievances on sites beyond company control. "There are enough other forums to blog or grouse," says Gwen Weld, who left Microsoft in 2004 after 20 years at the company. "The alumni network is not one of them."

For managers, alumni networks provide a laboratory for learning. Using online tools, they can map the hot topics, companies, products, and technologies mentioned. As they scout for new talent, they can study the patterns of user behavior. Some contributors, says Berkowitch, turn out to be mavens—experts in a science or technology. Others are effective networkers. They come often to the site, add new friends and connections, and link people to knowledge and opportunities. Host companies can use software to analyze the dynamics of each person's connections. Using such insights, one accounting firm reached into its alumni network last year to rehire 31 boomerangs, according to SelectMinds.



At lively corporate sites, alumni find opportunities far beyond the host company. Microsoft's 10-year-old network, run by Conenza, offers free job ads to companies looking to recruit from the 10,000 Microsoft alums on the site.

Erin Peterson, who heads global talent acquisition at consultant Hewitt Associates, pushed last year for an alumni network. Her reasoning: Alumni would include numerous top managers and executives at related companies, who could send opportunities in Hewitt's direction. "I was thinking business development," Peterson says.

But reaching the broad constituency—some 37,000 have left Hewitt voluntarily and otherwise since 1977—was a challenge. Her team messaged Hewitt groups on LinkedIn and Facebook, gathered e-mail addresses, and sent out 6,000 old-fashioned postcards. To date, nearly 2,700 alums have signed up. A few find themselves re-employed at Hewitt. That means they're bounced, at least for now, from the alumni-only network. | BW |

Suzy Welch's Big Strategic Thought

Her new book lays out a system of assessing the consequences of decisions—in business and in life

Suzy Welch, who pens The WelchWay column in this magazine every week with her husband, Jack Welch, has just released her first solo book. Dubbed *10-10-10*, it explores a decision-making tool she developed 13 years ago during a disastrous business trip to Hawaii with her 5- and 6-year-old children. (The highlights of which include one child's sun poisoning, insomnia, and offspring in hula skirts bursting in on her speech.) When faced with choices, Welch now stops to consider the consequences within the next 10 minutes, in 10 months, and in 10 years. She spoke with Senior Editor Diane Brady.

DIANE BRADY

Along with the stories of others, you share a lot of your own experience, from the decision to leave your first marriage to revealing moments with Jack and your four kids. Did you 10-10-10 how much of yourself to put in this book?

SUZY WELCH

Everybody in the book gave of themselves. I felt it would be this weird sleight of hand for them to be pouring their hearts out and for me to be cagey about my own story. It's hard for me to explain 10-10-10 without going into my own life.

What part of the equation do people tend to ignore?

Many people live in that 10-minute phase. I have a friend who's a fantastic psychiatrist who travels at all times with a candy bar in her purse because she doesn't want her kids to get mad at her. Then there are people who live for some distant future and never live in the moment. I think it's that middle 10—the 10 months—that we often don't bring into consideration. But you have to look at all three.

Take a guy on Wall Street who put his company at risk with, say, credit default swaps. He could think: In 10 minutes, I'll get praise from my boss; in 10 months, I'll have a million-dollar bonus; and in 10 years, the whole system may blow up, but that's not my problem.

I don't know what was going on in the minds of those guys. I don't think they stared coldly into the face of the consequences of what they were doing.

Is there anything in the current environment that makes you think, I wish people would stop and 10-10-10 this?

I wish there were a 10-10-10 conversation about the deficit and the economic policies being put in place. One side is talking all about the next 10 minutes. The other side is talking only about the next 10 years. I wish both sides would sit down and talk it over. Then the ones who accuse the others of being socialist could talk about their plan for the next 10 years. And the people who say, "What about the America you're creating?" could address what to do for the next 10 minutes and 10 months. People aren't having a conversation based on all the relevant time frames.

Everyone in business is nervous about the next 10 months. So how do you 10-10-10 that?

When it comes to resource allocation, 10-10-10 is a great managerial tool. In 10 minutes, you might be having extreme cash-flow problems. In 10 months, it's probably not going to be much better, so you have to prepare for that. And thinking about the next 10 years allows you to imagine what kind of company you want to be. Of course, that's not going to make the people being laid off feel better. But there are

BRAD TRENT

people who remain in your organization. They need to know where you're going. Using 10-10-10 may at least help you get on the same page. It allows you to be more strategic.

10-10-10: 10 Minutes, 10 Months, 10 Years: A Life-Transforming Idea by Suzy Welch; Scribner; 240 pp.; $24

Any good 10-10-10 decisions you've made lately?
My daughter Sophia, who's in college in Miami, wanted very much to come up for the launch of the book. She was thinking of blowing off her classes to come. So we got on the phone—Jack on one extension, me on the other—and we all came to the decision that it would be better for her to stay in Miami, and we would do something special when the book tour got there.

I also had a moment, about a month before my deadline, when I decided I had to stop writing the book. It all seemed too much. Nobody was happy. I remember Jack saying, "It's been a long time since I saw you smile." So I went into the bedroom one night while Jack was watching a game on TV and said, "I'm quitting the book." He looked up and said, "Let's 10-10-10 it." I said, "No, I don't want to. I made my decision." So he turned off the TV to talk about it.

During a game?
I know. He didn't even mute it. He led the discussion because I was a wreck. Halfway through, I got a pit in my stomach because I knew I was making the wrong decision. We got to the end, and I knew I had to forge on.

I wonder how much 10-10-10 would have affected Jack's decisions at General Electric.
I think he used it as a chief executive. We actually talk about it. Good managers 10-10-10 all the time. They don't have a name for it, and maybe they don't use it as often as they should. But they do it. |BW|

Kent is the first person to run Turner without its founder looming

CHRISTOPHER T. MARTIN

STRATEGIES

Taking the Ted Out of Turner Broadcasting

Understated CEO Phil Kent is challenging the networks with a roster of original programming

By Tom Lowry

You may not have heard of Phil Kent. After all, the CEO of Turner Broadcasting is a whole lot quieter than Ted Turner, the so-called Mouth of the South who remained front and center long after selling his cable empire to Time Warner in the 1990s. But Kent has emerged from Turner's shadow and is fast becoming one of Time Warner's most important executives. If the media giant spins off its long-troubled AOL division as expected, the collection of channels that Kent oversees—including TNT, TBS, TCM, and CNN—will contribute nearly half of Time Warner's earnings.

In the past six years, Kent has taken on the broadcast networks with a smorgasbord of programming matched by few other cable outfits. As more ad dollars flow from broadcast to cable networks, he is on a mission to get advertisers to pay as much for time on Turner as they do the Big Four broadcasters. It's a campaign Kent plans to press in the coming weeks as advertisers gather in New York for the annual ad-buying ritual known as the upfronts.

Kent, 54, is the first person to run

Turner without the looming presence of its mercurial founder, who stepped away from Time Warner in 2006. As such, Turner is a much changed place. "Under Ted," says Time Warner CEO Jeffrey L. Bewkes, "the top management was always Ted." Whereas Turner reveled in making his own news, Kent is the antithesis of the media executive. Although he learned the business working for legendary Hollywood power broker Michael Ovitz at Creative Artists Agency in the late 1980s, he finds Tinseltown self-promotion repellent and abhors the cult of the CEO. "He's definitely not a rock star chief executive," says Steven R. Koonin, one of Kent's top lieutenants.

Metalocalypse (above) is on Adult Swim; Dylan Minnette and Holly Hunter in TNT's *Saving Grace*

At two key junctures of his career, Kent took himself out of the fray—both times when he wasn't having fun anymore. After working for Ovitz for six years, he bailed and embarked on an around-the-world trip, ignoring the blandishments of headhunters, who tracked him to a rooftop café in Marrakesh. In the 1990s, Kent worked at Turner, but he quit in 2001 after the AOL-Time Warner merger. "Not until you leave a job do you appreciate that the sun really will rise and fall without you," he explains. "This does make you more fearless in making tough decisions. After all, if you've fired yourself, you're much less afraid of being fired."

PUMP UP THE BRANDS

Bewkes was looking for someone to make tough decisions when he lured Kent back to run Turner in 2003. At the time, the cable network was in a lull, and Bewkes, who turned HBO into a pop culture sensation, wanted Kent to pump up Turner's brands and create buzz around its channels.

Kent has invested heavily to broaden Turner's offerings in news, scripted shows, cartoons, and sports. To lure young, professional viewers, a coveted cohort, Kent pushed TNT and TBS into original programming with marquee names. TNT's *The Closer*, starring Kyra Sedgwick as a sugar-addicted police chief, has become one of cable's top-rated shows. Ditto for *Saving Grace*, which features Holly Hunter as an Oklahoma cop with a dark past and a guardian angel.

Kent backed Adult Swim, a comedy channel that appears on Turner's Cartoon Network in the evenings. This network-within-a-network has allowed Turner to reel in two key demographics: teenage and early-twentysomething males, who watch the racy fare on Adult Swim at night, and kids and their parents, who watch the cartoons during the rest of the day. This year, TNT and TBS will air 13 original shows, vs. none in '03.

Kent's strategy is attracting a range of blue chip advertisers, among them T-Mobile, DirecTV, Hewlett-Packard, and Procter & Gamble. Under Kent, Turner revenues, a mix of ad dollars and distribution fees, have nearly doubled, to $7 billion, according to people familiar with the numbers. So has cash flow, to $2.3 billion. (Time Warner does not break them out.)

The Kent CEO Manual

1. Carve out time to think, not just react
2. Sabbaticals give you useful perspective
3. Don't overschedule; leave time for colleagues

By many accounts, Turner has become a far more inclusive place since Kent took the reins. Kent says his sabbaticals taught him that the CEO mania for scheduling every moment of the day is counterproductive. Splitting his weeks between Turner's headquarters in Atlanta and New York, he leaves time for colleagues, walking the halls and popping into people's offices. Koonin says it was during one of those office visits that he and Kent talked about focusing more on underserved audiences. That chat led eventually to offering comedian George Lopez his own late-night talk show on TBS to compete with Conan and Dave and bring in Hispanic viewers.

Kent's tenure hasn't been seamless. In 2007 he was forced to apologize for an Adult Swim guerrilla marketing stunt in Boston involving cartoonish devices that passersby mistook for bombs. This month, TNT canceled the advertising comedy *Trust Me* after just one season. Now, as Turner emerges as a more important part of a leaner Time Warner, Kent will have to morph into a role that makes him uneasy: the high-profile CEO.

Investors will be watching closely to see if he can, in fact, get advertisers to pay more for commercial airtime on Turner channels. Cable networks typically get a third or so less in advertising rates vs. the broadcast networks. Kent acknowledges changing that dynamic won't be easy but says: "We can do a much better job of selling [the Turner] story." **BW**

BUSINESSWEEK.COM | Please see a BusinessWeek special report on The Future of Television and a slide show of programs with the most product placement at www.businessweek.com/go/09/tv

OUTSOURCING

The Sudden Chill at An Indian Hot Spot

Gurgaon, a high-flying suburb of Delhi, is suffering from a wave of layoffs as Western companies retrench

By Mehul Srivastava

GURGAON, INDIA

The terrace at the Hao Shi Nian Nian ("Here's to the Good Life") restaurant in Gurgaon's Central Plaza Mall offers a good sense of the city. A short drive from glass-fronted buildings that house Nestlé, American Express, and other multinationals, the Chinese restaurant is among the top lunch destinations in this suburb of Delhi, India's capital.

But on a recent weekday, the place has few customers. After the dumplings arrive, the manager declines to talk about his sales, but a waiter pouring water whispers bravely: "It's bad. No customers. No tips. I should get a new job." In the parking lot, used-car salesman Sachin Kulkarni displays late-model sedans, including a one-year-old Honda Civic sold by a couple who both lost their jobs. "People just look," Kulkarni says. "They don't buy."

Gurgaon's problem is that its economy has become intertwined with America's. A decade ago, Gurgaon was little more than a farming community. Then outsourcing boomed, and the town became a preferred location for companies that answer phones, create PowerPoint presentations, and do other business tasks for U.S. clients. As outsourcers added thousands of workers every month, developers rushed in and built offices and apartment towers.

The once-bucolic community has become a city of nearly 1 million and a nightmarish version of what India aspires to be—a destination for global investment—with water shortages, iffy electricity, and horrific traffic jams. "As things have slowed, Gurgaon's mentality has been affected. People are more conservative," says Nitin Aggarwal, director of research at Pipal Research, an outsourcing company that grew from five employees in 2002 to over 300 by last December, but which has put further expansion on hold.

A commercial real estate boom has turned into a glut, with vacancy rates of 28%

MICHAEL RUBENSTEIN/REDUX

Gurgaon is especially vulnerable because of the nature of the work it does. Higher-end jobs such as writing computer code typically go to Bangalore and elsewhere in the south because of that region's top-notch schools. Gurgaon is mostly lower level: call centers and business process outsourcers. With less work, these shops are starting to close, says Sukant Srivastava, country chief for Convergys, a Cincinnati-based outsourcer with 12,000 workers in India, about a third of them in Gurgaon. "The effects of the slowdown are beginning to show," he says.

Gurgaon isn't a ghost town. There's still enough traffic to make commuting unpleasant, for instance. But while India's economy may expand by 5% this year, the 9%-plus growth of recent times is gone and Gurgaon is feeling that decline more than most other places. In the second half of 2008, as American and European clients hit the skids, India's outsourcing industry saw contracts shrivel by 22%, its worst performance in a decade, according to research firm Technology Partners International. "We haven't seen large-scale layoffs," says Sid Pai, TPI's India director. Then he corrects himself: "We haven't seen large-scale layoffs as yet."

Nobody in India collects layoff data, but every day papers carry dire news: 200 workers cut from an American Express call center, 300 from Boston-based Sapient, 80 or so at Motorola. At a café, young engineers huddle over a laptop, dissecting an online rumor that Wipro Technologies, India's No. 3 IT provider, might lay off 5,000. (Wipro denied the report.)

DEVELOPMENT ON HOLD

The economic woe is taking its toll on the developers that built Gurgaon. As demand has eased, some 28% of commercial real estate here is vacant, compared with shortages a year ago. Office rents have dropped 25% and will continue to fall, says Sanjay Verma, South Asia head for real estate consultancy Cushman & Wakefield. "People are just waiting and watching before making any commitments," he says.

That's easy to see as you head toward the heart of Gurgaon from the Central Plaza Mall. On Golf Course Road, a few workers mill around half-completed buildings. At the Narsi office complex, huge signs advertise deep discounts. "I can give you a great deal, no rent for the first two months," says a real estate broker. "Just don't tell anybody." At the Sahara mall, a bored clerk points to a rack of men's clothing. "Eight suits for the price of three," he says. Still, he hasn't sold one in three weeks.

The bad news has the city fathers fretting that their revenues will plummet. In a dingy tax office the electricity is out, the telephone rings constantly, and an ancient computer is covered with a cloth. A disheveled clerk shows reams of printouts to A.K. Singh, a local tax commissioner. "Collection is down, certainly, this year," Singh says, marking the pages with a red pen. "Wait until June, when the final numbers come in. It will be drastic."

The new buzzword in Gurgaon is consolidation. Larger companies hope they have the cash to hold on while the global economy recovers, perhaps even enough to buy a rival or two. "Clients just aren't moving on proposals," says Ashish Gupta, chief operating officer of Evalueserve, an outsourcer with 2,400 employees, 2,000 of them in Gurgaon. "Smaller players are struggling. ... Many of these guys could get wiped out." |BW|

Business Exchange

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

Beyond Bangalore

Outsourcing to India may soon be old news. KPMG has identified 31 new hot spots, from Buenos Aires to Zagreb, and from Indianapolis to Iloilo City (a Philippines town known for its animation services).

To read the KPMG report, go to **http://bx.businessweek.com/global-outsourcing/reference/**

INNOVATION

Into Africa: Capitalism From the Ground Up

Peet's Coffee, working with a Gates Foundation nonprofit, is planting seeds of commerce in Rwanda

By Steve Hamm

KIGALI, RWANDA

Few food buyers can match Shirin Moayyad's willingness to take risks. As director of coffee purchasing for Peet's Coffee & Tea in Emeryville, Calif., she often treks to remote corners of the globe in search of great coffee discoveries—and in the process endures landslides in Papua New Guinea, menacing policemen in Yemen, and army ants in Tanzania.

But over the past year, Moayyad has taken on a new type of challenge. Peet's has joined an effort to develop a vibrant coffee industry in sub-Saharan Africa. The Coffee Initiative, as it's called, is run by TechnoServe, a Norwalk (Conn.) nonprofit, and funded by the Bill & Melinda Gates Foundation. The goal: to double the income of poor coffee farmers in Kenya, Rwanda, Tanzania, and Uganda by linking their products with coffee lovers in the developed world.

TechnoServe helps farmers improve the cultivation, processing, and marketing of gourmet coffee. Peet's is working to develop a special blend of these coffees that will be sold online and in its 191 cafés starting this summer. Moayyad says the motivation is

(LEFT TO RIGHT) RUDI DUNDAS; NOAH BERGER/BLOOMBERG NEWS

In Rwanda, Moayyad (right) is building closer relationships with farmer groups

to nurture new sources of great coffee and help farmers. "If they produce a high-quality product," she says, "we'll pay more for it." The company, which recorded $284 million in sales last year, hopes its efforts in Africa will be a brand-burnisher, too.

While executives across different industries are increasingly interested in ventures that combine profits with good works, Peet's initiative underscores the difficulties in getting them off the ground. In Rwanda, which has 450,000 family coffee farms, Peet's has had to contend with a frayed infrastructure, a shortage of money to pay for fertilizer, and suppliers who have little experience in dealing with quality control. "You have to be willing to plant some seeds and wait a few years," says Chief Executive Patrick J. O'Dea.

The Rwanda project differs from the company's usual purchasing efforts in several respects. Instead of dealing with sophisticated suppliers, it's setting up shop in a war-ravaged nation that exported just $47 million worth of coffee last year. While U.S. companies have long bought food from poor countries, few have made it a stated goal to boost the economic fortunes of producers in those markets. If Peet's is going to make the positive impact of its coffee a key selling point, it has to make sure the impact is real. TechnoServe, which is working with other roasters such as Starbucks and Green Mountain Coffee Roasters, expects 20 million coffee farmers will eventually benefit from its program.

O'Dea is determined to make it work. While the CEO laid off a handful of employees late last year, anticipating a slowdown, he hasn't backed off from the initiative. Customers increasingly care where their coffee comes from and about the fairness with which it is procured. "The return on investment is really the value of our brand, including the lifetime value of every loyal customer we have," he says.

PERILOUS JOURNEY

Doing business with African farmer cooperatives hasn't been easy. To start, there's no local market for coffee, as few Rwandans drink it. Jim Reynolds, Peet's roastmaster emeritus, spent two weeks in the country last spring visiting nine TechnoServe farmer groups. He sampled their coffee and gave them tips on how to improve quality. Some farmers had never tasted coffee and reacted as if they had bitten into a lemon. He had to teach them the hallmarks of a top bean. Last summer, back in Emeryville, Peet's buyers tried dozens of bean samples. In the end, they purchased coffee from three cooperatives.

Quality control at headquarters: The African coffee will hit Peet's cafés this summer

Because of bad roads and delays at border crossings, it took 12 days for a truck with a container full of green coffee beans to travel 1,000 miles to the Kenyan port of Mombasa. The sea journey from Mombasa took nearly two months. Worse, when the shipment arrived in Oakland, Calif., in late February, a portion of the coffee was slightly damaged.

Moayyad traveled to Rwanda to cement relationships with farmer groups and gather stories about the farmers for use in marketing. With a videographer tagging along, she navigated molar-crunching roads in a four-wheel-drive pickup to remote villages and farms perched on hillsides high above Rwanda's Lake Kivu. On the roadsides, children greeted the passing truck with an excited cry of "*Abazungu* [white people]!" Moayyad plans to post a journal of her travels on Peet's Web site, aimed at the company's most loyal customers, called Peetniks.

Coffee companies have run into trouble in Africa in the past. Starbucks wrestled with Ethiopia over the use of the country's name on its products. But fair trade advocates say TechnoServe's partners are on the right track. "It's good corporate citizenship, but it's also enlightened self-interest. They have to bring the farmers along so they have enough quality coffee," says Seth Petchers, who ran a campaign against Starbucks for Oxfam International.

For the efforts in Rwanda to pay off, Peet's needs to see more high-quality coffee produced. Last year's purchase amounted to just 8 metric tons of beans, a mere drop in its annual consumption of beans. At Peet's headquarters, Doug Welsh, the company's vice-president for coffee, pointed to a small sample of Rwandan coffee beans that he had just tasted. "The really good news is the inherent quality of the coffee is very good," he says. "That's why it's worth developing." |BW|

BUSINESSWEEK.COM | To see a video on how coffee goes from the fields of Rwanda to cafés, go to businessweek.com/go/09/coffee

Greening the Web

SAVING A FEW WATTS HERE AND THERE AT THE WORLD'S DATACENTERS CAN HAVE A BIG IMPACT ON THE ENVIRONMENT AND BOTTOM LINE.

In cooperation with The Green Grid

the green grid
get connected to efficient IT

The next time you're about to click on a Web site to send an email or view a video, think about what goes on behind the screen. After the request zips out onto the Internet, it ends up at one of the world's 10,000 datacenters that store, transfer and complete the Web's transactions. Each click requires a small amount of electricity, but it adds up quickly.

Call it clicks to kilowatts, but datacenters use 1.5 percent of America's electricity, and are responsible for releasing 70 billion tons of climate-changing carbon dioxide annually. It doesn't have to be that way, because every watt saved at a datacenter is a watt that doesn't have to be generated.

"Datacenters are a great place to save energy," says Mark Monroe, Director of Sustainable Computing at Sun Microsystems and a member of the board of The Green Grid. "There's a lot of low hanging fruit waiting to be picked." Based in Beaverton, Oregon, The Green Grid's membership list reads like a who's who of the Internet.

With power bills that total millions of dollars a year, electricity is the largest expense for the typical datacenter, making it an attractive target for aggressive cost-cutting. "Measurement is the first step towards reducing power consumption and raising a datacenter's efficiency," adds Monroe. The Green Grid develops tools to quantify and compare power use for datacenters and plans to publish a design guide that details the industry's best practices for others to follow.

Cutting a datacenter's power consumption starts with using the most efficient servers, streamlining their cooling and reducing the number of computers by running several programs on each server. "There are many different shades of green when it comes to datacenters," says Aaron Davis, Chief Marketing Officer at Schneider Electric. "Some have excellent cooling, others have the latest hardware and a few have solar panels and wind generators. Few do it all."

One of the world's largest electrical equipment suppliers, Schneider Electric can plan and supply a datacenter's entire infrastructure. Based in Rueil-Malmaison, France and with U.S. information technology business headquarters in West Kingston, RI, Schneider Electric's engineers model the flow of power and cooling for the datacenter with sophisticated software. "It takes the mystery out of designing a datacenter," says Davis. "We look at where every electron goes."

Using The Green Grid's Data Center Efficiency measure, some facilities today run at only about 30 percent efficiency, which means they waste more than two out of every three watts consumed. By contrast, a properly designed and operated facility can have an efficiency of about 82 percent. This can not only cut a datacenter's expenses, but it keeps hundreds of thousands of tons of carbon dioxide out of the atmosphere.

Take Switch Communications' NevadaNAP datacenter in Las Vegas. One of the world's largest datacenters, Schneider helped to plan and equip the 100,000 square foot facility with the latest power equipment. With an efficiency rating in the 80-percent range, it saves millions of dollars a year in power bills compared to other datacenters.

If only more datacenters were this concerned about reducing their power use, the Web would be a much greener place.

About The Green Grid
The goal of The Green Grid is to create innovative techniques for measuring and comparing power use at datacenters so that these facilities can cut their energy consumption without affecting reliability. www.thegreengrid.org

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PERSONAL BUSINESS

MONEY REPORT

LIQUID ASSETS

PepsiCo's plan to buy two of its largest bottlers, announced Apr. 20, has done little for its shares, which dropped 5% over the next two days.

Investors also dumped Coca-Cola, down 4%, and Dr Pepper Snapple Group, down 2%. All three have seen profits decline amid slowing consumer spending and higher costs for ingredients. But analysts say the tough times are helping Dr Pepper gain market share. Sales of its **Hawaiian Punch brand jumped 19%** in the fourth quarter as consumers increasingly favored low-cost drinks, including powdered versions that can be made at home. And its third-ranked orange soda, Crush, is gaining fast on Coke's Fanta Orange, thanks to enhanced distribution agreements. ¶ Goldman Sachs added Dr Pepper to its "Conviction Buy" list of best investment ideas on Apr. 9. Longtime beverage analyst Mark Swartzberg of Stifel Nicolaus recently raised his one-year target price to 23, about 20% higher than the current price. He figures gains from sales of Crush should add at least 6¢ to earnings per share, and that the stock, trading at less than nine times his 2009 earnings estimate, is undervalued. *–Aaron Pressman*

DRUGMAKERS

DOUBLE YOUR DOSE

Is weakness in the stock of Abbott Laboratories a buying opportunity? The stock hit a 52-week low on Apr. 15 in the wake of a mixed earnings report, sinking to 41.88—far from its high of 59.81 on Sept. 16, 2008. It now trades around 44. Part of the weakness stemmed from lower-than-expected sales of the Abbott's rheumatoid arthritis drug Humira, which accounted for 15% of global sales.

Richard Steinberg of Steinberg Global Asset Management in Boca Raton, Fla., says the stock has been unjustifiably pounded: "It's very cheap, with good prospects for low-double-digit earnings growth and a solid 3.7% dividend yield." He sees the stock doubling in two years. Another Abbott fan, Stephen O'Neill of Louisville (Ky.) investment firm Hilliard Lyons, has a two- to three-year target of 75. *–Gene Marcial*

3.7%

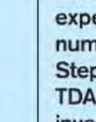
Abbott's dividend yield. The company has raised its dividend annually for 37 years

Data: Yahoo! Finance

SPENDING

SPLURGE STOCKS

Luxury handbag retailer Coach jumped 14.8% after beating earnings expectations Apr. 21. Stocks in the consumer discretionary sector—makers of items like handbags and electronics that consumers buy when they feel flush—have been on a tear since the stock market hit a low on Mar. 9. Since then, the sector is up 37%, outpacing the Standard & Poor's 500-stock index by 11%. Investors have been heartened by the



U.S. savings rate rise, from 0% to 4.2%, which some think could signal that consumers feel they've saved enough and are ready to start spending. Another sign came from better-than-expected retail sales numbers. But Stephanie Giroux, TDAmeritrade's chief investment strategist, points out that first-quarter spending was buoyed by deep post-holiday discounts and that consumers have more belt-tightening to do before the savings rate returns to its 30-year average of 5.5%. "The sector's gotten ahead of itself," she says. "Investors might want to take some profits." ***–Ben Levisohn***

ILLUSTRATION BY OLIVER MUNDAY

PHILIP MORRIS UNBOUND

(FROM PAGE 38)

By Aaron Pressman

Tobacco shares have historically been among the most resilient in recessionary times. But last year the sector tumbled along with the rest of the market on fears that the incoming Obama Administration would raise cigarette taxes and increase health regulations.

The reality turned out to be less dire than anticipated, prompting some fund managers to jump at the chance to buy beaten-down tobacco shares at high yields. David Winters, manager of the Wintergreen Fund, has 17% of his fund in tobacco. Charles Norton, who runs the USA Mutuals Vice Fund, says he has more invested in tobacco than ever. And Burns McKinney, co-manager of the Allianz NFJ Dividend Value Fund, says yields of tobacco stocks as a group top those of any other industry. "It's a pretty great combination to get the highest yields out there that are also some of the safest," says McKinney.

For many years investors shunned the stocks because of potential liabilities, but the risk has largely abated. Some of the biggest cases have been settled, and on Mar. 25 the industry won over a jury in Florida, where thousands of similar cases are pending, in a suit brought on behalf of a smoker who died of lung cancer in 1997. "Today [the risk] is no more than any kind of industrial business might face," says Norton. In February, Obama and Congress agreed to raise the federal excise tax to $1 per pack, from 39¢—in order to fund an expansion of children's health-care insurance—and many states are talking about hiking taxes. But industry profits aren't likely to take much of a hit: Companies have already pushed through price increases over the past six months that will keep revenue steady as higher taxes prompt some customers to smoke less.

Altria Group, the former Philip Morris, is a top pick of several managers. Morningstar analyst Philip Gorham cites its "fantastic collection of brands." After adding the Skoal smokeless tobacco brand through its $10 billion acquisition of UST last year, Altria is poised to generate billions of dollars in free cash flow this year to maintain its dividend, currently yielding 7.4%. Lorillard, owner of the Newport brand, is another company analysts consider undervalued.

Shares of U.S. producer Reynolds American, meanwhile, have fallen 2.4% this year. Some investors fear the leading purveyor of smokeless tobacco products could be hurt in a price war now that Altria has acquired its main rival.

ATTRACTIONS ABROAD

Winters says Reynolds has little to fear from Altria. "There may be some skirmishes, but all these companies have always been able to do quite well," he says, noting that Altria paid "a large price" for UST and wouldn't want to drive down profit margins. Including the value of its outstanding stock and debt, Reynolds trades at less than half what it is worth, he figures.

The tobacco market outside the U.S. has a different dynamic. Consumption is rising in many countries, and low or nonexistent taxes make cigarettes more affordable. One beneficiary is Philip Morris International, the non-U.S. tobacco business that Altria spun off a year ago. Another is Japan Tobacco, the top holding in Winters' fund. It's the third-largest player worldwide and has been growing through acquisitions. Its purchase of Britain's Gallaher Group in 2007 boosted sales in such fast-growing markets as Russia. The company, says Winters, "is diversified, becoming more efficient, and very undervalued"—a rare find. | BW |

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YIELDS ARE SMOKIN'

NAME/TICKER	PRICE	YIELD	P-E
Altria Group/MO	$16.99	7.4%	7.1
Lorillard/LO	64.98	4.3	12.7
Philip Morris International/PM	37.32	5.6	11.3
Reynolds American/RAI	39.60	8.6	8

Data: Yahoo! Finance; yield and price-earnings ratios are trailing 12 months. Prices as of Apr. 17.

MATTHEW HOLLISTER

COMPENSATION

PAY CUTS MADE PALATABLE

By Michelle Conlin

As the recession grinds on and anxiety over mass layoffs mounts, the managerial class is trying something new: the 10% (or so) solution. Executives at such companies as Hewlett-Packard, New York Times, and most recently, Best Buy, are slashing pay. Targeting compensation might seem like a no brainer: No one gets the ax. Bosses don't have to hire like mad when the economy snaps back. But there's little in officeland as psychologically loaded as money.

Yes, many employees would rather see their direct deposits docked than collect unemployment. But shriveled paychecks can make corporate strivers feel as if their lives are moving in reverse. "Employees know their bonus is going to go up and down, but base pay is supposed to be sacrosanct," says Laura Sejen, global director of rewards at employment consulting firm Watson Wyatt Worldwide. Some thought leaders in human resources warn that across-the-board pay cuts are anathema to a performance culture. "The last thing you want is for your A players—or people in key strategic positions delivering the most value—to leave because you've mismanaged your compensation system," says Mark Huselid, a Rutgers University human resources professor and co-author of the new book *The Differentiated Workforce*.

A few strategies for managing the inevitable fallout from salary cuts are emerging. One major trend is to give employees something in exchange, usually time off. This month Matt Ferguson, the CEO of online job site CareerBuilder.com, decided to institute a pay cut. Instead of passing off the task to one of his minions, or, worse, blasting off an e-mail, Ferguson scheduled conference calls with all of the firm's branches. His message was positive and specific: He told employees the cuts would avert layoffs and—knock wood—last only through the summer. In return, everybody only had to work a half-day on Fridays. Some worried Ferguson was merely prolonging the death rattle. But his management of a difficult situation still drew praise. "I don't think anyone is ever happy about a pay cut," says Sterling Dortch, a senior account manager in CareerBuilder's Phoenix office. "But giving us time off was giving us something back."

Other executives are starting to customize pay cuts up and down their companies even more finely (and, they hope, more fairly). Earlier this year, Hewlett-Packard CEO Mark Hurd implemented tiered pay cuts, from as little as 2.5% up to 20%, throughout the ranks. He shrunk his own paycheck by 20%.

Some companies are sparing their top performers altogether, working on the theory espoused by Huselid and others that you don't want to anger those you need most. Geonerco Management, a Seattle real estate development firm, has gone through five rounds of layoffs in the past two years. In December, Greg Szymanski, the HR director, decided to try something different at the still-struggling company. He reduced his own salary by 20%. Then he tailored pay cuts to recognize how people's jobs had changed. Geonerco's real estate lawyers, for example, were enforcing contracts rather than doing big deals. Their jobs, and responsibilities, had shrunk, so many of them saw their pay drop by a fifth. But others, including executives on the finance team, were actually busier and doing more complicated work. Their paychecks went untouched. At the same time, Szymanski decided to give raises to workers in the lower echelons who had taken on the duties of those who had been let go and whose efforts were actually making money for the company.

Even when handled well, though, the danger of mass resentment—and an eventual backlash—looms. One IT Manager at Capital One, in Richmond, Va., says his boss did everything right when he had to shrink paychecks. Not a soul complained aloud. "But in this economy," he says, "who has the guts to stand up to them?" BW

BE TRANSPARENT
Explain the reasons for the cuts and how long they'll last

GO SURGICAL
Don't dock the pay of your superstars.

GIVE BACK
Try time off, more flexibility, even promotions (though they may be in name only).

Data: Work+Life Fit

PAUL SAHRE

THE ECONOMY

'FLATION PROTECTION

By Lauren Young

Will the real 'flation please stand up? ¶ Experts are arguing about where the U.S. economy is heading as the global financial system tries to right itself. Is it on the path to inflation, deflation, or, worse, stagflation? ¶ Rising unemployment and excess production capacity are making it hard for the U.S. economy to climb out of recession. And that, in turn, is putting a strain on pricing power and wage growth—raising fears of deflation, which develops when a broad decline in prices amid falling demand feeds further price-cutting.

But what happens if the Federal Reserve's efforts to jump-start the economy take effect? Stimulus to the tune of $787 billion is supposed to rev up economic engines. Prices could climb too high as too much money chases after available goods and services—the classic formula for inflation.

"I describe [the potential dangers in] this economy in the form of a snowy Minnesota road," says Peter Rekstad, a financial adviser at TruNorth in Oakdale, Minn. "A car slid off the road into the deflation ditch. The way out of the ditch is to get a bunch of friends pushing while you rock the car back and forth. The big danger is that you get out of the deflation ditch and race across the road into the inflation ditch."

Or to take Rekstad's analogy further, say a car is straddling the road, with its wheels mired in both ditches at once—the worst of both worlds. That situation, where growth slows while inflation soars, is known as stagflation.

Here's an investor's guide to protecting your portfolio from these three forces.

Deflation

Deflation is the threat dominating headlines. "You've got a strong supply of goods and weak demand. That's a recipe for prolonged deflation," says A. Gary Shilling, economist and author of *Deflation: How to Survive & Thrive in the Coming Wave of Deflation* (McGraw-Hill). The problem is deflation's ripple effect: When banks stop lending, businesses stop expanding and wages fall. Consumers stop spending, which pushes prices lower. Why won't massive stimulus pull the economy out of the deflationary lane? Shilling fears that the U.S. government's economic tampering will have a "Big Brother effect," hurting innovation and permanently curbing growth.

THE SIGNS

The surest sign of deflation is a decline in the consumer price index, which tracks the prices of consumer goods and services. But it's hard to ignore lower real estate values, which aren't in the CPI. Home prices fell more than 18%

JOHN HERSEY

Simple Truth: Long-term perspective is key

**If you keep a steady hand,
the future is clear.**

Stay the course. This principle has never been more relevant than it is today. Market turmoil has been encountered before, and yet the market has built wealth for those who have a plan, and stick to it. Vanguard investors know that staying the course is easier if you hold the right balance of stock, bond, and money market funds. And when you combine balance with Vanguard's low costs and investment experience, you will be better prepared for whatever the markets bring–downturn or rebound. Vanguard. The simple truth about investing.

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Data: Bureau of Labor Statistics

in 2008, according to the S&P/Case-Schiller U.S. National Home Price Index. Another deflation indicator: the higher savings rate, which we're seeing for the first time in 25 years. Shilling expects the savings rate to rise from 4.2% to 10% in the next decade.

INVESTMENT STRATEGY

"Quality is paramount in deflationary markets," Shilling says. He thinks most investors should be in short-term certificates of deposit or money-market funds. Those with a 10-year time horizon should also buy tech stocks, such as semiconductors, he says. Companies facing deflation can't cut prices and must boost productivity through technology.

Inflation

THE ARGUMENT

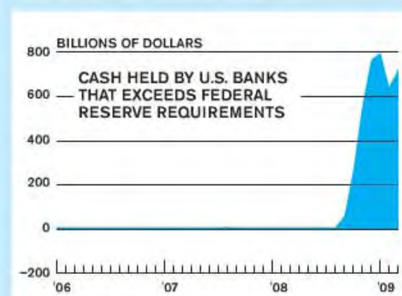
Many of the economists and financial advisers polled by *BusinessWeek* for this story believe the huge amount of money being pumped into banks by the Federal Reserve (chart, right) makes inflation a real threat. Hans Olsen, chief investment officer for JPMorgan Chase's private wealth management business, says the stimulus plan ultimately will lead to higher inflation. However, total inflation is basically nonexistent at -0.4%. The trick is figuring out when it will be a problem. "The nasty thing about inflation is that it's insidious," Olsen says. Banishing inflation from the economy once it is "infected" is hard.

THE SIGNS

The leading indicator used to measure inflation is the CPI. Commodity prices, particularly those of oil and copper, are another bellwether. One indicator Olsen tracks is government debt as a percentage of gross domestic product, which he sees surging from 40% to 80% over the next few years.

INVESTMENT STRATEGY

Mild price inflation is considered healthy for stock investors because it is a sign that the economy is growing. But when inflation spikes, as it did when it hit 13% in the 1970s, interest rates rise and borrowing stops. For bondholders, soaring inflation eats away at



Data: Federal Reserve

asset values over extended periods.

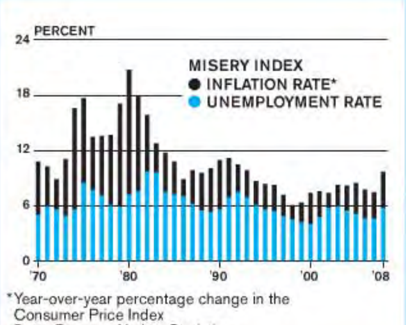
The most direct way to fight this is to buy Treasury Inflation-Protected Securities (TIPS)—government-backed bonds pegged to inflation via the CPI. (TIPS belong in tax-deferred accounts because they are not tax-efficient.) A study by economic consultancy Peter L. Bernstein Inc. found that, for an aggressive investor who is worried about inflation, a 47%/53% proportion of TIPs to stocks (the study tracked broad stock market indexes) provided the best risk-adjusted real returns over a wide range of inflationary environments.

Among mutual funds, advisers favor the Vanguard Inflation-Protected Securities Fund, which had an annualized return of 5% for the past three years. Other plays include the iShares Barclays TIPS Bond exchange-traded fund and Pimco Real Return Fund.

Commodities are another classic hedge. A well-diversified commodity play is the Pimco Commodity Real Return Fund, which combines commodities with TIPS. Many advisers also like the SPDR Gold Trust ETF and the First Eagle Gold Fund.

Stagflation

Stagflation is caused by the combination of slow growth and surging inflation. Slower growth will come from extreme caution by lenders, households, and businesses, while a shortage of production capacity will create inflationary bottlenecks, argues Mohamed El-Erian, chief executive officer at Pimco. "Stagflation will be part of the new normal," he says.



*Year-over-year percentage change in the Consumer Price Index
Data: Bureau of Labor Statistics

THE SIGNS

The misery index, which combines the unemployment and inflation rates, is the best gauge of stagflation. In March it was at 8.1%. El-Erian predicts that unemployment will hit 10% by yearend, and 2% inflation could bring the misery index up to 12% by the end of 2010.

INVESTMENT STRATEGY

Insulating your portfolio from stagflation is tough. Equity investors need to take a very conservative stance, focusing on high-quality growth stocks such as Johnson & Johnson and PepsiCo, says John Boland, financial adviser at Maple Capital Management. Gold, as well as TIPS, will help mitigate some of the inflation risk. El-Erian considers TIPS a bargain because 10-year TIPS are pricing in inflation of less than 1.5% for the next decade, and he sees inflation jumping as high as 6% by 2011. |BW|

–With Tara Kalwarski in New York

JUMPING ON JPMORGAN

In mid-2007, holding stock in financial outfits became taboo at Rutherford Investment Management, whose composite growth portfolio has snagged a five-star rating from Morningstar for the past five years. But a year later, Rutherford hopped back into financials. It bought shares of JPMorgan Chase (JPM), the global banking giant with assets of $3.2 trillion and operations in more than 50 countries. JPMorgan now offers what a long-term growth investor like Rutherford requires for its portfolio: a cheap, "best in class" bank and a "fortress" company with huge potential, says the firm's president, William Rutherford. JPM's global franchise will help it "come out stronger" from the financial crisis, he adds. Like most other banks, JPM shares have been battered—falling to 14.96 on Mar. 6, down from a 52-week high of 50.63 last Oct. 3. Its strong investment banking unit helped it post better-than-forecast first-quarter profits, and it had climbed to 31.90 by Apr. 22.

JPM'S DOWNS AND UPS

Data: Bloomberg

As JPMorgan "continues to take market share in most of its businesses, we view it as one of the group's better performers," notes Jason Goldberg of Barclays Capital (it has done banking for JPM). He rates the stock overweight, with a 12-month target of 42. Goldberg expects earnings of $1.75 a share in 2009 and $3 in 2010, vs. 2008's $1.40.

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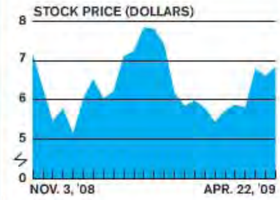
SMART BALANCE ON A SEESAW



Data: Bloomberg

Healthy Milk from Smart Balance

Fat-free milk that tastes like whole milk, enhanced with Omega-3? That's what Smart Balance (SMBL) is counting on to boost sales—along with its "naturally trans-fat-free margarine" and other foods using a proprietary vegetable oil blend. Its milk was launched in Florida in 2007 and in the Northeast last year. Milk sales in Florida hit $4 million in 2008 and could reach $10 million-$12 million in 2009. Shares have risen to 6.82 from 4 in October.

Ken Gau of investment firm Waddell & Reed, which owns stock, says Smart Balance's growth will be driven by such new products. Rising sales "give us confidence the company is on track to achieve first-quarter growth in the range of 18%," says Jon Anderson of William Blair, which has done banking for Smart Balance. He sees profits of 30¢ a share on sales of $266 million in 2009 and forecasts 47¢ on $320 million in 2010.

ESTÉE LAUDER: LOOKING UP

Data: Bloomberg

A Brave Face At Estée Lauder

The recession has been ugly for high-end beauty products. So, in spite of the global reach of its products, Estée Lauder (EL) saw its shares dive to 19 on Mar. 9, down from 54 last September. Since then they have rebounded to 27.90, despite the continued consumer-spending slowdown.

That's partly because Estée Lauder's price-earnings ratio, which ranged from 15 to 33 over the past five years, tumbled to 10 with the stock's fall. This makes the shares seem cheap, considering the company's earnings growth of 12% annually over five years, says Steven Ralston of Zacks Investment Research. Although he expects earnings to drop in 2009, to $1.35 a share from 2008's $2.40, he rates the stock a buy, with a six-month target of 40. Dan Natiello of EVA Dimensions, also bullish, says Estée Lauder will outperform its peers based on its earnings potential. | BW |

BRAD TRENT; CHARTS BY DAVID FOSTER

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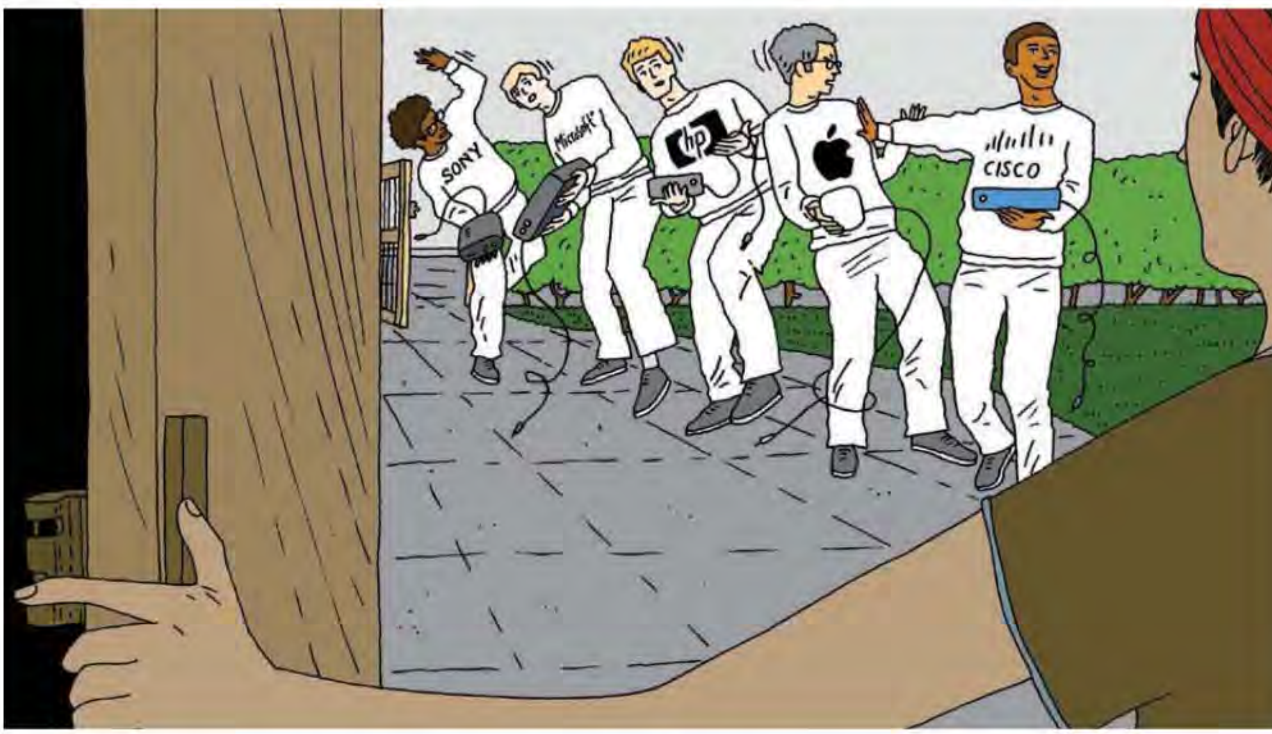
OPINION

TECH & YOU | STEPHEN H. WILDSTROM

Meet Cisco, the Consumer Company

With key acquisitions, it's positioning itself to be a big player in home entertainment



BRAD TRENT; ILLUSTRATION BY PETER ARKLE

Over the last few years, an assortment of technology and consumer electronics companies, from Microsoft to Sony to Hewlett-Packard to Apple, have made stabs at becoming the dominant player in "convergence." The term refers to the merging of computers, entertainment, and the Internet—and all the contenders have found it a tough nut to crack. Now Cisco Systems, which made its reputation and fortune building industrial-strength networking gear, is stepping up its efforts to dominate the connected home of the future.

Cisco brings some unique advantages but faces an array of obstacles. The company has built a growing corporate business around telepresence—high-definition videoconferencing—that it believes consumers will find alluring. And Cisco has an important beachhead in the home. In 2003 the company acquired Linksys Group, a manufacturer of home and small-business networking gear, and it has rebranded the products "Linksys by Cisco" to boost consumer awareness. It bought Scientific-Atlanta, a leading supplier of set-top cable boxes, in 2005, giving the company access to big-screen TVs in millions of homes. And in March, Cisco acquired Pure Digital Technologies, maker of the inexpensive and wildly popular Flip cameras used mainly to create online videos.

The opportunities and challenges that await Cisco are both on display

The Conductor, part of Cisco's new Linksys Wireless Home Audio line

in the company's new Linksys Wireless Home Audio line. It's a multiroom sound system, starting at about $450, designed to play music from any computer or storage system on your home network as well as from Internet sources.

Cisco's offering is clearly intended to compete with Sonos' music system, which offers similar features at comparable prices. But there is one huge difference. Getting Sonos up and running is a simple matter of plugging the device in, hooking up the speakers, and making a one-time connection to your network. You're ready to go within minutes of unboxing the gear. The Linksys Wireless Home Audio comes with a setup only a router engineer could love; it uses the badly named Linksys Easy Link Adviser software (Windows only) that is both unnecessarily complex and buggy. In the end the system feels more like a complicated computer peripheral than a simple consumer product. If Cisco wants to be a major player in home entertainment, it needs to develop much more of a consumer electronics mentality.

It might start by paying attention to the extreme simplicity of its Flip video cameras. Although the $590 million acquisition was small change for Cisco, the company sees it as a major strategic opening, once its cameras are integrated with both computers and video systems in the home. "The network is becoming a base to deliver new capabilities to consumers, focused around video," says Ned Hooper, Cisco's senior vice-president for corporate development and consumer business.

Those Scientific-Atlanta boxes could be the key to making this happen. The first, obvious step would be to combine a Flip camera with the set-top box, the cable connection, and the big-screen TV to create a videophone service so simple and compelling that families actually would yearn to use it. At a minimum, gathering around the TV to talk to grandma is more appealing than scrunching around the family laptop.

The second logical step could prove more difficult. Cisco's customers will want to use their cable boxes to bring video stored on a home server or streamed from the Internet to their TVs. In the U.S., at least, nearly all of those boxes from Scientific-Atlanta and its only significant rival, Motorola, are owned and controlled by cable or phone companies, which aren't eager to expose their video services to Internet competition. Hooper says Cisco plans to add new features only in close cooperation with the cable operators that buy its boxes.

I think the company will run into problems trying to serve two masters, consumers and the cable providers. Their interests are diverging. And to the extent that Cisco tries to keep the Time Warner Cables and AT&Ts happy, it could jeopardize the advantage it derives from those set-top boxes. All of this presents an opening for Microsoft or for consumer electronics makers, such as Samsung, LG, and others, that are bundling some Internet and movie services with their new televisions.

Cisco may be in a better position than anyone else to cash in on the home networking trend, but it must find a way to make its ties to the cable business a blessing, not a curse. |BW|

THREE CISCO BRANDS ARE AIMED AT THE HOME MARKET

LINKSYS

Cisco is adding Media Hub home servers and Linksys Wireless Home Audio players to Linksys' well established line of home and small business networking gear.

SCIENTIFIC-ATLANTA

Set-top boxes connected to large-screen TVs in millions of homes give Cisco a unique position at the heart of home entertainment. The difficulty: These boxes are owned and controlled by cable and phone companies—and Cisco isn't eager to cross them.

FLIP

Cisco acquired Pure Digital, maker of the cheap and ultra-simple Flip video cameras, in March. The goal: Bring telepresence—high-quality videoconferencing—to consumers.

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MEDIA CENTRIC | JON FINE

AOL's Plan: Content, Content, Content

Its MediaGlow unit is counting on a gusher of traffic for scores of sites launching soon

You may be forgiven for rolling your eyes at another story about AOL yanking back the curtains to present a shiny new notion. Ex-Google ad head Tim Armstrong is AOL's third new CEO since 2006. The company has gone through something like 72 strategies since merging with Time Warner in 2001, if I am counting correctly.

Nevertheless, the revenue-challenged (its ad dollars shrank 18% last quarter) and consummately uncool AOL is readying a blitz around Web content through its (unfortunately named) MediaGlow unit, which encompasses all of AOL's content sites. There now are more than 70, ranging from the broad behemoths—AOL News, celeb outlet TMZ—to the more tightly defined, like PlaySavvy, for parents of video gamers. And MediaGlow has previously disclosed plans to launch at least 30(!) more in 2009.

AOL has been here before. Online observers with elephantine memories may recall the company's mid-'90s unit, Greenhouse, set up to...incubate content sites. Still, MediaGlow's ambitions are swelling. A long-discussed general interest site for women will be launched this year, insiders confirm, to compete with the likes of NBC Universal's iVillage. Later this month comes PoliticsDaily, which will be edited by former *New York Times* reporter Melinda Henneberger and staffed with other established political writers.

Many of MediaGlow's most recent content hits—for instance, the young men's site Asylum, which last month garnered more than 3.6 million unique visitors, according to comScore—share a common online business model: Hire a few low-cost bloggers and stoke traffic by having them fling torrents of posts, links, and photo galleries at the Web. But a raft of recent hires of well-known writers, especially at AOL's sports site FanHouse, shows the company is willing to pay for established talent. Wobbly as the business of content may be, AOL is doubling down on it.

AOL's last few years have been an aria of falling revenue and internal tumult. And the for-sale shingle hung on the business apparently has drawn little interest. Still, AOL comes to this game with substantial advantages, thanks to its daily gusher of traffic.

MediaGlow's Wilson: Hiring well-known writers, not just low-cost bloggers

Its sites still get more than 100 million unique visitors each month; around one-third of that traffic hits the home page. And its e-mail and instant messaging services still are widely used. MediaGlow CEO Bill Wilson disclosed through a spokeswoman that around 40% of MediaGlow's traffic comes from AOL's home page and other sites in the AOL network. (MediaGlow executives declined to discuss revenue levels, but two familiar with the operations say revenues last year were well into nine figures.) The existing traffic makes it easier to notch serious numbers quickly for a newly launched content site. It also makes launching so many sites this year much less onerous than it would be for a new or smaller company. The mad rush toward growth in '09 makes more sense if you agree, as I do, with the widely held belief that Time Warner will pursue a spin-off of AOL before long.

All of this requires a tightrope walk. MediaGlow has to take advantage of AOL's bona fides—all that referral traffic—while understanding that the AOL brand is a turnoff, not catnip, to curious Webheads. The company renamed its AOL Sports portal FanHouse, and insiders say it also has mulled dropping the AOL News handle for one that doesn't mention the parent. (MediaGlow executives declined to comment on this prospect.) As for other launches, a spokeswoman confirms that sites targeting pet owners and gamers are on tap. AOL also owns a ton of trademarked names it has yet to use. Look for at least two—Kitchendaily and Reality Squad, a blog about reality TV—to surface in 2009 as well.

The new breed of offerings reflects a core reality: AOL has to take the riches still thrown off by declining assets—most of its portals, such as AOL News, have flat or reduced traffic—and invest them in new places to keep growing. This is a very Old Media problem for a New Media company, but AOL has always betrayed more than a hint of the traditional. The giant long ago lost its glow (sorry), but the massive traffic it continues to attract suggests that the online incumbents still have many advantages, no matter how retrograde they seem. | BW |

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

(TOP) BRAD TRENT

Before There Was Bernie...

Like Madoff, Ivar Kreuger rode a pyramid scheme to immense wealth in the '20s. Then the market crashed

It was the 1920s in America, the Jazz Age. Skepticism and fear had given way to postwar exhilaration. It was a time of stark ambition and little restraint, of excitable and credulous businessmen, bankers, and stock traders. It was the perfect place for Ivar Kreuger. He was a Swedish industrialist and brilliant mastermind; a charming, secretive man who tapped American investors to create a pyramid scheme that overshadowed Charles Ponzi's. By decade's end, Kreuger was one of the world's wealthiest and most powerful men.

Then it all came crashing down.

Frank Partnoy's biography, *The Match King: Ivar Kreuger, the Financial Genius Behind a Century of Wall Street Scandals*, is an absorbing tale and a poignant reminder that every boom has its scoundrels. Partnoy, a professor of law and finance at the University of San Diego, manages to explain Kreuger's complex dealings without diminishing the tension of his dubious rise and inevitable fall. What makes Kreuger an even more fascinating subject is the indelible mark he left. As the title suggests, he devised financial tools and tricks that are used to this day: off-balance-sheet financing and nonvoting B shares, to name just two. He was also inadvertently responsible for large pieces of the American regulatory system, including the Securities Exchange Act of 1934, which established the Securities & Exchange Commission and gave shareholders the right to sue for fraud.

Kreuger's assault on the U.S. began in 1923, when he was in his early 40s. By then, he had co-founded a construction company in Sweden (Kreuger & Toll) and, more important, built a match monopoly (Swedish Match). But his real ambitions were more grand. He wanted to be a global financier at a time when the leaders of struggling European countries were beholden to such men. His plan was to offer these leaders cheap loans in exchange for match monopolies. What Kreuger lacked was the money to lend them. For that, he came to America.

Like all great conjurers, Kreuger knew how to create an illusion. He understood how to entice the privileged by remaining aloof. He could appear confident at the worst of times. As Partnoy puts it: "He knew markets reflected emotions and perception. In finance, there was no such thing as reality." In short order, Kreuger founded a new company, International Match, and got Wall Street investment bank Lee, Higginson & Co. to sponsor a major bond offering. Kreuger promised huge returns, and investors took the bait. The money was loaned to Poland. He was on his way.

Kreuger lent hundreds of millions of dollars to France, Spain, Germany, and other smaller countries. Much of the money came from new investors drawn in by ever more complicated and lucrative offerings. But the profits from his match monopolies and the interest on the loans didn't cover these payouts. Kreuger constantly needed more cash.

Kreuger devised tools and tricks that are used to this day, including off-balance-sheet financing and nonvoting B shares

By 1928 he had displaced Jack Morgan as the world's top financier. Kreuger was a confidant of President Herbert Hoover and on good terms with most of Europe's leaders. He owned mines, railways, and real estate, and had created a web of deceptions and obligations so arcane that only he saw how precarious his empire was.

Few raised any suspicions until the markets crashed in 1929. As bankers began asking questions, the Match King retreated to his Match Palace in Stockholm, where he would lock himself in his Silence Room and shift around what money he still had. In March 1932 a group of leading bankers who were exposed to his securities planned to confront him in Paris. Kreuger committed suicide the morning of the meeting.

***The Match King: Ivar Kreuger, the Financial Genius Behind a Century of Wall Street Scandals* by Frank Partnoy; Public Affairs; 288 pp.; $26.95**

Lee, Higginson went bankrupt. But investors didn't lose everything. After 13 years of digging, the trustee for the bankruptcy court recovered 32¢ on each dollar. And Swedish Match survived. As Partnoy writes of Kreuger: "He was a builder as well as a destroyer."

Ivar Kreuger, Bernard Madoff: Both of their schemes were shocking in scope and audacity. Both ran circles around gullible investors and inattentive regulators. And both left us dumbfounded when the truth came out. Partnoy gives us a rich account of the Roaring Twenties' most astounding confidence man. Now bring on the Madoff books. | BW |

THE BUSINESSWEEK BEST SELLER LIST

HARDCOVER BUSINESS BOOKS

		LAST MONTH	MONTHS ON LIST
1	**HOUSE OF CARDS** William D. Cohan (Doubleday $27.95) A behind-the-scenes account of why Bear Stearns went bust so fast.	—	1
2	**OUTLIERS** Malcolm Gladwell (Little, Brown $27.99) The unexpected factors that lie behind success.	1	5
3	**THE SANDLER RULES** David Mattson (Pegasus $24.95) From sales-training guru David Sandler, 49 rules to sell by.	—	1
4	**PEAKS AND VALLEYS** Spencer Johnson (Simon & Schuster $19.95) The *Who Moved My Cheese?* author on finding the upside at work and beyond.	—	1
5	**THE GREAT DEPRESSION AHEAD** Harry S. Dent Jr. (Free Press $27) Prosper during an unprecedented economic downturn.	4	3
6	**TRIBES** Seth Godin (Portfolio $19.95) A man, a plan, and a group of followers—that's what you need to foster innovation.	15	6
7	**MELTDOWN** Thomas E. Woods Jr. (Regnery $27.95) Why the U.S. economy cratered—and why big-government solutions won't help.	7	2
8	**STRENGTHS-BASED LEADERSHIP** Tom Rath, Barry Conchie (Gallup Press $24.95) How able leaders inspire teamwork.	11	3
9	**LORDS OF FINANCE** Liaquat Ahamed (Penguin Press $32.95) How central bankers' actions precipitated the Great Depression and WWII.	12	2
10	**THE 4-HOUR WORKWEEK** Timothy Ferriss (Crown $19.95) Defining your dreams and cutting loose from work.	9	23

PAPERBACK BUSINESS BOOKS

		LAST MONTH	MONTHS ON LIST
1	**SUZE ORMAN'S 2009 ACTION PLAN** Suze Orman (Spiegel & Grau $9.99) Safeguards to put in place and mistakes to avoid.	1	4
2	**I WILL TEACH YOU TO BE RICH** Ramit Sethi (Workman $13.95) A crash course that aims to put 20- to 35-year-olds on the right financial track.	—	1
3	**BLINK** Malcolm Gladwell (Back Bay Books $15.99) Snap judgments deserve careful consideration, says a writer for *The New Yorker.*	4	24
4	**J.K. LASSER'S YOUR INCOME TAX 2009** The J.K. Lasser Institute (Wiley $18.95) Home office deductions, moving expenses, etc.	2	5
5	**HOW TO WIN FRIENDS & INFLUENCE PEOPLE** Dale Carnegie (Pocket Books $15) The classic networking guidebook.	9	22
6	**WHAT COLOR IS YOUR PARACHUTE? 2009** Richard Nelson Bolles (Ten Speed Press $18.95) The enduring job-search bible.	3	7
7	**RESCUE YOUR MONEY** Ric Edelman (Simon & Schuster $9.99) The financial adviser recommends having just one investment goal.	—	1
8	**THE SPEED OF TRUST** Stephen M.R. Covey (Free Press $15.95) Nurturing credibility in your personal and professional lives.	8	14
9	**AMERICA'S CHEAPEST FAMILY GETS YOU RIGHT ON THE MONEY** Steve and Annette Economides (Random House $12.95) Scrimp and be debt-free.	—	4
10	**NUDGE** Richard H. Thaler and Cass R. Sunstein (Penguin $16) Why we make flawed decisions and how we can start making better ones.	—	1

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LONG-RUNNING BEST SELLERS

HARDCOVER BUSINESS BOOKS

StrengthsFinder 2.0 Tom Rath (Gallup Press $21.95) • **The Total Money Makeover** Dave Ramsey (Thomas Nelson $24.99) • **Who Moved My Cheese?** Spencer Johnson (Putnam $19.95) • **Good to Great** Jim Collins (Collins $29.99) • **Five Dysfunctions of a Team** Patrick Lencioni (Jossey-Bass $24.95) • **Now, Discover Your Strengths** Marcus Buckingham, Donald O. Clifton (Free Press $30)

PAPERBACK BUSINESS BOOKS **The Tipping Point** Malcolm Gladwell (Back Bay $14.99) • **Rich Dad, Poor Dad** Robert T. Kiyosaki, Sharon L. Lechter (Business Plus $16.95) • **The 7 Habits of Highly Effective People** Stephen R. Covey (Free Press $15.95)

FEEDBACK

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MEXICO

BUSINESS HANGS TOUGH

Mexico may be reeling from drug violence and recession. But as we reported in "Mexico: Why Business Is Standing Its Ground" (Cover Story, Apr. 20), multinationals remain bullish on the country as a manufacturing base—drawn by its cheaper peso, sound economic policies, and drive to be competitive with Asia. Some readers thought we understated the problems. But many agreed that behind today's drug-war headlines is a story of another Mexico. *–Pete Engardio*

Despite the economic downturn and the drug-related violence, Mexico will continue to offer great advantages to North American companies interested in increasing competitiveness by taking advantage of a skilled, low-cost labor force. Mexico has the location advantage that allows [U.S.] companies to transfer operations nearby—at a greatly reduced cost.

Screen name: PR

Please explain why, if the tone of your article about Mexico was generally positive, you had to use such a distasteful depiction of the name of the country on your cover. I find this very damaging and, frankly, insulting.

Abel Espinosa
EGAN, MINN.

After working with people from India and people from Mexico, I can say that I find Mexican engineers to be equal to and in most cases better than their Indian counterparts. Also, the article didn't mention similarities between [U.S. and Mexican] cultures.

Screen name: Phil

Good article, but it fails to address the real problem: When are we going to eliminate the demand for drugs by legalizing and controlling them as we do alcohol and tobacco?

Screen name: Border Resident

EMPLOYMENT

FREELANCING'S UNWRITTEN RULES

Regarding "A Hidden Drag on the Economy" (News, Apr. 20): Please don't make victims out of us, the contract workers.

A contractor's hourly rate is generally higher than a [permanent] employee's. A company can pay a freelancer more because it saves on benefits and perks. And the contractors? We are supposed to use that extra compensation to build a rainy-day fund.

The system works. What may not be working is some contractors' responsibility chromosome.

Gene Haugen
COTTAGE GROVE, ORE.

AUTOS

HOW FIAT CAN ADAPT TO U.S. TASTES

Is Fiat CEO Sergio Marchionne really relying on "Chrysler knowhow" to adapt his company's cars to U.S. tastes ("Fiat: On the Road Back to America," News, Apr. 20)? Rather than trust a nearly bankrupt company on this, Marchionne should talk to American car buyers. Better yet, he should just buy a Honda Accord, a Toyota Camry, and a BMW 3 Series and imitate them.

Marcelo Salup
HOBOKEN, N.J.

CORPORATIONS

SEMANTICS AND THE BOTTOM LINE

I was amused by the letter to the editor from Steven Iaco, senior managing director at CB Richard Ellis, stating that the company would have been profitable in 2008 if not for its $1.2 billion noncash [goodwill] writedowns (Feedback, Apr. 20). Apparently management doesn't feel responsible for such writedowns because they were capitalized on the balance sheet for a few years before pesky accounting rules forced them to acknowledge the assets weren't worth what they paid for them.

Todd Eaton
ROCHESTER, N.Y.

MEDIA

I WANT MY (VERY OWN) CABLE TV

Regarding "The Online TV Threat Has Cable Scrambling" (What's Next, Apr. 13): What I would like is for cable providers to stop trying to cram 1,000 channels of garbage down our throats. Give me the opportunity to choose a basket of channels for a set fee. Until Time Warner comes up with something like that, I'll have soccer games going on my laptop while my kid watches Hulu on the desktop and my wife downloads movies through Apple TV.

Edward Galli
MANHATTAN BEACH, CALIF.

COMPANY INDEX

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

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The Economy: A Little Clarity

In today's climate of uncertainty, here's what we know—and what we don't

Just recently, we were walking down Lexington Avenue in New York when a young man in a suit stopped us. He told us he worked on Wall Street, read this column, and wondered if we might answer a question on the spot. We agreed to try, but he stumped us.

"When are things going to get better?" he wanted to know.

"Sometime in 2010," was our answer, "maybe."

Can you blame us for hedging? This recession has government experts and renowned economists reeling—that is, when they're not disagreeing with one another—clouding any kind of cogent consensus about what's ahead. Some people are seeing glimmers of hope, others dungeons of doom, and there are proponents of everything in between.

As for us, the best we can offer is a list of what we think we know for sure about the economy right now, and, perhaps as importantly, what we know we don't know at all.

Let's start with the five phenomena that seem fairly certain to us.

First, it appears the economy has hit some kind of bottom. We draw that conclusion based on order levels in every business we're associated with through private equity and consulting, plus what we hear on our travels from executives of every stripe. After a steady decline from May 2008 through January 2009, we've been told, orders received in February, March, and the first half of April were similar to or slightly better than January's. This good news, so to speak, is tempered by capital equipment orders that continue to slip. But all in, we feel confident (O.K., somewhat confident) in saying the economy has reached its nadir.

Second, we think we know that an uptick in demand will yield a quick response from the economy. Why? Because inventory reductions have been so thorough over the past nine months that any kind of surge in orders will reverberate through the supply chain.

Another thing we think we know—and perhaps the most relevant of the bunch—is that the American banking system is stabilizing. Yes, there is persistent criticism of the government's emergency care, with TARP, TALF, commercial paper backing, and the rest. But there can be no doubt that credit is starting to flow again, both from banks and from the many critical nonbank lending institutions.

Another "known" in our view: that Americans are generally feeling better, as reflected in the recent jump in the Consumer Confidence Index. This isn't a total surprise, what with the surge in refis, lower mortgage rates, and tax refunds. However, our incoming mail indicates that a vast majority of people are still terrified of losing their jobs, and that emotion will probably remain for some time if unemployment reaches into the double-digits, as is widely expected.

For starters, it appears the U.S. economy has actually hit bottom. Unfortunately, that's not the same as saying a recovery has begun

Which brings us to our final "sure thing"—and this one is alarming. President Obama's budget, based on the assumption of 4% GDP growth from 2010 through 2013, is simply not realistic. During the leveraged euphoria of the '80s and '90s, GDP growth averaged closer to 3%. These days, with deleveraging everywhere, larger deficits, and consumers turning frugal, GDP growth is more likely to be near 2%. The outcome? Not reduced government spending, we'd wager, but higher taxes and more federal debt.

As for what we don't know, well, for starters, we have no clue about the question on everyone's mind: the direction of the Dow. One day we think, "All that government money pouring into the economy has got to work, at least short-term." And the next, "Holy Cow, those looming deficits are going to cause a huge crash down the road." No wonder we've become such cowards, sticking our own investments mainly into Treasuries and high-grade corporate bonds. We've never been more puzzled by the stock market.

Finally, we don't have any idea when the economy is going to turn around. Even if we are at the bottom, we could be in the "bathtub" for a while. It's like we told our new friend in the street. We believe something good will happen in 2010, but we can't promise that with 100% certainty. Indeed, the only thing "guaranteed" these days is that a lot of uncertainty is a now a fact of life. BW

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Jack and Suzy look forward to your questions. You can e-mail them and view their new Web site at welchway.com. For their PODCAST, go to businessweek.com/search/podcasting.htm

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