

want to front-load the failures through early-stage screening in India, says C.S.N. Murthy, CEO of Bangalore-based Aurigene. "Here, you can get four failures for the price of one."

In the early days, Western executives were suspicious of their Indian partners with their history drug knockoffs. Yet they were also powerfully attracted. Mervyn Turner, a senior research vice-president at Merck, says his first trip to India in November 2007 was "mind-blowing." He was impressed by the local companies' yearning to do world-class research and by their passionate, charismatic leaders. In Mumbai, he met Piramal, the Harvard-educated daughter of a textile mogul, who explained that she chose medicine to find a cure for polio. She's "a force of nature," he says.

A look inside Forest Lab's partnership with Aurigene shows both the strengths of the new research model and the hurdles it faces. Forest has given Aurigene some prized, proprietary data on how novel drugs might attack metabolic disorders such as diabetes. Aurigene's job is to screen a library of therapeutic chemicals and come up with a drug. Each company has assigned three senior staff to a "joint research council," and parallel teams of chemists and biologists keep in constant touch via teleconferences. Murthy says speed is of the essence. While large U.S. labs struggle with bureaucracy, "in a place like this, a scientist makes some computations in the morning, and by the afternoon he has all the data. He doesn't call a meeting. He walks up to a colleague and stands over him until he gets what he needs." Forest and Aurigene recently designed a drug and started animal tests in just three months—a quick kick-off by U.S. and European standards.

Western drug companies are giving Asian partners more responsibilities than they ever imagined. Suvon Life Sciences, an Indian startup in Hyderabad, is co-developing drugs for brain diseases with Lilly. As part of the deal, Suvon can work on its own drugs for Alzheimer's, obesity, and Parkinson's disease, provided they don't compete with jointly developed products. Early on, Lilly sought to impose restrictions on Suvon's own research. "We didn't have any flexibility," says CEO Venkat Jasti. But as the relationship evolved, Jasti prevailed on his U.S. partners to toss that paperwork in the trash. "We can't do it the Lilly way," Jasti says. "Innovation comes from freedom." **EW**
—With Nandini Lakshman in Mumbai

LINKS

Taming the Drug Research Monster

In the May 2008 issue of *Harvard Business Review*, retired GlaxoSmithKline CEO Jean-Pierre Garnier says drug companies should bust up their research models. Many still operate under a "pyramid" setup, with scientists cubbyholed in their areas of expertise. "Something happened on the way to the new century," Garnier writes. "Employment multiplied by 20. The pyramid became a monster, and everything suffered." Instead of resorting to radical outsourcing, Garnier suggests building "constellations" of small, independent research units. Glaxo now has 12 research centers focused on disease areas, each with its own CEO, and there are no more than three management layers between the chief and key scientists.



BACK-TO-CHINA SYNDROME

In a reverse migration, U.S.-trained Chinese scientists are starting mainland companies

By Pete Engardio

The cocktail chatter in a private room at Manhattan's Cornell Club turned to a hush as 40 pharmaceutical executives, investment bankers, and attorneys raised their wine glasses to Raymond Wu, who died on Feb. 10. The Cornell University geneticist helped pioneer drought-resistant rice. But to the Chinese-American businessmen in the room, Wu was also known for a program he founded in the 1980s that helped 425 of China's most brilliant students earn advanced biology degrees at elite U.S. schools. Today, 2,500 life sciences faculty at U.S. research universities are native Chinese, as are an estimated 10% to 20% of scientists in the labs of U.S. drug and biotech companies. "Ray Wu opened the door for countless Chinese students," said Pfizer's Steve Yang, who offered the toast.

Now this wave of imported brainpower is building bridges between the pharmaceutical industries of China and the U.S. The catalysts are returnees, known as "sea turtles," creatures celebrated in Chinese lore for their brave oceanic migrations. Just as previous waves of Taiwanese and Indian engineers blazed trails in Silicon Valley before building computer, chip, and software industries in their homelands, mainland returnees are setting up biotech startups, contract research companies, and university labs modeled after America's. Pharma consultant Zhu Shen, a 1988 emigré, reckons there are 70,000 Chinese life science professionals in the U.S. and dozens of immigrant-founded biotechs in San Diego alone. "Everyone I speak to wants to open up in China," she says.

TIGHT-KNIT NETWORKS

The sea turtles could transform the nature of pharmaceutical research. While India is ahead in building far-reaching partnerships with multinationals, China has a big edge in basic biology and is emerging as a power in discovery. Last year, Shanghai's Jiaotong University licensed a new process for improving patients' absorption of complex drugs to Switzerland's Roche, in a deal that could be worth millions. And in April, San Diego-based HUYA Bioscience won Food & Drug Administration approval to begin human tests of a cancer drug developed by a research institute in Beijing—a first for a Chinese government lab.

Much of the Sino-U.S. activity is brokered through tight-knit networks. The most influential is BayHelix, or-

ganizer of the Cornell Club tribute for Wu. Membership in the seven-year-old group is by invitation only and limited to 300 top executives. They include Chinese execs at Pfizer, Merck, GlaxoSmithKline, Eli Lilly, and Novartis, as well as top venture capital and law firms. Half of its members are based in China, including sea turtles who founded research and development services companies such as Wuxi PharmaTech and Shanghai Genomics.

The heavy Chinese presence in U.S. life sciences began in the 1970s, when tens of thousands of Chinese college grads streamed into fast-growing biotech programs in American universities. Yang went to Michigan Technology University in 1989 because of the cheap tuition and earned a PhD in pharmaceutical chemistry at the University of California at Irvine before eventually landing at Pfizer. As head of Asia R&D, he now is setting up a network of collaborations.



Lab workers at Wuxi PharmaTech, which was founded by returnees

Today, opportunities in the mainland are luring those sea turtles back. Beijing's Tsinghua University, for example, recently snared alumnus Shi Yigong, a leading Princeton molecular biologist. After doctoral studies at Johns Hopkins and Memorial Sloan Kettering Cancer Center, he rose to full professor at Princeton in just four years, based on his research into the mechanism of cell death. Shi co-founded Tetralogic Pharmaceuticals in Malvern, Pa., in part to commercialize that work. Now he spends most of his time at Tsinghua University. "I feel I can use my talents better in China," Shi says.

Academia isn't the main destination for sea turtles, however. "Now most come back because they want to get rich and do big things," says Michael Hui, CEO of ShangPharma, a drug R&D outsourcing firm. A chemist by training, Hui picked up an MBA from New York University and returned to his native Shanghai. In six years, ShangPharma has seen its staff grow from 5 to 1,300 and counts Eli Lilly among its 60 foreign clients.

NO CRITICAL MASS

Some Chinese are joining mainland ventures because prospects in U.S. industry seem so dim now. Neurologist Charles Huang filed 10 patents and published 20 papers when he was a senior scientist with Neurocrine Biosciences in San Diego. Later he joined fast-growing Shanghai R&D outsourcing firm Sundia MediTech, also headed by Chinese veterans of U.S. industry. He calls the job picture in America "gloomy." What's more, Princeton's Shi warns that shamefully few Chinese scientists rise to the top of major U.S. companies or research programs, compared, say, with Indians or Europeans. "Unless the U.S. solves this glass ceiling problem, you will see a serious brain drain," he predicts.

So far, China's talent gain has not been America's loss. Sea turtle ventures in China still work mainly for U.S. drugmakers. And with 9,000 Chinese students a year earning U.S. biology master's and doctoral degrees, more talent is arriving in the U.S. than is leaving. Chinese companies still don't have a critical mass of veteran scientists who can turn discoveries into products, says John V. Oyler, a former McKinsey consultant who heads Beijing-based

contract research company BioDuro. "In five years, as much drug research will be done in Shanghai and Beijing as in Boston and San Francisco," he predicts. "But China's pharmaceutical industry will only be able to succeed by collaborating with the U.S." **(BW)**

—With Chi-Chu Tschang in Shanghai

"NOW MOST COME BACK BECAUSE THEY WANT TO GET RICH AND DO BIG THINGS," SAYS CHEMIST MICHAEL HUI, CEO OF SHANGPHARMA

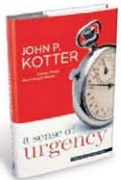
COMBATING COMPLACENCY

BOOK EXCERPT

By John P. Kotter

Illustration by Christoph Neimann

Changing a company is never easy. To get everyone on board, argues this Harvard B-School professor, you must enlist hearts as well as minds



Most attempts at organizational change fail, according to the research of noted author John P. Kotter. Why should this be so? Kotter believes that if the sense of urgency is not high enough at the very beginning of any such project, complacency will win out. His new book, A Sense of Urgency, provides a guide for successful trans-

formation. In this excerpt, Kotter describes the importance of an appeal that goes beyond the intellectual.

I was present recently at a well-known company's annual top management meeting, where two division managers made speeches. Manager No. 1 walked to the podium, asked for the lights to go down, and began his speech. A new, information-rich PowerPoint slide appeared every 30 to 60 seconds. He looked at his notes about a third of the time, the slides another third, and what he could see of the audience in the dim room the final third. He was remarkably articulate.

His speech described the problems that faced the company and, he said, all audience members. It offered a new set of goals and strategies for moving forward and a method for implementation. When the speaker was done, the lights went up and he answered questions for 30 minutes.

The next morning manager No. 2 was noticeably more nervous in his presentation. He set aside his notes and

stood beside the podium. Because the lights automatically went down, he was mostly in the dark along with the audience. He made a joke: "Kerry [the CFO] keeps telling us we are all in the dark, and I guess he may be right." Instead of moving behind the podium and into the spotlight, he asked that all the lights be turned up. He then talked for an hour employing few PowerPoint slides.

Manager No. 2 was less articulate than Manager No. 1. He paused at times as if searching for the right words.

In making a case for change much like the first speaker's, he used only a few statistics—about 10% as many numbers as in the first speech, but all of his data were attention-grabbing.

For nearly half of the address, he told stories: about his father's company that had gone into bankruptcy, leaving his family in difficult circumstances; about a friend of his who worked at a competing firm and who recently, after a few too many drinks at the clubhouse, disclosed information about his company's very aggressive new strategies; about the speaker's great pride in working for his company when he was a young man, a time when the firm was No. 1 in all its markets; about how he and his wife had talked about early retirement but decided against it because he wanted to retire a winner—which, he said, he damned well planned on doing. He ended and received the longest applause heard at the entire meeting.

Whether either man knew consciously what he was doing, I have no idea. But I do know that what each did, on the same stage, had a very different effect.

Low lights signal to our senses that the workday may be over and it's time for sleep, making it hard for an audience to pay careful attention. When we stand behind a big

wooden podium, it can feel as if there's a shield between us and the audience. PowerPoint slides so dense that they cannot be read in the last seven rows can annoy observers and raise irrational worries: Does the speaker not care whether I can see because he thinks I cannot understand the information anyway?

Neurologists say that our brains are programmed much more for stories than for abstract ideas. Tales with a little drama are remembered far longer than any slide crammed with analytics. Personal stories also create a more intimate atmosphere—one that communicates the feeling that no one here intends to take advantage of anyone else. And the use of humor can reduce stress and encourage the audience to feel that the speaker understands them.

We worry about appearing awkward in a presentation. But up to a point, most people seem to feel more comfortable with less-than-perfect speaking abilities. It makes the speaker more human—and more vulnerable, meaning he is less likely to attack our decisions or beliefs.

Our rational minds tell us that none of these issues of presentation should matter. What is important is content: Is this a solid analysis and plan or not? But the best plan may raise little urgency in a company whose very successes have left it so complacent that most people are not looking for, and are not inclined to listen to, a new plan.

Within the company in question, six months after the yearly meeting many people were moving with a new sense of urgency to deal with their considerable challenges. The second man's speech was only one of many actions that undercut a sleepy contentment with the status quo. But it was an important action.

The sequence of events seems to have been as follows: First, an emotionally compelling speech was given at a very important meeting to a very important audience. Then urgency rose among many of those in the meeting, including the speaker's boss. The increased urgency was one factor in helping create a committed team to deal with the challenges. The team worked energetically with others to create a new, sensible vision and strategy, with the first speaker's ideas having a significant effect at that point. The energized team spent hours carefully and cleverly communicating the strategies, visions, and

plans with both their minds and their hearts—and onward from there.

Great leaders understand that historical success tends to produce stable and inwardly focused organizations, and these outfits, in turn, reinforce a feeling of contentment with the status quo. Later failures to produce short-term results or to adapt to change can produce a great deal of activity—but this is often unproductive activity driven by anxiety about one's own future (not the organization's future) or by anger at others. In a competitive, fast-moving world, all this can be deadly. And none of it can be fixed by a mind-only strategy.

The most successful "heart-head" approaches fall into four categories.

In the first, people dramatically bring outside reality into groups that are too inwardly focused. They do not just collect data and dump it on individuals or massage valid information into goals and present them on PowerPoint slides, as the first speaker did. Instead, they create emotionally compelling experiences involving other people, information, and even the right kinds of business cases, as the second speaker did.

Second, they behave with true urgency themselves. They do not just say the right

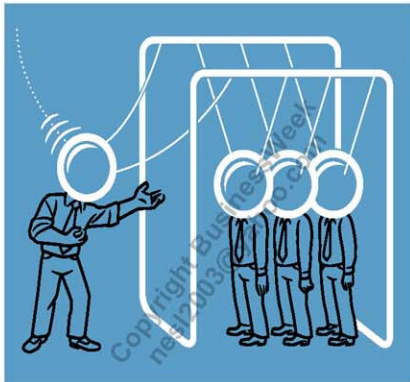
words daily, but they make their deeds consistent with their words.

Third, they look for the upside possibilities in crises, but very selectively and with great care. They do not view a crisis as only a threat but also as a potential opportunity to shake up an organization and reduce complacency.

Fourth, they confront the problem of "No-Nos." They do not accept the notion that an organization must put up with people who relentlessly work to kill urgency.

All four tactics can have an effect that is visceral, not merely intellectual, influencing attitudes, thoughts, feelings, hopes, dreams, and behavior. You can transform complacency with the status quo, or the anger and anxiety associated with a perceived mess, into a determination to move and win, now. **BW**

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Simple Truth: Investment costs count

The lower the costs



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Many investment firms call themselves low cost. But, the truth is, many of them charge about six times as much as Vanguard.* This can cost you thousands of dollars. For instance, over twenty years, if you invest \$10,000 a year with an average return of 8% before expenses, you would keep about \$58,000 more with the Vanguard fund!† And the longer you invest, the greater the savings. It's your money. Keep more of it. Vanguard. The simple truth about investing.

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Visit www.vanguard.com, or call 877-527-4941, to obtain a prospectus, which includes investment objectives, risks, charges, expenses, and other information; read and consider it carefully before investing. Investments are subject to market risk. *Source: Lipper Inc. as of 12/31/2007. †Based on 2007 industry average expense ratio of 1.22% and Vanguard average expense ratio of 0.20%. Hypothetical example does not represent any particular investment. Simple Truth. The simple truth about investing.

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Prospective tenants have pulled out of Mori's new Shanghai tower (center)

REAL ESTATE

Global Office Space Is in the Basement

Developers of commercial properties from London to Tokyo are suffering as banks cut lending

By Carol Matlack



First came the U.S. housing bust. Now comes the overseas aftershock. As the global financial system reels from the credit crunch, skyscraper projects have stalled in London, Tokyo developers have gone belly-up, and Indian office space can be had for fire-sale prices.

What do bad U.S. home loans have to do with office buildings halfway around the planet? Plenty. Global lenders, chastened by the subprime mess, are denying credit to many builders and demanding tougher terms on loans to buy or refinance

commercial properties. And as those same lenders lay off thousands of workers, they need less office space—putting downward pressure on rents and spurring developers to rethink their plans.

"It's impossible now—adays to keep financial crises in one area," says Minoru Mori, chief executive of Japan's Mori Building, which just cut the ribbon on the 101-story Shanghai World Financial Center, China's tallest skyscraper. He ought to know: Lehman Brothers recently scrapped plans to move into the building, and Morgan Stanley said it would rent only four floors instead of eight.

Dealmaking has slowed sharply. The value of commercial real estate transactions worldwide in the first six months of this year was only \$306 billion, about half the level of the same period in 2007, research group Real Capital Analytics estimates. "It's hard to sugarcoat what's going on," says Dan Fasulo, Real Capital's managing director of research. "The environment is the most difficult it has been in some time."

BRITISH BLIGHT

London may be suffering the most. As costs for commercial real estate financing in the British capital have soared, only 3 of 19 major office projects announced since 2004 have gone ahead as planned. Developer British Land is delaying construction of a 47-story skyscraper popularly known as the Cheese Grater (owing to its triangular profile). Overall, purchase prices for British commercial property are down 20% from mid-2007 and could fall 15% more in the coming year, says Kelvin Davidson, an economist at London consultancy Capital Economics. "The market won't pick up before 2011." That might be too late to help

Metrovacesa. The Spanish property group spent \$3.7 billion in 2007 for the London headquarters of bank HSBC, Europe's biggest-ever real estate deal.

HSBC agreed to remain in the building and extended Metrovacesa a \$1.5 billion short-term loan, to be repaid this fall after the Spanish group lined up long-term financing. But analysts reckon the building has since lost at least 25% of its value, and Metrovacesa hasn't yet secured new funding. The company says it's confident it can work out an agreement.

Subprime isn't the only source of trouble. In Japan, banks fared relatively well in the wake of the U.S. mess. But a flagging economy and weak consumer confidence have clobbered smaller developers.

Nine publicly traded real estate and construction groups have filed for bankruptcy this year, including Sohken Homes, which sought protection from creditors on Aug. 26. That, in turn, provoked profit warnings by banks that lent to the companies.

In contrast to past real estate downturns, overbuilding isn't a big problem. Vacancy rates remain low in many markets, so rents are stable. "People learned from the 1980s" when loose lending led to massive investment, says David J. Siopak, co-manager of the Schwab Global Real Estate Fund, which has \$190 million in assets. This time, he says, "there was a little more discipline."

Overexuberant development has been confined largely to fast-growing markets, particularly China and India. In the Chinese cities of Chongqing and Zhengzhou, more than 30% of existing space is vacant after a building bings two years back, and an additional 4.8 million square feet of space is due for delivery this year in the two cities,

according to Jones Lang LaSalle. In India, inflation, high interest rates, and stock market turmoil have taken a toll, with rents off by as much as 40%, says Pranay Vakil, chairman of Knight Frank India, a property consultant. The U.S. slowdown, meanwhile, has dampened demand for "cubicle developments" used by outsourcing shops. "Most IT companies said, 'No more expansion,'" Vakil says.

So far damage to lenders has been limited. But banks in Ireland and the Netherlands might be forced to take writedowns, and investment funds targeting Western European property could be in trouble. The outlook is even grimmer in Spain, where real estate fades have been in free fall. Martinsa-Fadesa, a major property company, filed for bankruptcy in July, and another big developer, Colonial, is struggling with \$14 billion in distressed debt.

For all the bad news, the situation creates opportunities for those with cash. Pension funds and sovereign wealth funds "still have money to invest," says Tim Jowett, an analyst at Swiss bank UBS. But developers may have to wait awhile. Those conservative investors won't likely put money into the market now, Jowett says, if they think that "in 6 months or 12 months prices might go lower." **IBW**
—With Peter Coyin in New York, Mark Scott in London, Chi-Chu Tschang in Beijing, Ian Rowley in Tokyo, and Nandini Lakshman in Mumbai

TAILSPIN

Office-building sales are down worldwide

CHANGE IN VALUE OF TOTAL TRANSACTIONS, FIRST HALF OF 2008 VS. FIRST HALF OF 2007

Germany **-80%**

U.S. **-69%**

Britain **-64%**

France **-51%**

China **-16%**

Total worldwide **-60%**

Date: Real Capital Analytics

LINKS

Sovereign Saviors

Sovereign wealth funds have helped prop up struggling financial companies. Now they may be poised to rescue commercial real estate, too, the *Asia Property Report* said on Aug. 8. By some estimates, the funds have invested \$7 billion in British hotels, offices, and other properties. And Singapore's Government Investment Corporation recently bought a Westin hotel in Tokyo, while the Investment Corporation of Dubai tried to purchase a troubled Spanish developer.



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To secure America's energy future, we need all energy options. That means investing in alternatives, while at the same time discovering new U.S. oil and gas resources from new places offshore and onshore. As the largest oil and gas producer in the U.S., BP is providing more energy, safely and cleanly. We also own and operate the largest fully integrated solar plant in the U.S. Because energy security is something we should all be sure of. Learn more about America's most diverse energy portfolio at bp.com/us.



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65 mpg—but the U.S. Can't Have It

Ford's Fiesta ECONetic is an impressive fuel sipper. It just happens to run on diesel



The ECONetic will go on sale in Europe in November

By David Kiley

If ever there was a car made for the times, this would seem to be it: a sporty subcompact that seats five, offers a navigation system, and gets a whopping 65 miles to the gallon. Oh yes, and the car is made by Ford Motor, known widely for lumbering gas hogs.

Ford's 2009 Fiesta ECONetic goes on sale in November. But here's the catch: Despite the car's potential to transform Ford's image and help it compete with Toyota Motor and Honda Motor in its home market, the company will sell the little fuel sipper only in Europe. "We know it's an awesome vehicle," says Ford America President Mark Fields. "But there are business reasons why we can't sell it in the U.S." The main one: The Fiesta ECONetic runs on diesel.

Automakers such as Volkswagen and Mercedes-Benz have predicted for years that a technology called "clean diesel" would overcome many Americans' antipathy to a fuel still of-

ten thought of as the smelly stuff that powers tractor trailers. Diesel vehicles now hitting the market with pollution-fighting technology are as clean or cleaner than gasoline and at least 30% more fuel-efficient.

Yet while half of all cars sold in Europe last year ran on diesel, the U.S. market remains relatively unfriendly to the fuel. Taxes aimed at commercial trucks mean diesel costs anywhere from 40¢ to \$1 more per gallon than gasoline. Add to this the success of the Toyota Prius, and you can see why only 3% of cars in the U.S. use diesel. "Americans see hybrids as the darling," says Global Insight auto analyst Philip Gott, "and diesel as old-tech."

Many Americans still have an antipathy to diesel, thinking of it as the smelly stuff that powers tractor trailers

None of this is stopping European and Japanese automakers, which are betting they can jump-start the U.S. market with new diesel models. Mercedes-Benz by next year will have three cars it markets as "BlueTec." Even Nissan and Honda, which long opposed building diesel cars in Europe, plan to introduce them in the U.S. in 2010. But Ford, whose Fiesta ECONetic compares favorably with European diesels, can't make a business case for bringing the car to the U.S.

TOO PRICEY TO IMPORT

First of all, the engines are built in Britain, so labor costs are high. Plus the pound remains stronger than the greenback. At prevailing exchange rates, the Fiesta ECONetic would sell for about \$25,700 in the U.S. By contrast, the Prius typically goes for about \$24,000. A \$1,300 tax deduction available to buyers of new diesel cars could bring the price of the Fiesta to around \$24,400. But Ford doesn't believe it could charge enough to make money on an imported ECONetic.

Ford plans to make a gas-powered version of the Fiesta in Mexico for the U.S. So why not manufacture diesel engines there, too? Building a plant would cost at least \$350 million at a time when Ford has been burning through more than \$1 billion a month in cash reserves. Besides, the automaker would have to produce at least 350,000 engines a year to make such a venture profitable. "We just don't think North and South America would buy that many diesel cars," says Fields.

The question, of course, is whether the U.S. ever will embrace diesel fuel and allow automakers to achieve sufficient scale to make money on such vehicles. California certified VW and Mercedes diesel cars earlier this year, after a four-year ban. James N. Hall, of auto researcher 293 Analysts, says that bellwether state and the Northeast remain "hostile to diesel." But the

risk to Ford is that the fuel takes off, and the carmaker finds itself playing catch-up—despite having a serious diesel contender in its arsenal. | BW |

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Google's Broadside Against Microsoft

Why the search giant's new Chrome browser could change the way we use computers

By Heather Green

This won't be like the last browser war. When Google unveiled its Web browser, Chrome, on Sept. 2 the immediate buzz was that the bruising battles played out between Netscape and Microsoft in the late 1990s, were back on.

Google, though, has much bigger ambitions. The goal, say Google execs, is not merely to win share of an existing market, but also to change the nature of Internet browsing—and the way we use computers. If Chrome works as planned, it will lead much of computing from the desktop—Microsoft's domain—toward remote data centers. These, in the tech industry, are collectively known as the cloud. Google runs the biggest and most efficient data centers on earth, and moving much of the world's computing to them is at the heart of the company's strategy. "Google really believes the future of the Web is running applications on the Web," says Danny Sullivan, who runs Calafia Consulting, a Web consulting firm. "They want to be leading the charge."

Microsoft begins this battle with an enormous head start. Its Internet Explorer dominates the browser market, with nearly a three-quarters share. Microsoft is also launching its latest upgrade, IE8, loaded with new features—including a couple that could



affect Google's business. One makes it easier for users to block information that helps Google deliver more relevant ads. Google's Chrome, by contrast, is barebones. Its power, say Google engineers, will come from its ability to run applications faster and more securely, especially those that are handled outside the PC, on the cloud. Unlike Google's top-secret search algorithms, Chrome is open-source software others can examine and even modify.

Google execs say they developed the browser, in part, for internal use. Their engineers constantly work on Web applications such as Gmail and YouTube. And they were crashing the traditional browsers, which are more oriented toward viewing Web pages. So two years

ago, Google began work on Chrome.

Now, by offering it to the public for free, Google hopes to encourage people to run more applications, like word processing, spreadsheets, and video editing, on the Web. If Chrome sparks this trend, it doesn't even need massive market share to help Google. More activity on the Web, whether users arrive by Chrome or other browsers, provides Google with more places to collect data and to serve search ads. "Google believes that the more time people spend on the Internet and the more things they do on the Internet, the more that will benefit Google," says Nick Carr, author of the book *The Big Switch: Rewiring the World, from Edison to Google*.

HIDDEN MAGIC

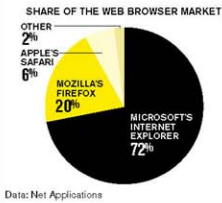
Google is starting off in browsers ambitiously. The company is launching Chrome in 43 languages and 122 countries. Most of the magic is hidden inside the system. Google engineers developed a multiprocessor architecture,

which means the browser can run separate applications in different tabs, or screens, at the same time. If one application crashes, the rest keep ticking. Another interesting feature: The search and address bar are one and the same. Type in what you're looking for,

and Chrome delivers either the Web page or search results.

Early reviews point to drawbacks of the browser, including the lack of a way to manage bookmarks. Google concedes that it's following its familiar pattern of "launch early and iterate." John Lilly, chief executive of Mozilla, which makes the competing Firefox browser, says it's hard to gauge how popular Chrome can become. "I think that a lot of people will start experimenting right away with Chrome. But this is a story that will play out over weeks, months, and years, not hours and days." | BW |

NEW BROWSER WARS





Despite lower fuel prices, shipping will likely remain weak in 2009

UPS and FedEx Think Outside the Box

Both are on cost-cutting campaigns, and UPS is even starting to lend to small customers

By Matthew Boyle

Package delivery giants United Parcel Service and FedEx are making aggressive moves to pare back rising fuel costs. But UPS is also taking a more unusual step: trying to boost customer demand by loaning money to small businesses. On Sept. 9 the Atlanta company plans to unveil Cargo Finance, aimed at helping small customers that need funds to keep their product orders flowing. "We found that entrepreneurs would love to have someone provide them with working capital," says UPS Capital Senior Managing Director Chris Vukas.

Given that the lending business has long been an albatross for nonfinancial companies—and isn't exactly a sweet spot for anyone these days—UPS's move reflects the lengths to which shippers are willing to go to get out of a bind. Having already watched their stocks drop 12% and 23%, respectively, over the past year, UPS and FedEx are

trying to drum up new business and cut costs as the critical holiday shipping season approaches. Even with oil prices easing, analysts expect shipping volume to remain weak through 2009.

Having already made obvious moves, such as limiting hiring and rolling out hybrid trucks that are more fuel-efficient, UPS and FedEx have decided it's "time to get unconventional," says John J. Coyle, professor

emeritus at the Center for Supply Chain Research at Pennsylvania State University. FedEx, which is expected to report a 40% decrease in first-quarter earnings per share on Sept. 18, is testing new software that should streamline the takeoff and landing schedules of its larger airplanes and reduce idling time. Newly equipped forklifts can weigh freight instead of hauling goods to scales. (FedEx declined to comment before its earnings announcement.)

WHAT ABOUT DEFAULTS?

UPS has asked pilots to taxi with one engine when possible, and it is experimenting with a type of landing during which engines are idle. The latter measure alone could save up to 70 gallons of fuel per flight. UPS trucks, about 60,000 of which are on the road every day, have begun using so-called telematics technology to track more than 200 pieces of data, including speed, oil pressure, and even the number of times a truck is put in reverse. That helped drivers reduce engine idling by 24 minutes per day, saving \$188 per driver.

Cutting fuel costs is one thing; building a finance business is another. UPS's Vukas figures loans will average around \$150,000, and he anticipates one or two defaults for every 100 loans issued. "UPS does well with its cash flow, so they have some money they can use [for loans]," says Penn State's Coyle. "But it's a little risky in today's market." UPS has offered such financing to customers over the past decade, but much of the lending was government-backed.

One of its trial customers is Pedors, a \$2 million Marietta (Ga.) importer of orthopedic shoes. Along with shipping Pedors products from Chinese factories to U.S. warehouses, UPS pays the Chinese supplier up front for the goods. Pedors wires UPS half the cost of the shipment once the shoes leave China and has 60 days to pay the balance, with interest. Pedors Chief Executive John O'Hare says working with UPS has helped his firm expand its product line. "This service cuts out all the middlemen in international trade," he says. Prior to the UPS deal, O'Hare relied on a bank credit line secured by his personal assets. With UPS, the collateral is the shipment itself. **| BW |**

RIVALS COMPETE ON THE DOWNSIDE

	UPS	FEDEX
Operating Income*	-18%	-28%
Stock Price (12 months)	-12%	-23%

*Most recent reported quarter
Data: Company data, Merrill Lynch



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Hanging Tough In Asia

The region's top companies are finding ways to triumph

By Bruce Einhorn

**ASIA
BW 50**

HONG KONG

Chinese e-commerce company Alibaba.com, flagship of Hangzhou's

Alibaba Group, runs a business-to-business service for small-to-mid-size importers and exporters. Since a November IPO, the shares have fallen over 60% amid worries about China's weakening exports and rising labor costs. CEO Jack Ma even said recently Alibaba needs to prepare for "winter."

Yet on Aug. 28, Alibaba surprised investors with a 136% jump in second-quarter earnings, to \$102 million. "During downturns, stronger leaders such as Alibaba tend to seize market share at the expense of weaker rivals," notes Morgan Stanley analyst Richard W. Ji.

Alibaba ranks No. 3 on this year's list of the Asia BW 50. Although many on the list have seen their stocks take a beating, almost all still have robust sales, good margins, and strong market positions. The rankings, compiled by Standard & Poor's Compustat, are based on average return on capital and sales growth over the past three years. Trends to note: infrastructure plays in India, the surprising presence of Pakistani blue chips, and the resilience of Taiwanese tech. For more on the BW 50 methodology and on how these companies perform, see businessweek.com/globalbiz/asia. | BW |

COMPANY	COUNTRY	BUSINESS
1 Siemens (India)	India	Communications Equipment
2 Unitech	India	Real Estate
3 Alibaba.com	China	Internet Services
4 China Molybdenum	Hong Kong	Metals & Mining
5 INPEX Holdings	Japan	Oil & Gas
6 Cipla	India	Pharmaceuticals
7 Hong Kong & China Gas	Hong Kong	Gas Utilities
8 Belle International Holdings	Hong Kong	Apparel Retailing
9 DiGi.Com	Malaysia	Telecommunications
10 Unilever Indonesia	Indonesia	Consumer Products
11 Hong Kong Exchanges & Clearing	Hong Kong	Financial Services
12 Asea Brown Boveri India	India	Electrical Equipment
13 Tech Mahindra	India	Tech Services
14 Country Garden Holdings	Hong Kong	Real Estate
15 Largan Precision	Taiwan	Optics
16 COSCO (Singapore)	Singapore	Marine Shipping
17 Hindustan Zinc	India	Metals & Mining
18 DLF	India	Real Estate
19 NHN	Korea	Internet Services
20 Chiyoda	Japan	Construction & Engineering
21 Guangzhou R&F Properties	China	Real Estate
22 Esprit Holdings	Hong Kong	Apparel Retailing
23 HTC	Taiwan	Computer Hardware
24 Kot Addu Power (KAPCO)	Pakistan	Electric Power
25 Golden Agri-Resources (GAR)	Singapore	Agricultural Products
26 Arif Habib Securities	Pakistan	Banking & Brokerage
27 Bharat Heavy Electricals	India	Electrical Equipment
28 Pakistan Petroleum	Pakistan	Oil & Gas
29 International Nickel Indonesia	Indonesia	Metals & Mining
30 Agile Property Holdings	China	Real Estate
31 Li & Fung	Hong Kong	Trading & Distribution
32 Firich Enterprises	Taiwan	Electronic Equipment
33 Telekomunikasi Indonesia	Indonesia	Telecommunications
34 China COSCO Holdings	Hong Kong	Marine Shipping & Logistics
35 Shimao Property Holdings	China	Real Estate
36 Compal Communications	Taiwan	Communications Equipment
37 Singapore Technologies Engineering	Singapore	Aerospace & Defense
38 Aneka Tambang (Antam)	Indonesia	Metals & Mining
39 Singapore Exchange	Singapore	Financial Services
40 Lion Diversified Holdings	Malaysia	Retailing
41 Hyundai Mipo Dockyard	Korea	Shipbuilding
42 Hopson Development Holdings	Hong Kong	Real Estate
43 Motech Industries	Taiwan	Electronic Equipment
44 Perusahaan Gas Negara (PGN)	Indonesia	Gas Utilities
45 ITC	India	Cigarettes, Hotels
46 GOME Electrical Appliances	China	Appliances & Electronics Retailing
47 Hyundai Heavy Industries	Korea	Diversified Heavy Equipment
48 Bank of Punjab	Pakistan	Diversified Banking
49 Pakistan Oilfields	Pakistan	Oil & Gas
50 Tata Consultancy Services	India	Tech Services

Data: Standard & Poor's Compustat



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HEALTH CARE



Hospitals and Insurers Try Flat Fees—Again

Caritas and Blue Cross say this time they'll build in safeguards to prevent the problems of managed care

By Catherine Arnst

Managed care, that much maligned symbol of greedy insurers and lousy health care in the 1980s and '90s, is coming back. This time, though, its advocates swear they can get it right.

Consider what is happening in New England. Blue Cross Blue Shield of Massachusetts, that state's dominant insurer, and financially struggling Caritas Christi Health Care, its second-largest hospital network, want to switch from a system that charges

patients for every medical service to a managed-care-like flat fee per patient. The yearly fee would be adjusted for age and illness.

Dr. Ralph de la Torre, the newly named CEO of Caritas, believes charging patients a flat fee—to be paid, ultimately, by the insurer—will allow him to offer cost-efficient care with an emphasis on preventing illness. Such an approach will distinguish his six smallish medical centers from the many large teaching hospitals in Bos-

ton that levy fees for every visit, test, and medical procedure. For its part, Blue Cross Blue Shield hopes to halve growth in medical spending within a year by hospitals and doctors who accept flat-fee reimbursements, according to Andrew Dreyfus, who heads the insurer's health-care services.

First, though, they have to overcome managed care's horrible reputation. Usually provided by a health maintenance organization, the approach was widely rejected by patients who felt they were denied care when it was deemed too costly. This time, Caritas and Blue Cross say they will build in safeguards to make sure flat fees are fair to both patients and doctors.

FUNDAMENTAL REARRANGEMENT

If they're right, Caritas, Blue Cross, and a handful of other flat-fee innovators may have a profound impact on the national debate over health-care reform. "Managed care is the best idea for financing we have," says Dr. Donald M. Berwick, CEO of the nonprofit Institute for Healthcare Improvement in Cambridge, Mass. "Working within



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Dr. La Torre aims to reap big savings by emphasizing preventive care

a managed budget is the only rational way to control costs."

Skeptics worry that patients are too varied and doctors too accustomed to providing unlimited care for a one-size-fits-all payment policy. "The problem is, you can't just change the payment system. You have to have a fundamental rearrangement of providers," says Dr. Stuart Rosenberg, head of a group of 1,400 doctors at Beth Israel Deaconess Medical Center in Boston. Rosenberg says the 70% of U.S. doctors who are specialists would be loath to enroll in a system that emphasizes primary care.

QUANTITY OVER QUALITY

Still, even critics of flat fees agree that medical costs must come down. U.S. outlays have risen over 10% annually for the last few years. As a result, health care is on track to balloon to 20% of gross domestic product by 2015, up from 16% now, according to the Centers for Medicare & Medicaid Services.

At least a third of those trillions is wasted on unnecessary care, according to the nonprofit Dartmouth Institute and other researchers, and medical experts blame widespread fee-for-service plans. These encourage volume over quality—doctors and hospitals have a financial incentive to perform more and more tests and operations whether they're needed or not.

Overhauling the payment structure is rarely mentioned in the national dialogue. Although Senators Barack Obama and John McCain have both made health-care reform a center-

piece of their Presidential campaign platforms, their focus is on extending insurance to the 45 million Americans without coverage. The candidates are vague on where they will come up with the money to pay for their proposals.

Yet without payment reforms, most hospitals, insurers, and economists agree that universal coverage will become a crushing burden. For proof, they point to Massachusetts, the only state to mandate health insurance for all of its residents. The program kicked off in July 2007. A year later, almost half the state's uninsured inhabitants have signed up for coverage—and the plan is \$150 million over budget. The shortfall is expected to be even worse in 2009. "The plan is unsustainable if costs aren't brought under control," says Alan Sager, professor of health policy at Boston University.

Caritas and Blue Cross think flat fees are the solution. But they need to persuade skeptical patients and doctors to

LINKS

Where the Waste Is

PricewaterhouseCoopers examines the huge amounts spent on unnecessary care in its April 2008 report, *The Price of Excess: Identifying Waste in Healthcare Spending*. The firm estimates that more than 50% of U.S. health-care spending is wasted—a higher share than is usually cited. That's because the report includes care for "preventable" ills such as obesity, which can be treated with lifestyle choices.

sign on. Flat-fee pay structures, often referred to as "capitation" because they cap the amount that can be charged per patient, came into vogue in the '80s. A decade later, consumers came to see capitation as a way for hospitals and insurers to ration costly procedures. Doctors were unhappy because they felt the system limited their earnings

while subjecting them to constant second-guessing by bean-counting payers. "For too many insurers, managed care was all about managing the money, not the care," says Berwick.

Blue Cross hopes to win the confidence of patients and physicians by offering bonuses to doctors if quality of care improves. Also, if treatment costs come in below the agreed-upon fee,

the doctor gets to keep the savings.

De la Torre believes such quality bonuses will save the day for Caritas. A renowned cardiac surgeon at Beth Israel Deaconess, he arrived in April with virtually no administrative experience. But he has a vision: to remake his struggling hospitals into one-stop shops where many departments will work together to care for a patient, all for a flat fee. He is in talks with Blue Cross about a capitated contract.

De la Torre is encouraged by the experience of capitation pioneers such as Geisinger Health System in Danville, Pa. It started offering flat fees for coronary artery bypasses in 2006. A study of 181 patients treated in the first year showed that readmission rates fell by 44%, and bills were 5% lower. De la Torre hopes for even greater savings by emphasizing preventive care. That's key, says Dr. Eugene Lindsey, CEO of Atrius Health, the largest doctor group in Massachusetts. "The biggest ill of fee-for-service is that it focuses on fixing broken people," he says. "We will never get where we need to go on costs if we keep focusing on illness." | BW |

\$4 Trillion

Projected amount the U.S. will spend on health care in 2015—equal to 20% of GDP. Without radical reform, at least a third is likely to be wasted on unnecessary or harmful care.

Data: Centers for Medicare & Medicaid Services, Dartmouth Atlas Project

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WHEN A FUND LOSES ITS STAR

By Aaron Pressman

Tracy Wright was sitting in shock in her Boston office. It was April 2007, and the junk bond analyst for Pioneer Investment Management had just learned that the firm's star fund manager, Margie Patel, had abruptly resigned to join a rival. Wright and colleague Andrew Feltus would take Patel's place at the \$6 billion Pioneer High Yield fund. "There were a number of holy this's and holy that's," she says.

Wright, 39, and Feltus, 40, had fewer years of investing experience combined than the 58-year-old Patel, who left to join Boston-based Evergreen Investments. And they had to get up to speed fast: Within weeks of the two being named co-managers, the junk bond market peaked and began a nasty downturn that hasn't ended.

Fund manager transitions can often be rocky, all the more so when the departing talent racked up top-notch results like Patel's. Investors will have to brace themselves for similar turbulence ahead as a wave of Baby Boom-era stars heads for retirement. The proportion of workers in the finance industry over 50 and nearing retirement will double in the next 10 years, according to a Boston Consulting Group study.

Regardless of the skill of incoming managers, funds in transition suffer from common problems. Hedge funds and other traders try to guess what positions might be sold and design strategies to squeeze profit from a fund's shifts. Sometimes investors in a fund jump ship en



Pioneer's Feltus and Wright: Former manager Patel is a tough act to follow

076 INVESTING

masse, forcing ill-timed asset sales. In many cases there is a change in investing styles. The lesson for investors isn't necessarily to flee when a star manager moves on but to make a more informed decision by being aware of challenges new managers face.

Feltus and Wright were not high-yield neophytes. Feltus had racked up a better record than Patel while running the firm's smaller but similar global high-yield fund over the previous five years. After taking over the junk bond fund, Feltus and Wright finished 2007 with a 7% gain, ranking in the top 2% of all high-yield funds, according to Morningstar. But 2008 has been a tough year for junk bonds, with the average fund down 3.3%. Pioneer has lost 3.6% and ranks below 7 out of 10 similar funds.

That's quite a drop from the fund's 10-year track record, which beats 99% of the industry. Says Feltus, "I expected to see a correction in the market. I did not expect to see the financial system of the United States melt down." Whether because of a bad market for junk or nerves about the new managers, investors pulled over \$2 billion from the fund in 2007. Financial adviser David Nielsen at cfd Investments in Indiana wasn't one of them. "Most high-yield funds have had a bad year," he says. "The managers have been following in Margie's footsteps very well."

That doesn't mean they are copying Patel's style. When they evaluated the portfolio, they immediately wanted to make some big changes. And repositioning a portfolio without tipping off the markets is one of the biggest challenges for managers taking over a fund. For Wright, who had a less traditional career path than Feltus—she was a professional-level snowboarder for four years, while he went straight into the financial world—that meant trying to keep the markets guessing about whether they were going to get rid of Patel's biggest position: a holding of over 10% in debt issued by paper giant AbitibiBower. Wright saw paper as an industry in decline. Feltus objected to the size of the position: "I don't want to have one [position] that's going to make or break my year."

Dumping Abitibi was the exact move many Wall Street junk bond trading desks expected, however. Traders sold AbitibiBower bonds short, pushing down prices. Feltus and Wright didn't want to sell at depressed values so they zig-zagged, sticking with Abitibi some days and selling heavily other days. After six weeks they had flummoxed the shorts, who moved



First Eagle manager Ewellard had to replace his first successor with a new one

on to other trades. Patel had also left the fund with 18% in equities, the maximum allowed in the prospectus. Selling off several hundred million dollars' worth of stocks was easier. Feltus and Wright dropped the equity stake to 12% within a few weeks, lessening the impact of the market's tumble this summer.

Not all of the pair's initial moves worked out as well. Last summer they sold some corporate bonds and used the money to buy bank loans from the same companies. Yields were about equal, even though bank loan holders have a much stronger claim than junk bond investors on a company's assets in bankruptcy.

Unlike junk bonds, which pay a fixed rate of interest, rates on bank loans are pegged to the Federal Reserve's benchmark interest rate. So when the Fed cuts rates, holders of bank loans get paid less yield and the value of their loans suffers. Last year, with the market anticipating continued Fed cuts, investors sent values of bank loans skidding. Feltus and Wright dropped the strategy. Now the Fed is moving toward raising rates and Pioneer is buying some loans again. "I'm not investing for the next 30 days," says Feltus. "I'm looking at the next two years."

KEEPING TALENT ON DECK

Funds with established succession plans can largely avoid dramatic overhauls. Some firms

If a star manager leaves, it's a good sign if:

- The new manager has a positive track record running a similar fund
- The firm's analysts substantially contributed to the fund's success
- The fund's basic strategy will remain the same
- The old manager groomed the new leader

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assign up-and-coming managers as understudies for years or keep a deep bench of seasoned analysts. When value investing legend Jean-Marie Evellard first retired in 2004, for example, his replacement at First Eagle Funds was Charles de Vaulx, who had spent 16 years at the company. The younger man was named Evellard's co-manager in 1999. When he took over, there was little change in style, and the funds performed well over the next few years.

But even a well-planned transition plan can go awry. Evellard, enjoying his retirement in Paris, got a surprise call last March telling him de Vaulx had suddenly resigned. (He later joined New York-based International Value Advisers.) Evellard rushed back to New York to take over the First Eagle funds again and start a new search for a successor. In July, he named Matthew McLennan, a London-based fund manager for Goldman Sachs' private clients, to run his biggest fund, the First Eagle Global Fund.

Some companies take steps to avoid transitions altogether by creating teams of managers. At top-selling American Funds, assets are divided between as many as a dozen managers. Dodge & Cox uses a group of managers who work together to pick stocks. Vanguard Group actually splits large funds among outside management firms that can be replaced as needed.

Fidelity takes a different approach, often cycling analysts through industry sector-focused mutual funds to train them to manage more diversified funds. When Neal Miller stepped down two years ago as manager of the

Fidelity New Millennium Fund after 13 highly successful years, he was succeeded by John Roth, an analyst who had run several sector funds over the previous seven years. Miller had been a top-notch trend spotter, making big bets on industries ahead of most investors. He was buying Internet stocks in 1995 and sold most before the bubble burst. Roth has run the fund in a more conventional manner and lagged similar funds by about one percentage point a year since taking over, according to Morningstar. Fidelity says the fund's goal is to

Some companies have understudies ready to take over. Others avoid transitions altogether by creating teams of managers

outperform the Standard & Poor's 500-stock index, which it has done, gaining 4.9% since Roth took over vs. a 3.9% gain for the index.

Over at the Pioneer High Yield fund, the managers are hopeful. Outflows have slowed, and while neither manager expects a quick turnaround to the credit crisis, they note that junk bond investors are being paid for taking on risk. Junk bonds now pay about eight percentage points more yield than U.S. Treasury bonds for the same maturity. That compares favorably with a premium of less than three points when the duo first took over. Says Feltus: "We think U.S. high yield is the place to be." | **BW**

BIG SHOES TO FILL

Long-planned or abrupt, a star manager's departure throws up a lot of challenges for his or her successor. Here's how some high-profile transitions are unfolding.

FUND	ASSETS (billions)	OLD MANAGER	TENURE	TRANSITION
Fidelity New Millennium	\$1.9	Neal Miller	1/93-7/06	John Roth, who managed sector funds at Fidelity for seven years, has eliminated the big bets on a few stocks or industries that were Miller's signature when he ran this midcap growth fund
First Eagle Global	22.5	Jean-Marie Evellard	1979-2004; 3/07-9/08	Matthew McLennan, a former money manager for private clients at Goldman Sachs and Evellard's second hand-picked successor for the large-cap global stock and bond fund, starts this month
Pioneer High Yield	3.1	Margie Patel	2/98-3/07	Star fund manager Margie Patel's replacements took over just as the junk bond market peaked
Turner Midcap Growth	1.3	Robert Turner/ William McVail	10/96-9/06	The now, internally promoted co-managers, Tara Hedlund and Jason Schrotberger, got off to a quick start in 2007 but have lagged in 2008
Vanguard Wellesley Income	12.8	Jack R. Ryan/ Earl E. McEvoy	1/82-6/08	New stock picker W. Michael Reckmeyer worked under Ryan for more than a decade

Data: Fund statistics from Morningstar

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EDITED BY SUZANNE WOOLLEY

SHORT-TERM THINKING MAY BE A SAVER'S BEST FRIEND

Financial planners often suggest clients figure out how much they'll need to retire and save toward that huge number. Utpal "Paul" Dholakia, associate professor of management at Houston's Rice University, thinks people would do better to think about how much they'll save next month. A paper he co-wrote with Leona Tam of Old Dominion University found that those who planned savings for the next month did far better than those who tried to plan further out. In one experiment, people said they'd save an average \$287 next month but saved \$440. When asked to plan ahead four months, they said they'd save an average \$946, but put aside just \$123. Amy Feldman spoke with Dholakia.

Did the results surprise you?

We were shocked. How can someone tell you they will save \$1,000 and then only save \$100? It's a gross miscalculation of behavior.

So we're better off trying to save for next month than next year?



That's it. Don't plan in advance because it makes you overoptimistic. You think, "I might get a windfall or a raise?" And not only do people who give a savings estimate for four months from now estimate too high but they become more risk-seeking.

Is this just an American problem?

We're working with colleagues in China and Korea to see if this translates. In Korea, the young are Westernized, so we think [their behavior] will look like that of Americans.

RA, RA, STOCK-BOOM-BA

Equity analysts get accused of being cheerleaders. They may also deserve grief for being wowed by management-speak. A University of Oldenburg in Germany study examined analyst recommendations from 1991 to 2002, a period when the term "core competency," the notion that companies should downsize and focus on what they do best, was in ascendency. The study showed that analysts overestimated earnings of companies that jumped on the bandwagon, perhaps giving the notion too much credence. But analysts have their uses. A University of California at Irvine study found that while analysts are slow to downgrade stocks, CEOs are more likely to be purged when they do. —Ben Levisohn

4 in 10

Parents say the weak economy has led them to cut back on saving for their children's education.

Data: TD Ameritrade Holding survey

CD RATES A-POPPIN'

Troubled financial institutions, confronted with tight capital markets and at least \$871 billion of debt set to mature by 2009, are hiking yields on certificates of deposit. "As hokey as these retail promotions may sound, banks can raise billions in a short time to pay off maturing liabilities," says JPMorgan Chase analyst Alex Roeber. Some of the best rates, often available in only selected states, are for CDs maturing within a year. Is it safe to stash your money with these companies? As long as you put away \$100,000 or less, it's covered by FDIC insurance. Still, buying a CD from the folks that control failed bank IndyMac might stir a few butterflies. —Lauren Young

INSTITUTION/ MATURITY	ANNUAL PERCENTAGE YIELD (APY)*
Washington Mutual 13 months	4.5%
Wachovia 1 year	4.1
Countrywide Bank 7 months	4.0
IndyMac Federal Bank 7 months	4.0
Average 1-year APY	2.4

Data: Bankrate.com; financial institutions; *rates as of Sept. 2

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NOBLE'S OIL RIGS ARE RUNNING FLAT OUT

With all the clamor to “drill, drill, drill,” you’d think rig operators would be the darlings of investors. Not quite. Shares of drillers, particularly those operating offshore, such as Noble (NE), have been slammed along with Big Oil as crude prices have eased. “It makes no sense, as global demand for offshore drilling services and day rates for equipment use are on the rise,” says Scott Black, president of investment firm Delphi

NOBLE GOT HIT BY THE PRICE DROP



Management. He says Noble's stock decline — to 45.90 on Sept. 3, down from a 52-week high of 67.98 on June 9 — makes the stock among the most undervalued in the oil patch, based on his earnings forecast of \$5.85 a share in 2008 and \$7.25 in 2009. Black, who owns stock, figures Noble is worth 70.

Noble is operating at near-full capacity, having signed long-term contracts as demand for rigs continues to exceed supply. Noble's diversified fleet of 62 deepwater and shallow drilling rigs is mainly in the Middle East (25%), with less than 15% in any other single region. Its deepwater rigs in the Gulf of Mexico were not damaged by Hurricane Gustav. Stewart Glickman of Standard & Poor's, which has a strong buy rating, says Noble is a “solid play on growing demand for drilling equipment,” with a strong presence in Brazil, Mexico, West Africa, Europe, and the Middle East. In 2009, he sees shallow-water rigs accounting for 60% of sales, and deepwater floaters and drill ships 40%.

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MARCHING UPWARD AT COMBIMATRIX



Diagnosis By DNA

Unlike most biotechs, tiny CombiMatrix (CBMX) is on the rise. What's behind the stock's climb to 16.03 on Sept. 3, up from 4.50 a year ago? The company is in a hot sector: DNA diagnostics. It develops DNA microarrays — chips that let labs analyze many genes at once. Dr. Ryan Robetorye, director of molecular diagnostics at the University of Texas in San Antonio, says the chips help analyze tumor genomes to determine whether a patient with, say, chronic lymphocytic leukemia needs a more aggressive treatment.

CEO Amit Kumar reports second-quarter sales jumped 55%, to \$2.1 million. Raymond Myers of investment firm Emerging Growth Equities says Combi's genetic diagnostics let doctors “characterize patients' susceptibility to disease and offer personalized prognosis [for] treatment.” He puts the market for the tests at \$1 billion. He rates the stock a buy.

WYNDHAM'S STOCK IS SLUGGISH



Wyndham, a Busy Innkeeper

Despite the economic slump and sluggish consumer spending, Wyndham Worldwide (WYN), one of the world's largest lodging companies, is doing well. But not so its shares, down to 19.72 on Sept. 3 from 33.80 in July 2007. Based on the sum of its parts, Wyndham is way undervalued, says Robert LaFleur of investment firm Susquehanna, who rates it “positive,” with a 12-month target of 30.

He puts the value of Wyndham's three units — time shares, hotels such as Ramada and Days Inn, and vacation exchanges and rentals — at 33 a share. LaFleur's valuation is based on comparisons with others in its peer group.

Wyndham posted a surprisingly strong second quarter, according to Value Line's Dominic Silva, who notes that overseas expansion will help offset U.S. weakness and will support earnings growth through 2011-13. | **BW** |

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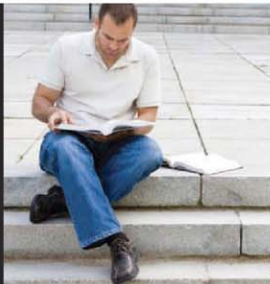
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Schools to watch

THE NUMBER OF MBA PROGRAMS IN GERMANY IS INCREASING AND A HANDFUL OF GERMAN SCHOOLS HAVE THE POTENTIAL TO BECOME PART OF THE INTERNATIONAL TOP LEAGUE IN THE FUTURE.



For Andrew Delmenhorst, the Mannheim Business School (MBS) was exactly the right choice. "MBS exposed me to many more international opportunities than any US program could have," says the American. The 27-year-old spent parts of his one-year MBA program in Copenhagen and Paris and worked on a strategy project in Abu Dhabi with a German consulting company. The MBS offered by the University of Mannheim state school is considered a shooting star among the German business schools. It

is the first German institution to hold all three international accreditations (AACSB international, Equis and Amba). Less than one percent of all business schools worldwide can boast having this "triple crown." At the same time, Mannheim was late in entering the MBA market. In 2002, the first full-time program together with the Parisian business school Essec and the British-based Warwick business school started. The joint Essec & Mannheim Executive MBA began in 2004.

German universities still have a difficult time with the MBA concept, which up until now hasn't fit well into the German education system. But this is changing with the Bologna Process, which also forces German universities to adapt their programs to Bachelors and Masters degrees by 2010. This has already caused a boom in MBA programs. However, roughly three quarters of the over 200 German MBA programs are considered more as technical Masters programs that often have little in common with the classic General Management

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education. Leading universities like the Ludwig-Maximilian University in Munich in turn have consciously decided against entering the MBA market.

The number of internationally accredited German business schools is also correspondingly low. At this point, just a handful of them hold the certificate that lets them compete with the best schools. One pioneer is the WHU-Otto Beisheim School of Management in Vallendar. Its Executive MBA offered together with the Kellogg School of Management in Chicago since 1997 is already among the best programs in the world today. Almost half of the current 45 participants are managers from abroad. Also on the right path is Frankfurt University's Goethe Business School, (founded in 2004), with its joint Executive MBA with the Fuqua School of Business at Duke University. One of the best independent full-time programs is at the HHL – Leipzig School of Management. Now the private university is focusing on growth.

The European School of Management and Technology (ESMT) in Berlin is taking up a special role. While all German MBA programs on offer have an established university in their corner and some have also started programs with renowned business schools. The ESMT, founded in 2002 by 25

large German companies – among them Allianz, Deutsche Bank and ThyssenKrupp, is going it alone. "I consider it a better strategy to first build up our own name," explains ESMT President Lars-Hendrik Röller. The first full-time program started there in 2006 with 29 students – today there are 31 – despite scholarships in the millions.

Even the full-time market is considered to be a difficult business. "It is simply still going to take a few years until the German demand also booms," explains Michael Frenzel, Dean of the WHU. There will only be an upswing when the first Bachelors graduates begin an MBA program after a few years of work experience.

The first indications of increasing demand can already be seen. Indeed, according to a current report by the Graduate Management

Admission Council (GMAC), when it comes to Germans interested in an MBA, the German business schools are already in second place behind the US – albeit with a considerable distance between them – and are ahead of the British schools. Also, more and more foreigners are discovering the German offers, like the 28-year-old Indian Sathish Kumar: "While everybody is flogging the US and UK, I prefer Germany for the reason that in Europe, Germany is one of the forward moving countries in terms of technology and business practices and a country with a very different culture."

Barbel Schwertfeger

Freelance journalist Managing director MBA Channel, www.mba-channel.com



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There are painfully real reasons why America's savers feel they've drawn the short straw



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McMansion to pay the reset on your liar loan. Your credit score would have gotten you into Harvard at age 12.

Good for you! Your reward: injuri-

ous savings yields, inflationary rot, and election-season neglect, all served up with a dollop of institutional insecurity.

Even with a current account deficit that, starved of domestic savings, requires \$2 billion a day in foreign financing, economic policymakers are fixated on propping up credit and giving the participants in the housing bubble second chances. In order to do so, they are stripping the hides off of net savers.

Since August of last year, the Federal Reserve has slashed interest rates from 5.25% to 2.00%—wielding a blunt instrument that was swung enough to bend the yield curve in favor of suffering banks. You know, the institutions that screwed up but were too big and important to be deprived of an inalienable right to cheap deposits that they can loan out at several points higher.

Indeed, a year ago, a six-month certificate of deposit earned, on average, 3.53%, according to Bankrate.com. Today, that's down to 2.03%. A one-year CD that earned 3.75% at this point in 2007 was offered for as little as 1.92% in April, before inching up to its present 2.38%. It's hardly a secret that banks are only able to pay out such pittance thanks to depositors' knee-jerk desire for security: "Hey, I might be earning crumbs on my cash, but at least I'm not losing money!"

Sure you are. Wholesale inflation has soared 9.8% in the past 12 months, the highest clip since 1981.

The more widely cited consumer price index jumped to 5.6%. In other words, while your saved buck was adding 2¢ or so on one end (and even less after taxes), three times as much was getting singed off the other end of that dollar bill. "Inflation is just deadly to savings," says David Gitlitz, chief economist at Trend-Macrolytics, an investment adviser. Gitlitz observes that, taking into account the hit from inflation, rates haven't been this negative since the dreary 1970s. (That, in turn, gave way to an early '80s that saw the worst inflation in U.S. history since the Civil War.) "It steals your purchasing power and sets less and less of an incentive to keep money in the bank."

You're telling me. My trusty Manhattan pizza guy recently hiked the cost of a slice for the second time in the past year, from \$2 to \$2.50 to \$3. "Why you mad?" he blurted, pounding a ball of dough. "Prices are nuts; you can't even buy a glass of milk no more." ("We're paying 128% more for a bag of flour," added his grandson-apprentice, with startling accuracy.) Even my barber justified taking up the cost of a standard trim and buzz by 20%. "Fuel surcharge," he deadpanned in his Uzbeki accent. (As it turns out, he rides the subway.)

In a perfect world, the Fed's rate-cutting campaign would have shored up real estate and the stock market. Instead, investors have been running

for inflationary cover in hard assets like crude oil, gold, and even fertilizer. Oil, we all know, went from \$70 to more than \$140 in one year flat, sending gasoline and utility costs soaring and counteracting the lift from monetary and fiscal stimulus. Still comforted by

vetoed out of the process. Consider some recent news reports:

"President Bush Signs \$300 Billion Housing Rescue Bill" (AP)—increasing to \$625,500 from \$417,000 the size of home loans in high-cost areas that Fannie Mae and Freddie Mac are



Mortgage borrowers at failed bank IndyMac may catch a break

that 2% savings yield? (Your mattress and piggy bank are in stitches.)

Commodity inflation has also been exacerbated by concurrent weakness in the dollar, which is stuck between a Europe that is loath to cut interest rates and a Washington that is too scared to hike them. Even with its recent rally, the greenback is only worth two-thirds of a euro. You practically have to wheelbarrow dollars to places like Madrid and Berlin.

All of which might be tolerable to the lonely and beleaguered saver if he weren't taunted daily by lopsidedly pro-spending, pro-creditor news stories. Forget about moral hazard. Forget

about rewarding profligacy. Washington is hell bent on putting a floor beneath the housing market. And subtly got

allowed to buy.

The number of Chapter 7 filings—designed to give individual debtors a "fresh start" by discharging many of their debts—recently rose by 36% (CNNMoney.com).

"The FDIC may lower mortgage rates for delinquent IndyMac borrowers after suspending foreclosures.." (Bloomberg).

Maybe savers' ultimate vindication will arrive when and if every asset is so deflated, credit is so choked off, and misery is so prevalent that only those with cold hard cash can lob in lowball offers for homes, cars, and everything else. Assuming, of course, they didn't stash all their money in one of the many banks that is about to go under; the feds are closely watching 117 of them—and counting. The phone lines have never been so jammed with nervous clients.

Oh, the joys of saving. | **BW** |

Assuming your bank doesn't implode, you can expect inflation to eat your savings while subprime players get rescue packages

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The Internet Has Lots of Running Room

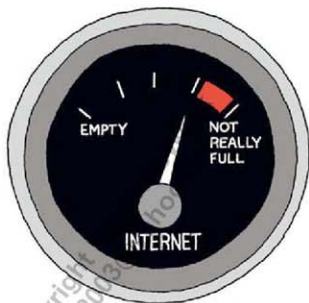
Why arguments that traffic growth is straining Web capacity are mostly hogwash

Are we running out of Internet? That's what some experts say. AT&T's top lobbyist, James Cicconi, recently warned that "we are going to be butting up against the physical capacity of the Internet by 2010." Cicconi and others say this warrants charging heavy users a premium, and he doesn't want new laws that would stop AT&T from doing so.

Advocacy groups say that if the AT&Ts and Comcasts of the world have their way with Congress, they'll slow transmission of movies and video on the Net—except when it's content they provide for a fee. They have a point. The service providers' lobbying is all part of a major fight over government's role in insuring access to Internet content, an issue known as "Net neutrality." Unfortunately, the debate is generating a lot more heat than light, with neither side willing to let the facts get in the way of a passionate argument.

The service providers have an interest in creating the impression that Internet capacity is a scarce and expensive resource. AT&T executive Richard N. Clarke argued in a recent white paper that the cost of providing unlimited Internet service to some homes may be as high as \$416 a month. Such claims bolster service providers' arguments that, to manage their networks efficiently, they must closely monitor what their customers are doing and possibly impose surcharges or caps to control excess usage.

The problem is, there's little evidence of any capacity shortage. Despite a surge in online video watching, the growth of Internet traffic does not appear to be accelerating. An ongoing Internet traffic study at the University of Minnesota and parallel research



by Cisco Systems show that traffic is growing at 35% to 50% a year, about the same rate as in the past several years. "If anything, the trend is down rather than up," says Andrew Odlyzko of the University of Minnesota's Digital Technology Center. "There is no sign of the [predicted] explosion of traffic."

That's not to dismiss the growth or deny that it presents challenges. Cicconi actually understated the case when he said AT&T expects volume to increase fiftyfold by 2015; at current growth rates, the increase will be closer to a hundredfold. But this is the same growth rate network providers have coped with for years.

The fact is, technological advances have allowed massive increases in the data capacity of networks, and those advances keep coming. Yes,

there is growing congestion on cable systems, where the final bit of bandwidth is shared, leading Comcast to impose a 250 gigabyte-per-month limit on some subscribers. But the logjam is being alleviated by upgrades in cable technology, so Comcast's new rules will probably be short-lived. With prices falling on the fiber-optic cables and routers that make up the Internet, a capacity crunch seems unlikely in the next two years.

If the big service providers are resorting to hyperbole, the same is true of their opponents. On its Web site, the SaveTheInternet.com Coalition warns that the phone and cable companies "want to tax content providers to guarantee speedy delivery of their data. They want to discriminate in favor of their own search engines, Internet phone services, and streaming video—while slowing down or blocking their competitors."

There is barely a shred of evidence in word or in deed to support such claims. It's true that the Federal Communications Commission recently sanctioned Comcast for violating principles of network neutrality by interfering with a fast file-sharing technology called BitTorrent. It was a ham-handed effort, and Comcast compounded the damage by failing to come clean when users complained. But there's no sign Comcast was acting out of malice.

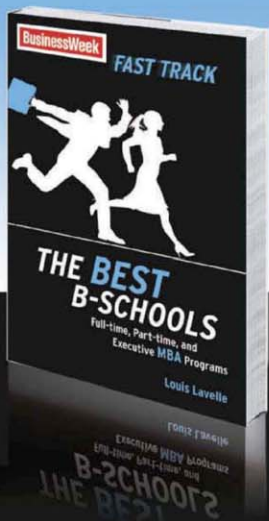
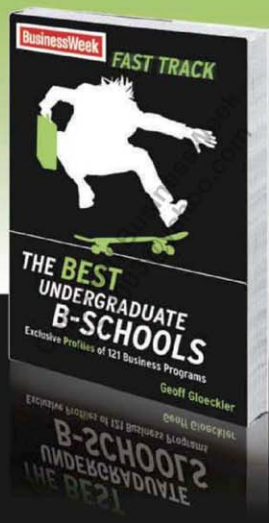
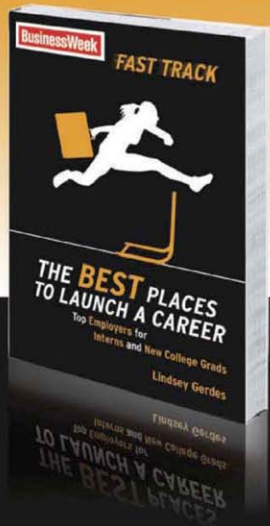
There are valid questions about how governments should manage networks, if at all. But at this point, exaggerations and distortions are standing in for serious debate. **| BW |**

Yes, congestion is growing on cable systems. But the logjam is being alleviated by upgrades in technology

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Ahead on the Web: Nothing Heavy

The fall promises a slew of major new sites that are longer on sizzle than substance

Most of us lazed away the final moments of August and Labor Day weekend in a blissful, if temporary, reprieve from the working week. But sleep-deprived minions operating in relative obscurity were glued to computer monitors and racing to beat deadlines. They were readying this fall's bumper crop of significant new Web-only

content plays from established names in Old and New Media. Among them:

AOL is putting finishing touches on a major new site for young women that's slated to launch in late September, possibly under the name LemonDrop.

Turner Networks is beta-testing a young women's site called TheFrisky. It's one of several sites an incubator group within the Time Warner cable programmer is developing for this audience and may not be the only new Turner site to hit the Web this year.

Hearst Magazines' digital unit is working with Microsoft's MSN on *delish.com*, a food site that will cover local food festivals and the goings-on of *Top Chef* as much as it dishes out recipes and cooking tips.

News Corp.'s MySpace is at work on a major women's site as well, although an executive familiar with the pioneering social network's plans said a debut is unlikely until early next year. A MySpace spokeswoman declined to comment on any aspect of the company's plans for such a site.

There's already been chatter about former *New Yorker* editor Tina Brown's The Daily Beast, a news-related site she will launch with the backing of Barry Diller's IAC. It appears that The Daily Beast will combine editors' choices on the best of the Web with magazine-style articles. Another former magazine type who is chucking print for online is

Keith Blanchard, the editor who oversaw *Maxim's* growth spurt. Blanchard's venture is not affiliated with any media company, he says, but has secured financial backing for The Daily Low-down, which he described, without any



other elaboration, as an aggregation site aimed at men. "Magazine editorial ideas are still good," says Blanchard, in explaining his shift from print. "But they run faster on a Pentium."

Almost all of the preceding ventures (sole exception: The Daily Beast) opt for the softer end of the subject spectrum and will shy away from, say, news and business. Simple realities dictate this. Ambitious news sites require lots of bodies; lighter sites are much cheaper to launch. The beauty of the model favored by virtually all of the Web startups listed above—heavy linking to other sites' content and

using freelance contributors rather than staff—is that it can pull in millions of visitors with minimal staffing. LemonDrop, should it be called that, will be modeled on Asylum, an AOL site for young men. Asylum launched last December, drew over 3.3 million unique users in July and now ranks No. 6 on comScore's rankings of top U.S. entertainment sites. It hit The Web with a full-time editorial staff of two, which has since swelled to all of five, says Bill Wilson, AOL's executive vice-president for programming.

And the landscape for lighter-themed sites is much more fluid than that for news and business. The latter categories are dominated by longstanding players, be they Yahoo! Finance or Drudge Report. But men's, women's, and entertainment sites are filled with newer players. (Think AOL's TMZ.com.) Even more recent entrants—some of them is Holy Taco, a men's site owned by Break Media—are building traffic at rates that could soon land them in their category's top tier. This is partly because, unlike established outlets in news and business, the dominant players in those niches have been slow to stake strong claims online. One example: The Web site for Hearst's top-selling women's mag *Cosmopolitan* does not appear among the top 15 women's sites, a problem one Hearst executive attributes to the company's not having gotten full control of the site from former Web partner iVillage until May, 2007.

What's launching online may also, for good or ill, say something about what information we collectively seek on the Web. But then we've long opted for sizzle over substance elsewhere. **| BW |**

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INFLATION

A PRICE SPIRAL AHEAD?

"Bracing for Inflation," a Web-only opinion piece (Aug. 16), provoked a slew of comments. The essay, by John K. Castle, chief executive of private equity firm Castle Harlan (which owns a range of businesses), warned of double-digit U.S. inflation as early as next year—despite oil's softening prices. Castle cited two big reasons: more fallout from still-high commodity costs and rising inflation in China, our go-to low-cost producer. Some readers echoed Castle's call for policymakers to recognize this threat. Others argued that productivity and flagging demand will work to lower prices. And a few pointed fingers, blaming consumers or the Fed for creating the problem.

Interest rates that were held too low for too long created a glut of money now chasing commodities and other goods. A bitter pill will need to be swallowed if we expect this problem to go away anytime soon.

Screen name: Ludwig

As owners of an electronic parts distributor, we've witnessed huge increases in the cost of products across the board: jumps of 30% to 35%. I've seen nothing like this in 22 years. China has figured this out. Consumers have no idea of the firestorm heading their way.

Screen name: Glen

The article is based on two fallacies: that the current situation will continue and that the economy is not interactive. Higher prices bring lower demand, which lowers prices.

Screen name: Holly Garfield

There's no reason to assume that our productivity gains won't continue. The trend will be that things will become cheaper, not more expensive.

Screen name: Justin Time

You know the quickest way to stop inflation? Stop using your credit cards! Quit borrowing money! Tell politicians to stop spending

money we don't have!

Screen name: Mad Dollar

OIL

AN IMPORT DUTY, NOT A CONSUMPTION TAX

As stated in "The Real Question: Should Oil be Cheap?" (In Depth, Aug. 4), we need to put a floor under the cost of oil to encourage alternative sources of supply and prevent OPEC from opening the taps and driving down prices when we do so. But a tax on consumption is not the answer. It would prevent new investment in domestic alternatives. Similarly, a carbon tax would inhibit innovation in the name of an



unproven climatic threat.

Instead, we should impose an import duty that kicks in at \$80 to \$90 per barrel and rises as the cost of oil dips. This would protect U.S. development of alternatives and allow consumers and businesses to benefit from lower energy costs.

KF Frosell
NAPLES, FLA.

ENTERTAINMENT

EMI WON'T GET NO SATISFACTION

"The Stones Roll" (News You Need to Know, Aug. 11) suggests the Rolling Stones did EMI a "favor" by leaving for Universal Music Group. But the opposite is true. The Stones are taking their back catalog, meaning EMI will lose recurring revenue on finished goods.

New ways to repack-age old music—digital downloads, preloaded USB drives, and video game placements—can add up. Just ask The Who, which has its own edition of the *Rock Band* game.

The Stones are among the top 0.0001% of commercially successful artists and hold a permanent place in international culture. EMI has lost Paul McCartney, Radiohead, and others in the past two years. Keeping one of rock's last surviving pioneers could have helped it maintain credibility.

Darren Paltrowitz
NEW YORK

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Does America Need a Bailout?

Yale economist Robert Shiller says the U.S. credit crunch rivals the crisis that led to the Great Depression

The stock market is down sharply from its peak. Bank failures are rising. The federal government is taking extraordinary actions to shore up a beleaguered economy. In the midst of the crisis, a government official reflects: "We cannot stand by when a house is on fire to engage in lengthy debates.... In such a situation, we instinctively seize upon

and utilize whatever method...offers assurance of speediest success."

Quick: Is that Federal Reserve Board Chairman Ben Bernanke speaking before Congress? U.S. Treasury Secretary Henry M. Paulson Jr. on the bailout of mortgage giants Freddie Mac and Fannie Mae? No, it was Henry B. Steagall, chairman of the House Committee on Currency & Banking—in 1932.

Quoting Steagall, economist Robert J. Shiller asserts that today's crisis requires remedies every bit as fundamental as those impelled by the Great Depression. In his new book, *The Subprime Solution: How Today's Global Financial Crisis Happened, and What to Do about It*, the Yale University professor sounds an alarm that the credit crunch, now early in its second year, poses a dire risk. His text is a stimulating, rapid response to current events—and a forceful demand for dramatic action from Washington, where, he says, the White House and Congress have been "totally inadequate" to the task. Generally accessible, although at times assuming too much economic expertise on the part of the reader, the book offers numerous proposals for avoiding future crises. These are provocative, but many are too sketchy.

So, how did we get here? Like most other observers, Shiller puts the real estate boom and bust at the epicenter

of his explanation, but the foibles of human psychology play an unusually large role in his scenario. Adapting the argument first offered in a previous book, *Irrational Exuberance*, the author notes that, over the past several decades, financial democracy spread until we all became investors. That made society ever more vulnerable to the mass psychology of bubbles. Rising real estate prices fed "new era stories" about how the old rules for valuation no longer applied; those tall tales drove prices even higher, and more yarns were spun justifying the upward spiral; eventually the irrational investment fever spread contagiously; and then, finally, the fever broke.

Clearly, psychology matters, although this approach seems to neglect such economic fundamentals as demographics and interest rates. More persuasive is the author's adroit puncturing of the all-too-common notion that real estate prices inevitably go up over time. Along the way, he emphasizes a valid point that's too rarely made: "It is in no way bad news if home prices fall" so long as our incomes are rising.

The time for society to be concerned is when prices drop rapidly, like now. Shiller calls for a bold bailout involving measures that range

from creation of a new organization modeled after the 1933 Home Owners' Loan Corp. to the possibility of federal tax rebates for years to come. Although I remain skeptical, it's one of the best cases I've read for New Deal-scale short-term intervention by Washington.

His approach to the long term is more persuasive—even if it's sometimes insufficiently detailed. Opposed to both heavy-handed regulation and

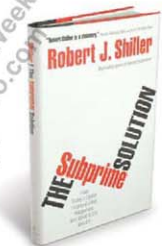
misguided attempts to return to some simpler time, Shiller advocates tapping into modern technologies and information systems to advance the democratization of finance. Among his ideas: the creation of new insurance products for hedging against major personal finance risks, a financial products safety commission, and im-

proved financial disclosure.

Another particularly intriguing idea: federal subsidization of independent

financial advice to make it available to everyone. This might take the form of a co-pay arrangement similar to Medicare and private health insurance. "We need both medical and financial advice on an ongoing basis, and failure to obtain either ultimately imposes costs on society when our health—medical or financial—suffers," Shiller writes.

As with universal health care, it could be some time before our society adopts such measures. Nevertheless, a storehouse of valuable, provocative ideas awaits the reader of *The Subprime Solution*. |BW|



The Subprime Solution: How Today's Global Financial Crisis Happened, and What to Do about It by Robert J. Shiller; Princeton; 196 pp.; \$16.95

Shiller says Washington must also see to it that individuals gain access to more sophisticated investment tools

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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.
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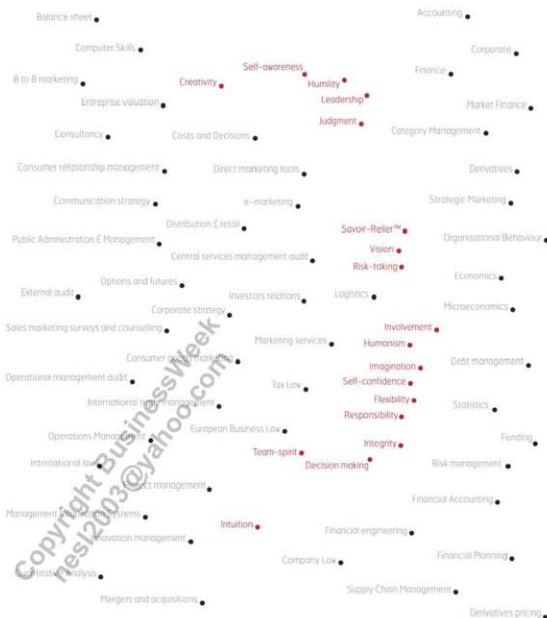
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What's Hobbiling the IRS

When workers have ironclad job security, managers have few means to motivate



If you were its commissioner, what one thing you would do to improve the efficiency and effectiveness of my workplace, the IRS?

Ned Nazarro,
WASHINGTON D.C.

Simple: We'd differentiate between employees. And we believe that, within five years, radical change in its management system would catapult the IRS to a new, supercharged level of productivity and results. Agents would be energized to work faster and smarter, and ideas for improvements would flow across the organization. More than 100 million customers—every adult taxpaying U.S. citizen—would feel the positive impact.

Too bad it's impossible. And not because the IRS is a special case. It's like every other government agency, from the Post Office to public schools (as disheartening as that is to think about). Because of their staff's lifetime job security, managers have few mechanisms to reward great performance, so employees have little reason to be more effective or efficient. All they need to do is show up and, well, not screw up.

Now, with its 115,000 employees, the IRS undoubtedly has thousands of self-motivated, change-hungry civil servants in its ranks. You, for one, care passionately enough about its future to ask your question. But the prevalence of organized labor thwarts public agencies from making change, except around the edges. An IRS commissioner might lobby for new technology to streamline online filing. Or he might work around union rules to encourage his achievers with customer-service awards.

But beyond such modest suggestions, we can't answer your question. Our approach to management, with differentiation at its base, is like the approach used to field the best team in sports. It can't work unless managers can reward the best players so they're motivated to stick around and "play" even harder, coach the middle ones to improve, and move out the underperformers.



Sure, some pieces of our approach can translate into the IRS setting. The agency could, for example, develop a clear mission and link it to gritty, actionable values. It could also adopt our principle of candor in all communications and ensure that all employees have their voices heard with respect.

But none of our principles can transform an organization without differentiation as an "enforcement" device. Say, for instance, that the IRS intended to make taxation a faster and less painful experience. What values (and therefore behaviors) would it seek from its employees? We can only guess, but rapid response and courtesy would probably be on the list.

Great, but then what? If managers can't reward courteous, fast employees or move out the surly

and slow, mission and values are like laws in a country without police.

The same goes for candor. Without a reward for it, why would anybody in the IRS, or elsewhere, muster up the courage to speak frankly? Without differentiation, in other words, our whole system is pretty useless. (You can read about our management philosophy on our Web site: welchway.com.)

Sorry to offer you such a frustrating response, but we're frustrated ourselves. A week doesn't go by when we aren't asked a question like yours, about improving performance or creating change in a government setting. Usually we write a personal note of apology—not our area—and leave it at that. But the IRS touches so many people. And its inability to change due to lack of differentiation may soon become a much wider problem.

Why? The answer is the Employee Free Choice Act, proposed legislation that aims to remove the secret ballot from organized labor elections, which could foster union-building. In 2007, the last time this legislation was politically alive, it passed the House but stalled in the Senate. Come January, there may be a new configuration on Capitol Hill, and the stall would likely shift into "full steam ahead." If so, companies large and small might face a wave of unionization efforts. And in short order, they might also be faced with the same limitations that constrain your employer. The IRS's hobbling lack of differentiation would no longer be the exception; it could be the rule. | 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.

If the Employee Free Choice Act passes, organizations large and small could start looking more and more like the IRS

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