Practice 2.1

Part A

Watch the following video

The Explainer: The 5 Forces That Make Companies Successful
https://www.youtube.com/watch?v=XCWHSeDU-zk

Porter's Five Forces - A Practical Example

https://www.youtube.com/watch?v=OCnlArFuU-E

and read the following articles and answer the question:

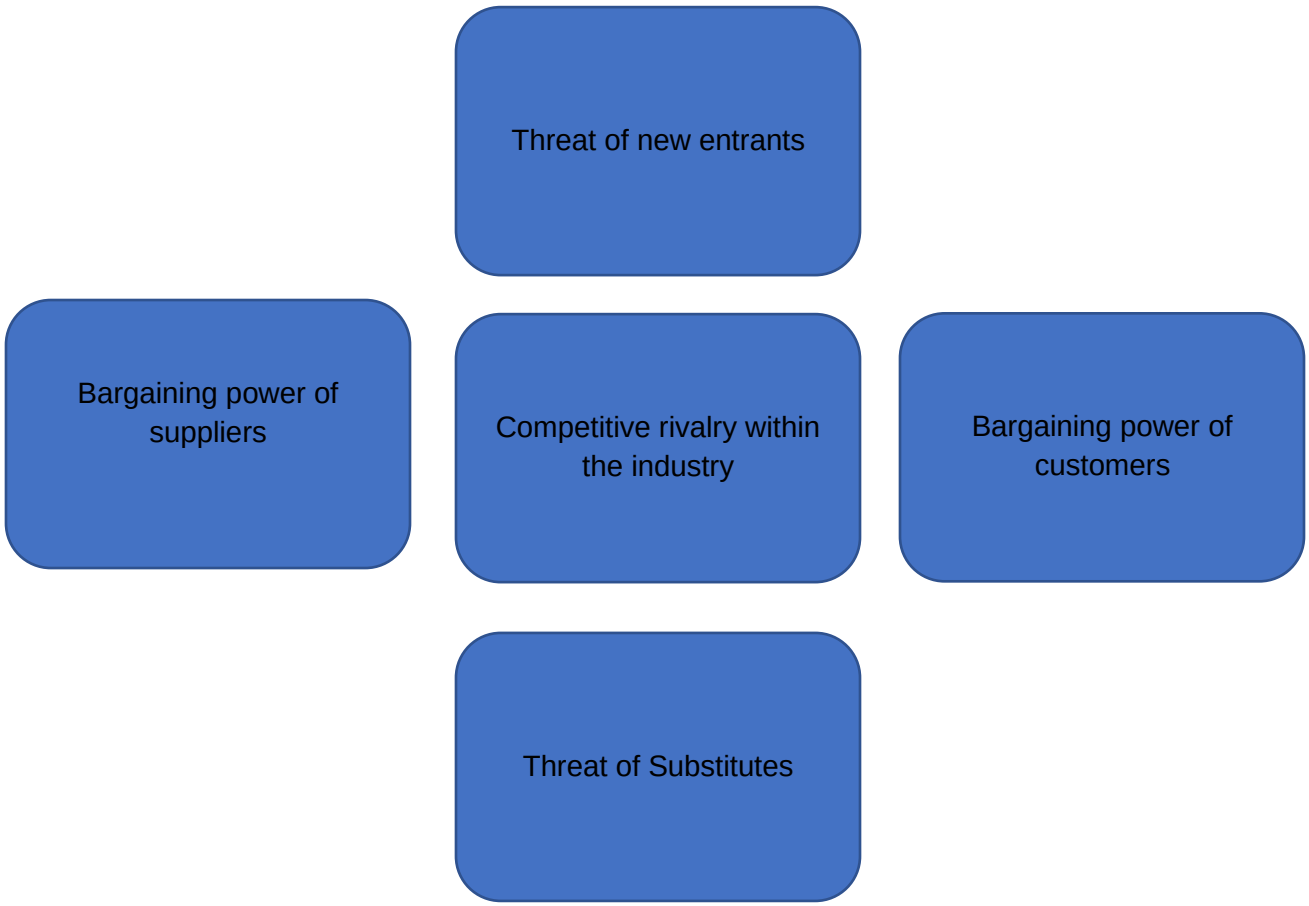
Which articles refer to the general business environment and which to the specific business environment? Justify your answer with arguments from the articles related to the theory (discussion in class).

Part B

Find a company and apply Porter´s five forces to examine the attractiveness of the sector that this company belongs by describing the following (in groups or individually, in class -discussion follows):

1.-Identify the main players: competitors, clients, providers, substitutes
2.-Discuss the key factors for each force and how are affecting each force.
3.-Considering the analysis in the previous question, discuss the degree of rivalry and the profitability in this sector

Part B template



The Auto Industry Bailout

SOURCE: http://useconomy.about.com/od/criticalssues/a/auto_bailout.htm

Why GM, Ford and Chrysler Asked For Government Loans

Updated March 28, 2012

In December 2008, the three major U.S. auto industry companies -- GM, Chrysler and Ford -- asked the government for a $34 billion bailout to avoid bankruptcy. The Big 3 stated that their demise would trigger 3 million layoffs within a year, plunging the economy further into recession.

In January 2009, the Federal government used $24.9 billion of the $700 billion bank bailout fund to rescue two of the Big 3 :

- $17.4 billion for General Motors and Chrysler.
- $6 billion for GMAC.
- $1.5 billion for Chrysler Financial.

The purpose of the loans was to provide operating cash for GM and Chrysler, and to keep making auto loans available for car buyers. Ford Credit planned to use funds from the Term Asset-Backed Securities Loan Facility (TALF),a government program for auto, student and other consumer loans.

Many opposed the bailout, saying U.S. automakers brought their near-bankruptcy on themselves by not retooling for an energy efficient era, reducing their competitiveness in the global market.

Auto Bailout Specifics

The auto bailout proposal from the Big 3 auto companies totaled $34 billion in government loans. In return, the companies promised to fast-track development of energy-efficient vehicles, and consolidate operations. GM and Ford agreed to streamline the number of brands they produced. They also won agreements from the UAW union to delay contributions to a health trust fund for retirees and reduce payments to laid-off workers. The three CEO's agreed to work for $1 a year and sell their corporate jets.

GM's Bailout

GM received $6 billion through GMAC, which became a bank holding company. GM asked for $18 billion in loans, of which $4 billion was needed to avoid bankruptcy before the end of 2008. In return, GM agreed to give the government warrants for common stock, preferred stock, and a

promise to repay the loan in 2012, when it anticipates it will again break even. GM pledged to cut its debt by $30 billion by converting debt ownership for equity. It agreed that union health-care benefits would be paid to retirees in 2010. It promised to sell its Saab, Saturn and Hummer divisions, reducing the number of models for sale to 40. It would reduce employment from 96,000 to 45,000 by 2012. (Source: Bloomberg, Chrysler Financial to Get $1.5 Billion to Aid Car Sales, January 19, 2009)

Chrysler's Bailout

Chrysler's $1.5 billion EESA loan was made to a new financing corporation, Chrysler Financial, set up for the purpose. The interest rate for the loans was 1 point above LIBOR. In addition, Chrysler Financial promised to pay the government $75 million in notes and reduce executive bonuses by 40%. As a result, car buyers will get 0% financing for five years on some models.(Source: Washington Post, U.S. Expands Aid to Auto Industry, January 19, 2009)

Chrysler received $4 of the $7 billion bridge loan it originally requested. It also asked for $6 billion from the Energy Department to retool for more energy efficient vehicles. In return, Chrysler's owner Cerberus vowed to convert its debt to equity. Chrysler wanted the Big 3 to partner with the Federal government in a joint venture to develop alternative energy vehicles. Chrysler pledged to debut an electric vehicle in 2010, ramping up to 500,000 by 2013.

Ford's Bailout Proposal

Ford requested a $9 billion line-of-credit from the government, and a $5 billion loan from the Energy Department. Ford pledged to accelerate development of both hybrid and battery-powered vehicles, retool plants to increase production of smaller cars, close dealerships, and sell Volvo. Ford is in better shape than GM or Chrysler because it had already mortgaged its assets in 2006 to raise $24.5 billion. Although Ford didn't need, and didn't receive any funds, it also didn't want its competition to get the upper hand thanks to the government bailout.

Congressional Plan

Congress first explored whether a planned bankruptcy reorganization was the best alternative for the companies, but realized that would take too long to implement. Congress was divided on whether to use the $700 billion EESA funds, instead of the $25 billion available from an Energy Department energy-efficient loan program.

Why the Bailout Was Needed

In December 2008, auto sales had dropped 37% compared to a year earlier. This was 400,000 fewer vehicles, or the equivalent of two factories' annual output. GM and Chrysler had the worst decline, while Ford's loss was about the same as industry leaders Honda and Toyota.

However, many in Congress accused the auto-makers of not operating competitively for years. The companies delayed making alternative energy vehicles, instead reaping profits from sales of SUV's and Hummers. When sales declined in 2006, they launched 0% financing plans to lure buyers. Union members were paid $70 per hour, on average, while new hires made $26 per hour. GM had twice as many brands as needed, and twice as many dealerships, thanks to state franchise regulations. For them, the bailout was needed to restore the U.S. auto industry to global competitiveness. (Source: WSJ.com, Big Three Seek $34 Billion Aid, December 3, 2008;

Bloomberg, UAW Offers Cuts, December 3, 2008; The Economist, Back AgainDecember 3, 2008))

The Impact of the Big 3 Automakers on the U.S. Economy

At the time of the bailout, the auto industry contributed 3.6%, or $500 billion, to total U.S. GDP output. A 30% decline in auto sales translated directly into a 1% decrease in economic output. The auto industry also employed 850,000 workers in manufacturing, and 1.8 million workers in auto dealerships. Therefore, a decline in output resulted in direct job losses, as well as auto-industry related losses. (Source: BLS, Auto Industry Employment)

These figures included foreign-owned as well as the Big 3 auto makers. At the time of the bailout, many analysts felt that Chrysler would go bankrupt, even with a bailout, and Ford didn't really need it. Therefore, the main impact from the bailout was to save jobs at GM. However, the economic slowdown caused GM to slash its employment and production, whether it received a bailout or not. Furthermore, once the recession was over, Toyota and Honda would continue to increase their U.S. factories, providing jobs for U.S. auto workers.

EMI-Universal deal cleared by EU and US regulators

SOURCE: http://www.bbc.co.uk/news/business-19672277

Music Week editor Tim Ingham: "Universal now owns the holy trinity of 20th century rock and roll"

EU and US regulators have approved the takeover of UK music firm EMI by Universal Music, but it must sell some of the firm's most valuable labels.

The European Commission said Universal would have to sell off assets including the Parlophone label, home to artists such as Pink Floyd and Kylie Minogue.

The US Federal Trade Commission later approved the deal in its turn without imposing any conditions.

The £1.2bn ($1.9bn) takeover of EMI was announced in November.

Although the European Commission said its ruling would allay competition fears, rival music labels have condemned the move.

EMI, with a history dating back to 1897, is home to artists including the Beatles and Pink Floyd. Universal is a unit of French media giant Vivendi.

The Commission's demand for assets sales also includes disposal of EMI's Chrysalis, Mute, and Classics labels, as well as Universal's Sanctuary and Co-op Music labels.

"The very significant commitments proposed by Universal will ensure that competition in the music industry is preserved and that European consumers continue to enjoy all its benefits," EU competition commissioner Joaquin Almunia said in a statement.

'Preserve choice'

He said a combined group would have a market share with the European Union of less than 40%, the threshold which typically prompts regulators worry about market dominance.

Mr Almunia said: "Competition in the music business is crucial to preserve choice, cultural diversity and innovation.

"In this investigation, we have paid close attention to digital innovation, which is changing the way that people listen to music."

Citigroup is selling EMI, having bought it when buyout firm Terra Firma defaulted on loans owed to the US investment bank. Regulators have already allowed a group led by Sony to buy EMI's music publishing arm for $2.2bn.

Universal welcomed the commission's decision, saying: "Today's approval brings to an end an extensive EU regulatory review and the acquisition will benefit the artistic community and music industry."

The company said that after the asset sales, its catalogue would include the Beatles, Beach Boys, Genesis, Katy Perry, Emeli Sande and Robbie Williams. The Beatles, part of Parlophone, was exempted from the sale.

A source close to Universal said the company had already received interest in the assets for sale from well-funded potential buyers.

'Universal's arrogance'

Smaller rival music labels reacted angrily to the commission's decision. Impala, which represents independent label across Europe, claimed that the commission's conclusions acknowledged that "Universal's power is a problem across the whole market".

Helen Smith, executive chair of Impala, said: "This decision has finally put a freeze on Universal's ability to expand further and sets a benchmark for constraining abusive behaviour across the whole market.

"Following the approval of the Sony/EMI merger, however, this decision nonetheless reinforces what is already a powerful duopoly. Contrary to the basic principles of competition in cultural markets, artists and consumers will ultimately pay the price."

Martin Mills, chairman of Beggars Group, said: "It's good to see that the Commission has seen this deal as such a threat to the market that it has demanded and received truly swingeing commitments to divestments.

"However, that should not conceal that fact that Universal's arrogance has paid off for them, that they have destroyed a significant competitor, and that even with these divestments their ability to dominate and control the market has reached even more unacceptable levels.

"Anyone trying to start a new digital service will be realising that very soon, and we will continue to look to the regulators to monitor ongoing behaviour."

Hmmm. . . . Looks Like Competition In the Music Industry is Working . . . .

SOURCE: http://www.publicknowledge.org/node/796

As reported by the NYT, legal music downloading for which record labels received royalty payments more than doubled last year. Nevertheless, the industry is still not making as much money as it would like. Unsurprisingly, the industry and sympathetic trade reporters attribute the difference between the huge profits the industry actually makes and the obscene profits to which they believe they are entitled to 'piracy.'

Allow me to proffer a different explanation: we should expect that technology that shifts power to customers and makes the industry more competitive will lower the profit margins for incumbents. That's Econ 101. In fact, if we didn't see a decline in profits, it should make us profoundly suspicious of claims of competition. Competition, after all, supposedly lowers prices -- remember?

As I have written previously, the music industry is increasingly running into the hard wall that is "reality." The happy days when if you wanted music you bought it when the music cartel wanted, where they wanted, and how they wanted to sell it to you, are rapidly passing (barring such legislative actions as PERFORM designed to preserve the "glory days" of the music cartel forever). Not only was the industry forced to renounce the price-fixing ways that marked its conduct in the 1990s, but digital technology has now forced it to lose another arrow in its anticompetitive quiver: bundling.

Historic note: "Bundling" was a term in Colonial times for the practice of men and women courting one another to lie together in bed fully clothed for the purposes of mutual warmth while platonicly conversing. As with modern "bundling," supporters of the practice claim that screwing people is NOT the object of the exercise -- but one does have to wonder.

What I mean by "bundling" in this particular instance is requiring a person to buy a lot of songs they don't want along with the song they do want. Everyone has heard the lament that a CD has maybe two or three good songs, but you must buy the whole CD. There's a good economic reason for that. By requiring you to buy the whole CD, the music industry gets to charge you a stiff price for the song you actually want. But digital technology lets you buy just the one song you want -- and at a price to match.

It is therefore unsurprising that as consumers embrace digital technologies, the entertainment cartel will continue to see profits fall. This is not a bug, it is a **feature**, because music industry profits until now were artificially inflated. In a more competitive market, we should expect profits of music companies to decline from obscene to "merely" ridiculous.

The problem in policy-land is that the music industry has been very good at framing the debate. First, the music industry stipulates that it is losing money due to piracy (using numbers of dubious validity). Then, it points to declining profits as proof that piracy is a scourge that Congress must eliminate at all costs. Unfortunately, this tends to make the debate about whether the music industry is actually losing money, if so how much, and what that means.

I propose we flip the framing on its head. If the music industry is competitive, why isn't it experiencing the kind of razor-thin profit margins one associates with competitive industries? And given that most music companies entered into a consent decree saying (without admitting) that prices for music CDs were artifically inflated from 1995-2000 by the music cartel, shouldn't we expect that music companies are seeing a decline in profitability? Indeed, wouldn't it be highly suspicious if the usual suspects were achieving exactly the same level of profitability as they were before all the supposed competition of the Internet emerged?

So the next time some music industry flak trots out stats that show how the music cartel keeps losing money, congratulate them on proving the system works. You can console then with the thought that while it is tough to make a living in a competitive market, and incumbents would always rather regulate than compete, you have no doubt they can get the hang of it. They just need to buckle down and start selling customers what they want, rather than get Congress to pass laws requiring customers to pay inflated prices for the pleasures of "bundling."

When Your Contract Manufacturer Becomes Your Competitor

by Benito Arruñada and Xosé H. Vázquez

Contract manufacturers cut OEMs' costs and free up capital. But the hungry ones are starting to bite the hand that feeds them. Smart OEMs know how to keep such hazards under control.

IBM essentially created the personal computer industry. It won't be long, however, before the company's nameplate disappears from PCs and IBM leaves the business, except for the joint venture it recently formed with PC maker Lenovo. Founded in 1984 as a distributor in China of equipment made by IBM and other companies, Lenovo will eventually affix its own logo to the PCs. Certainly, Lenovo has come a long way. So has Sanmina-SCI, the actual manufacturer of some IBM PCs in the United States: It recently acquired some of the factories where the computers are made. Like Lenovo, Sanmina assembles products for a variety of well-known brand owners. The company has expanded its role, however, and now also designs and engineers custom electronic components. These two firms are representative of a host of formerly anonymous makers of brand-name products that are stepping up and pushing the brands themselves aside. Indeed, the complexities of IBM's environment challenge the common view of contract manufacturing as no more or less than the anxious resort of large brand owners suffering from thinning profit margins.

Yes, outsourcing the entire manufacturing of a product allows original equipment manufacturers (OEMs) to reduce labor costs, free up capital, and improve worker productivity. OEMs can then concentrate on the things that most enhance a product's value—R&D, design, and marketing, for instance. Facilitating these gains are the contract manufacturer's (CM) special strengths, which may include location in a low-wage land, economies of scale, manufacturing prowess, and exposure to the engineering and development processes of products it handles for other OEMs. (Such exposure puts the CM in a position to propose improvements to different clients' products.)

As IBM and other companies have learned, however, contract manufacturing is a two-edged sword. For one thing, a CM is privy to an OEM's intellectual property (IP), which it can leak to other clients or arrogate. For another, an ambitious, upstart CM can claim for itself the very advantages it provides an OEM. Having manufactured an OEM's product in its entirety, the CM may decide to build its own brand and forge its own relationships with retailers and distributors—including those of the OEM. When these things happen, the OEM may find itself facing not only more dangerous incumbents but also a competitor of a new kind: the once-underestimated CM. Adding insult to injury, if the OEM had not given its business to the traitorous contract manufacturer, the CM's revenues and knowledge might have remained sufficiently meager to prevent it from entering its patron's market.

Although launching a brand would not be a trivial undertaking for any contract manufacturer, a brand identity rooted in the CM's production prowess would have immediate credibility. Moreover, a CM working for several OEMs has experience making a wider range of products than do most of its clients, permitting it to concentrate on producing the most profitable ones. And its cost structure does not necessarily bear the burden of investments in R&D.

In short, OEMs' humble attempts to realize operational improvements and cost savings can plunge them into a strategically treacherous realm in which partners quickly outgrow one another, spy more attractive opportunities elsewhere, and, in the most flagrant cases, bite the hand that has been nourishing them. Put simply, OEMs that retain contract manufacturers may unleash forces they find hard to control. It would be no exaggeration to say that the players

soon find themselves immersed in a melodrama replete with promiscuity (CMs pursuing liaisons with a variety of OEMs), infidelity (retailers and distributors shifting their business to an OEM's CM), and betrayal (CMs transmitting an OEM's intellectual property to the OEM's rivals or keeping it for themselves).

OEMs cannot evade this dilemma by terminating their outsourcing arrangements: Modularization, codification of manufacturing processes, and diminished transaction costs make contract manufacturing irresistible to less well-capitalized OEMs. But OEMs *can* manage their relationships with CMs so that the OEMs don't become weak or the CMs too strong. Doing so requires a few things: modesty about revealing one's secrets; caution about whom one consorts with; and a judicious degree of intimacy, loyalty, and generosity toward one's partners and customers. OEMs can also elude CMs' backbiting tendencies by using their surplus intellectual property to enter markets beyond those for their core products. Ironically, CMs' barrier-breaking abilities, otherwise used to invade OEMs' markets, can offer OEMs access to new markets—and sometimes a way out of the dilemma.

Heightened Competition

Few industrial companies still consider manufacturing an essential part of their businesses. Traditional brand owners—what we know today as OEMs—prefer to focus now on product research, design, and sales, leaving production to the new specialists: contract manufacturers.

Contract manufacturing involves outsourcing an entire manufacturing process to the point where, in many instances, none of an OEM's employees will have physically touched the product they're marketing and selling. The practice began in 1981, with the manufacture of the first IBM PCs, but a decade passed before it reached such everyday products as toys, clothing, footwear, beer, and pharmaceuticals. Today, even a few corners of the automobile industry have embraced it: Finland's Valmet Automotive assembles the Porsche Boxster, and Austria's Magna Steyr assembles cars for Mercedes, BMW, and Saab.

Gateways to Entry

by George S. Yip

Managers today, increasingly interested in long-term planning, are achieving corporate growth by selecting new markets to enter and developing the appropriate entry strategies. The other two sources of corporate growth—present markets and acquisitions—are far less attractive today for many companies than a decade ago. Some companies participate in growth markets, but many others languish in stagnant ones. Moreover, as companies have struggled to manage their newly adopted, fully grown, and intractable "children," acquisition has lost much of the luster it used to hold.

Despite its increasing popularity, direct entry is elusive. Newcomers must penetrate that first line of market defense—barriers to entry. Why do some companies succeed and others fail? Entry is one of the supreme tests of competitive ability. No longer is the company proving itself on familiar ground; instead it has to expose its competences in a new area.

Entry is also a trial for incumbent competitors. The efforts of newcomers to establish themselves frequently render the market less profitable for all. Even worse for the incumbents, the new players often possess superior skills, greater resources, and new ways to compete.

The concept of barriers, developed by industrial organization economists, was introduced into the business world decades ago. Some incumbents may take comfort in thinking that they have erected impregnable barriers to protect their profitable markets. Potential entrants may worry about the heights they have to scale. Yet there has been no systematic approach for managers to use in determining the effectiveness of entry barriers—or to devise ways of overcoming or sustaining them.

This article offers such a framework by building on Michael E. Porter's pioneering work in integrating industrial organization economics with business strategy. The "threat of new entrants" is one of the five forces Porter identified as governing competition in an industry.[1]

On the basis of my two-year study of barriers to entry, which includes collection and analysis of new data, I will provide a framework for evaluating the different types of entry barriers and how they work. At the same time, I will describe the concept of "gateways to entry," which shows that the same factors giving rise to barriers can be exploited to an entrant's advantage. One crucial conclusion, which I shall elaborate on, is that potential entrants are far less deterred by barriers than marketing managers might think.

Types of Barriers

What constitutes entry depends on the definition of the particular market. The entries I will concentrate on are limited to products, assets, and activities developed internally for new markets. Likewise, the barriers described are those that apply to direct entry. Another route that many large companies prefer—acquisition—faces a different set of problems that I will discuss later.

The disadvantages that entrants face relative to incumbents arise from the fact of direct entry and are separate from the disadvantages of size or general inferiority in skills and resources. Smaller-company entrants face the

usual size, skill, and resource handicaps common to most existing small competitors. Entry against established incumbents creates additional problems.

Autos: Economic climate change sees demand increase for small cars

By Daniel Schäfer in Frankfurt

At **Volkswagen**'s headquarter in Wolfsburg, it is easy to see why the car industry has such a relevance for Europe's largest economy: one can get lost in a production site that is almost as big as Gibraltar, consumes 0.35 per cent of Germany's power demand and employs more than 85,000.

But now this key sector of the German economy is beginning to falter, as profits are squeezed by a plunge in demand, high oil prices and fallouts of the financial crisis.

However, different from previous downturns, workers and managers at Volkswagen's vast Wolfsburg production site are not the first to suffer.

This time, the economic turmoil has hit premium brands before mass market producers.

Daimler has been the first to warn. But many others – be it car manufacturers such as **BMW**, or suppliers like **Continental** – have followed suit in preparing investors for lower profit margins.

Analysts and car executives were puzzled by the speed with which the European car market turned into a lame duck.

"In 2009 and 2010 the car market is likely to stagnate on today's fairly low volume," says Gregor Matthies, partner at Bain & Company. Talk to chief executives of German car companies and they will privately admit the same thing.

"I definitely do not think this was just a two months blip," says one.

However, even in the light of these tougher times, the German car industry, employing 756,000, operates from a position of strength. Daniel Schwarz, analyst at Commerzbank says: "Daimler has reduced its return on sales forecast for Mercedes from more than 9 per cent to 8 per cent. But that is still a decent margin."

Demand shift from saloons to smaller, less fuel-consuming cars poses a threat to profitability: little cars equal small profit margins. But it is a threat the industry is confident of mastering thanks to the huge amount of money it has invested in the development of less fuel-guzzling engines. "It is a myth that people want to drive smaller cars, they just want to drive less fuel-consuming cars," says one executive.

And there is still room for improvement. Jürgen Leohold, head of Volkswagen's research and development, says despite all of the talk about electric cars, the combustion engine will have a long future.

"There are still a lot of possibilities to reduce fuel consumption." Here, German car companies can count on their innovative strength. Mr Leohold says that more than 50 per cent of VW's multibillion research and development spending flows into the creation of better or new engines – be it hybrids, fuel cells, electric or the classical combustion engines. Although technologically often at the forefront, some say German companies have lost ground to rivals in one crucial area: battery technology. Mr Matthies says many competitors have already positioned themselves better by creating joint ventures or even – like **Toyota** – owning a battery supplier. "Some companies are in a danger of falling behind here."

In another crucial area Germany's renowned car companies recently shifted into a higher gear: co-operations with utility companies.

Daimler has just announced the biggest such enterprise as it teams up with RWE on an electric car project: 500 charging points will be installed in Berlin by the end of 2009.

Financial Times, ft.com
Published: September 29 2008 14:42 | Last updated: September 29 2008 14:42

Inflation + Subsidies: An Explosive Mix

by Ian Bremmer

Although the global economic upheaval of 2008 is undermining emerging-market growth, the balance of economic power will continue to shift in favor of developing countries, where recent economic successes have already improved the prospects of almost 4 billion people. The result is likely to be further strong demand for commodities. Multinational corporations should be aware that even if energy prices remain lower for a while and inflation moderates, some developing nations' policies for dealing with commodity demand—namely, price controls and subsidies—ensure the ongoing risk of upheaval, both economic and political. Certain countries have recently used these policies to avert popular demonstrations in the streets. In Malaysia, estimates suggest that food and fuel subsidies will be more than 7% of GDP in 2008, and China is expected to have spent US$40 billion in fuel subsidies, nearly double what it provided in 2007. These countries may have the money to make subsidies work today, but over time, in view of the global economic slowdown, the subsidies will become more difficult to maintain.

The consequent price increases will be painful for local consumers, who may blame reform-minded incumbent politicians, foreign corporations, and the markets themselves. Populist rage over the collapse of subsidies could, as history suggests, lead to election upsets, greater nationalization of resources, and unpredictable regulation. In extreme cases, it could destabilize political regimes, such as when escalating food prices in Haiti last spring led to the ouster of Prime Minister Jacques-Édouard Alexis. Developments such as these can obviously have serious consequences for foreign investments.Some of the most economically promising countries—those that have brought millions of people into the global economy for the first time (and thereby contributed to worldwide inflation)—are among the most vulnerable. In India, which heavily subsidizes diesel fuel, the state-run oil companies are on track to post losses of more than $50 billion by the end of 2008. When the Indian government increased the price of diesel by 10% in June, nearly 4 million truckers went on strike, a delicate situation for a country in which 70% of goods are transported by truck. Also in June, riots broke out in Burullus, Egypt, after officials stopped the sale of subsidized flour to citizens. And inflation related to the discontinuation of fuel-price subsidies might make the 2009 presidential election in Indonesia more competitive for its reformist leader, Susilo Bambang Yudhoyono, while stalling reforms in electricity pricing.

Even energy exporters aren't immune from risks created by price supports for consumers. Countries such as Venezuela and Iran have used revenues from high oil and commodity prices to subsidize their populations and minimize discontentment. Despite the slowdown in major industrial economies, Russia has been growing over the past year, primarily on the strength of government spending of oil revenues. Declining oil prices could eventually limit the number of options these governments have.

Ultimately, countries that remove subsidies will help themselves, and the foreign investors in them, by making their economies more efficient. After all, although it is the poor who take to the streets, it's the rich who take the most from subsidies. According to an IMF study in selected emerging-market countries, the richest one-fifth of households receive almost half of all subsidies; the poorest fifth receive only 10%. Cutting subsidies will free governments to divert more resources to the poor and toward education, health care, the environment, and infrastructure projects. It also will enhance energy efficiency and increase investment in developing alternative sources of energy.

Nevertheless, governments must proceed cautiously as they discontinue subsidies or risk substantial short-term pain for themselves and the companies investing in them.