Opening Profile: Economic Crisis Spreads Through Financial Globalization

A perilous global crisis of confidence has revealed both the scale and the limitations of globalization.[1]

The 2009 World Economic Forum in Davos, Switzerland, announced its theme—"Shaping the Post-Crisis World." What crisis? What caused the crisis? Some of the developments **as they occurred** are discussed below, and the effects will no doubt be continuing as you read this book. Discuss updates in your class and how the effects are impacting international business.

In September 2008, fears of a global recession fed a stock market panic as worries about toxic assets (highly leveraged securities mainly linked to risky mortgages taken out in the United States) spread from the financial sector to the credit markets and then to the broader economy.[2]

The American export—the subprime mortgage mess—caused the global economy to hit the brakes. The problem is that Finance has become one of the most international of industries, with banks from around the world doing business across numerous countries. However, regulation of that industry is still only national or local. Because fear gripped depositors around the world concerned that their deposits and savings will disappear, and fear led banks worldwide to cease lending to one another, the entire credit system shut down. Lending to even creditworthy companies dried up in Europe in 2008, causing the International Institute for Labor in Geneva to state:

> **The financial crisis is hitting the world of work. . .**
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> *The financial crisis which developed over the past year and erupted last August represents one of the most significant threats to the world economy in modern history. The credit crunch and collapse of stock markets are starting to affect firms' investment decisions as well as workers' incomes and jobs. Several major developed economies have practically entered into recession and unemployment is on the rise. Economic growth in emerging economies and developing countries has slowed down, in some cases significantly.*
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> INTERNATIONAL INSTITUTE FOR LABOR.[3]

The United States Treasury Secretary, Henry Paulson, proposed a $700 billion bailout plan for banks, which (then) President Bush signed on October 3, 2008, the beginning of the most expensive government bailout in history, and there was an unprecedented coordination of central banks on three continents to cut interest rates. However, these moves seemed only to generate more fear, and did little to free up credit lines either between banks or to their customers. Stock markets around the world continued their massive losses—estimated at $6.5 trillion on October 6 and 7, 2008. Iceland came to the brink of bankruptcy because several banks whose assets were greater than the country's economy were experiencing problems.

The failure of banks and other financial institutions prompted governments to attempt to intervene. In the United States, the giant mortgage companies Fannie Mae and Freddie Mac were nationalized, Lehman Brothers and Washington Mutual companies were allowed to fail, but then the government later decided to bail out AIG, the huge global insurer, for fear of the global repercussions. A global problem called for a global solution. However, coordinating policies for Europe's many countries, for example, presents many difficulties. Some of the government rescue actions taken around the world were widely reported, and examples are summarized below as they developed in late 2008 and early 2009.

The International Monetary Fund said it was ready to lend to countries hit by the credit crunch, using an emergency funding mechanism first used in the 1990s Asian financial crisis.

CHINA: China joined the interest rate offensive, cutting rates by 0.27 percentage points.

SOUTH KOREA: The central bank of South Korea, joined the growing number of countries to cut their interest rates.

AUSTRIA and GREECE officially announced a guarantee for all personal bank savings.

BELGIUM and DENMARK's governments agreed to guarantee bank deposits.

ICELAND: With the country on the brink of bankruptcy, Iceland's parliament passed emergency legislation giving the government wide-ranging powers to dictate banks' operations. Negotiations were under way with Russia for a big loan to support the country's banking system. Moscow has offered more than $5 billion in emergency loans.

IRELAND: Ireland was the first government to come to the rescue of its citizens' savings, promising on 30 September to guarantee all deposits, bonds, and debts in its six main banks for two years. The move initially prompted consternation among some European partners, but several countries have since followed suit.

ARAB STATES: Share prices dropped precipitously, amid fears of weakness in Dubai's property boom and exposure to global markets.

INDIA: The central bank moved to inject 600bn rupees ($12.2bn) into the money markets after sharp falls in Mumbai's stock exchange and the plunge of the rupee to an all-time low.[4]

These moves made it clear that the global ripple effect of Wall Street's woes had debunked the theory of "decoupling," the notion that the rest of the world was robust enough to ride out a U.S. domestic crisis. While attempts to stabilize the global financial system seemed to stagnate, Britain's Prime Minister Gordon Brown announced a plan to recapitalize its major banks and try to find a broader international solution. The U.S. then followed on October 14, 2008 with a similar plan to buy $250 billion of non-voting preferred stock in major banks and financial institutions—thus also partially nationalizing the U.S. banking system. At that juncture, it became clear that Europe—led by Britain—was leading the way with a financial bailout plan that set the pace for Washington. However, by the end of 2008, it became clear that "the world's dramatic financial rescue efforts are both unprecedented in scope and creativity—and wholly inadequate."[5]

In spite of the huge amounts of money that governments around the world are spending to attempt to stanch the bleeding, there seems little to prevent the world economy from major downturn, according to the International Monetary Fund. Some encouraging news to combat the global slowdown came as China announced a huge economic stimulus plan on November 9, 2008, aimed at bolstering its weakening economy. The Chinese government topped the world in its rescue package saying it would spend an estimated $586 billion over the next two years—roughly 14 percent of its gross domestic product each year—to construct new railways, subways, and airports. China's banks, at least, remained relatively unscathed.

Not to be outdone in the fight, The United States Federal Reserve and the Treasury announced $800 billion in new lending programs, sending a message that they would print as much money as needed to revive the nation's crippled banking system. That commitment amounted to about $7.8 trillion in direct and indirect financial obligations—equal to about half the size of the nation's entire economy and far greater than the $700 billion that Congress authorized for the Treasury's financial rescue plan.

European countries then mounted a joint approach; the EU commission announced a 200 billion euro rescue plan among the 27 member states. The EU Commissioner urged that all attempts be made to bolster the sagging growth and confidence in the region.

However, at least as of early 2009, although it seemed that the various measures had staved off financial collapse, the world awaited the stimulus that governments were spending billions of their taxpayers' money to gain. Meanwhile, credit was still tight and confidence was low; companies around the world were retrenching, shuttering plants and offices, and laying off thousands of workers. Protectionism and nationalism were increasing, further hampering trade, and the World Bank announced that the global economy is likely to shrink by one or two percent in 2009.

In February 2009, President Obama signed a $787 billion stimulus package (3 percent of GDP). However, while the goal of much of the package was to create jobs in the U.S., concern about "Buy American" clauses, such as for the steel industry, led to cries of protectionism that aroused fears of retaliation in trade wars.

Increasing awareness of the causes and effects of the financial crisis led many to conclude, as posed in the *New York Times*, that:

> *This crisis has shown the Achilles' heel of a globalized financial system to be a lack of high-quality, and consistent, regulation to prevent overconfident bankers from taking irresponsible risks. A year and a half ago, when it appeared to be a subprime mortgage issue for the United States, most countries thought they could glide past it. But it turned out that everyone in that globalized system was vulnerable to the collapse that began at the center.*
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> WWW.NYTIMES.COM,
> *February 8, 2009.*

In addition, the irony seemed to be that the rapid growth in open economies, as a result of globalization, was coming back to bite them; whereas those with more restricted financial systems appeared more able to weather the storm. Iceland is broke; India was one of the few to expect continuing economic growth.[6]

Another unfortunate result, as noted at the global economic conference in Davos, Switzerland, in February 2009, was the warning that the global recession could sharply reduce lending across borders. Investment of private capital to emerging markets in 2009 was expected to be 82% lower than it was in

2007. British Prime Minister Gordon Brown said in an interview, "It's the first stage of a financial protectionism that will lead eventually to the kind of trade protectionism that we've seen in the past."[7]

Time will tell the long-term consequences around the world, but clearly executives and their companies have been caught in the grip of a storm that will likely revolutionize business.

> *The deep freeze of capital markets, the implosion of financial groups and the resulting rise in governments' sway over the private sector has called into question some of the foundations of Anglo-Saxon capitalism.*[8]

In an effort to develop consensus about how to revive a paralyzed global economy, the leaders of the world's largest economies met at the Group of 20 (G20) meeting in London on April 2, 2009. They agreed to bail out developing countries, stimulate world trade, and regulate financial firms more stringently. Leaders of those countries committed to $1.1 trillion in new funds to be available to the International Monetary Fund with the goal of a revival in trade, which was expected to contract in 2009 for the first time in 30 years. But differences of opinion between Continental Europe and the United States over whether to act now or wait to see whether existing spending measures took effect resulted in what many considered a shortfall of measures needed to stimulate the world economy. Prime Minister Gordon Brown of Britain concluded the conference saying:

> *This is the day the world came together to fight against the global recession. Our message today is clear and certain: we believe that global problems require global solutions.*[9]

As evidenced in the opening profile, managers in the twenty-first century are being challenged to operate in an increasingly complex, interdependent, and dynamic global environment. In a globalized economy, developments such as those described in the opening profile can have repercussions around the world almost instantaneously. Clearly, those involved in international and global business have to adjust their strategies and management styles to those kinds of global developments as well as to those regions of the world in which they want to operate, whether directly or through some form of alliance.

Typical challenges that managers must face involve politics, cultural differences, global competition, terrorism, and technology. In addition, the opportunities and risks of the global marketplace increasingly bring with them the societal obligations of operating in a global community. An example is the dilemma faced by Western drug manufacturers of how to fulfill their responsibilities to stockholders, acquire capital for research, and protect their patents while also being good global citizens by responding to the cry for free or low-cost drugs for AIDS in poor countries. Managers in those companies are struggling to find ways to balance their social responsibilities, their images, and their competitive strategies.

To compete aggressively, firms must make considerable investments overseas—not only capital investment but also investment in well-trained managers with the skills essential to working effectively in a multicultural environment. In any foreign environment, managers need to handle a set of dynamic and fast-changing variables, including the all-pervasive variable of culture that affects every facet of daily management. Added to that "behavioral software" are the challenges of the burgeoning use of technological software and the borderless Internet, which are rapidly changing the dynamics of competition and operations.

International management, then, is the process of developing strategies, designing and operating systems, and working with people around the world to ensure sustained competitive advantage. Those management functions are shaped by the prevailing conditions and ongoing developments in the world, as outlined in the following sections.

THE GLOBAL BUSINESS ENVIRONMENT

Following is a summary of some of the global situations and trends that managers need to monitor and incorporate in their strategic and operational planning.

Globalization

> *The World Is Flat*
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> THOMAS FRIEDMAN[10]