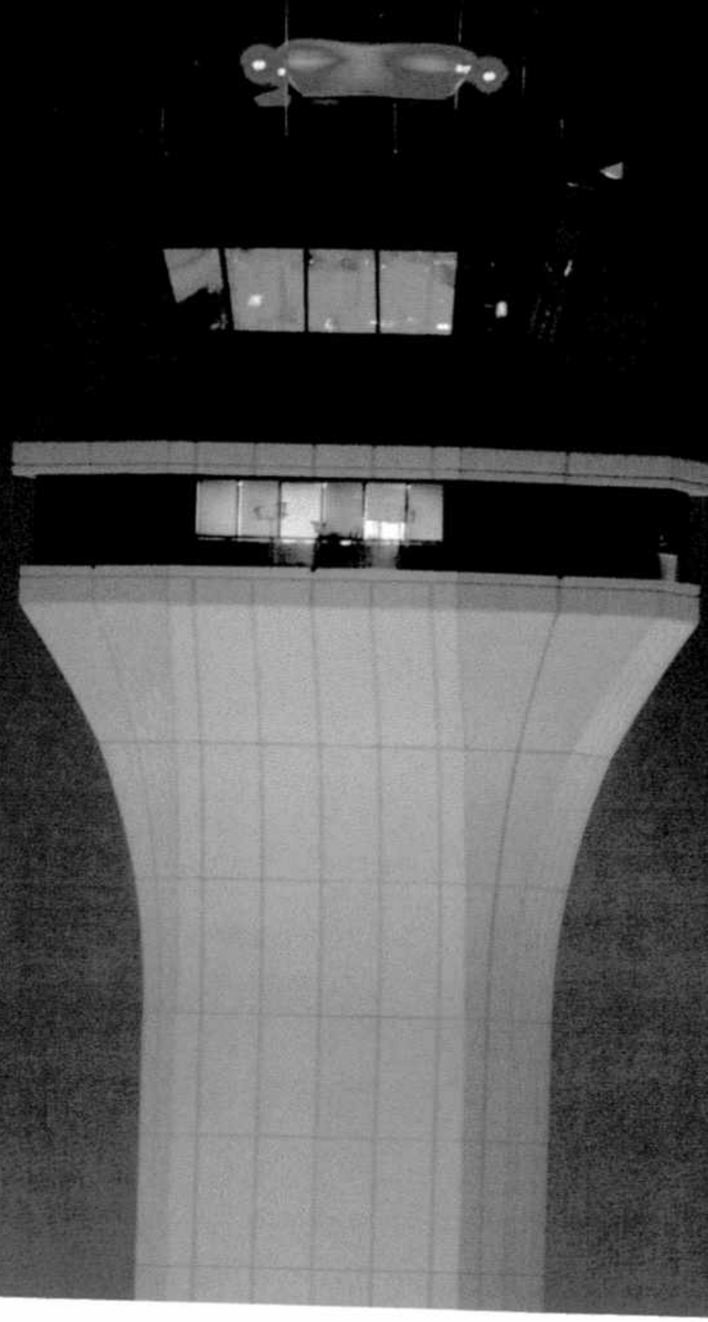
DETROIT METRO • WILLOW RUN
WAYNE COUNTY AIRPORT AUTHORITY

Why is it important to continue development of Michigan's access and business connection to Asia?



TESTIMONY OF

Lester W. Robinson
Chief Executive Officer
Wayne County
Airport Authority

OUR VISION

Making the world available

OUR MISSION

To operate safe, secure and dynamic air transportation facilities for our customers, creating economic vitality by providing global travel, cargo and business opportunities

Why is it Important to Continue Development of Michigan's Access and Business Connection to Asia?

At the Wayne County Airport Authority we consider Michigan's connection to Asia strategically important for our future economy. If you exclude the western states that enjoy a historical connection to Asia, Detroit Metro Airport is arguably the third most important US port of entry behind only New York and Chicago. As airport management, we consider Detroit Metro Airport a portal to the global economy and in our vision statement we state that we are:

"*Making the World Available*" as we accomplish our mission "*To Operate Safe, Secure and Dynamic Air Transportation Facilities For Our Customers, Creating Economic Vitality By Providing Global Travel, Cargo And Business Opportunities*".

I believe that the Aerotropolis proposal of Wayne and Washtenaw Counties has the potential to significantly enhance Michigan's role in the global economy. For many visitors we represent the front door and the back door to the State of Michigan since we are the first experience coming into the State and most often the last Michigan experience. Delta has informed us that while we are not its biggest hub, we still represent the airlines most important connection to Asia. We believe that we represent the entire State of Michigan in welcoming Asian visitors and want to ensure they experience the best in airport services. Detroit Metro Airport has air service to Asia provided by Delta Airlines to Tokyo and Nagoya Japan; Shanghai, China, and soon Hong Kong China, and Seoul, South Korea.

Everyone these days has an opinion and some understanding of the impact of globalization of our economy and how internal or external economic events can impact us all. In his book "Sonic Boom-Globalization at Mach Speed", author Gregg Easterbrook states that in the last generation world economies have become reasonably free economies and participate in free trade. Easterbrook states that the good news is that Democracy is spreading and economies are in many cases are free. The bad news is that internationally linked computerized economies mean twenty-four-hour stress, frequent shakeup in industry and cause job insecurity. China is central to many issues in Asia from environmental, to trade, to political and a perhaps the most important factor in Asian business growth. China's impact on global markets will effectively measure in exponentially greater factors beyond any growth rate common to the North American or European Union for the foreseeable future. The enormous impact of China on business and markets make it central to any assessment of the reasons for Michigan to develop relationships and business opportunities in Asia.

Some people say we have arrived at the age of the service-worker and the knowledge-worker due to the influence of free trade and globalization. Some even warn that globalization is the reason for our current economic problems. But, I think that globalization is the fuel that will drive our future economic fortunes and it is the "Genie" that can't be put back into a bottle. Protectionism cannot succeed for the same reasons that the Chinese government can't control the liberalization of its society. We are far too interdependent in economic ties and information is far too globally available for closed societies or closed markets to work independently. What we need to prepare for is the even faster pace of global financial and business change. In his book The World Is Curved, author David Smick writes a theory about the politics of globalization:

"My argument is that the last quarter-century has represented a relatively seamless, bipartisan political consensus in favor of free trade and liberalized financial markets.... Indeed, there was not much difference in economic policymaking between Democrat Bill Clinton and Republican Ronald Reagan."

"...in his 1997 State of the Union address, Clinton called for the authority to conclude new trade agreements that open markets... We need not shrink from the challenge of the global economy."

Mr. Smick's theory is that American Presidents Ronald Reagan and Bill Clinton both believed in free trade and that trade would lead to prosperity within the United States. The assumption was that our economy through development of knowledge based jobs would generate new jobs through innovation and globalization. These factors would generate new jobs that would replace and exceed the number of jobs lost and therefore keep the Nation at full employment.

Although there is a lot of criticism about free trade, we at the Wayne County Airport Authority think that Detroit Metro Airport is a vital connection for the State to the global economy and we will continue to progress. The following summarizes DTW's passenger and cargo air service to important Asian destinations.

a) Detroit's business ties to the Asian region are largely born from the auto industry. In addition to being the home to numerous parts manufacturers that do business with Asian car companies, Metro Detroit is also home to satellite facilities for companies such as Hyundai and Kia. R&D in a number of areas also creates traffic between the USA and Asia. The Hybrid Research Center in Dearborn is a great example of a cross-manufacturer facility that needs air access from automakers located all over the world.
b) Detroit's non-stop ties to Asia mean that Detroit is the 7th largest U.S. gateway city to Asia, carrying nearly ¾ of a million passengers per year between the USA and Asia on non-stop flights. Excluding West Coast cities which have greater geographic and ethnic ties, Detroit is 3rd behind only New York and Chicago.
c) Removing connecting passengers, Detroit is the 12th largest market to Asia from the USA. Nearly ¼ of a billion dollars is spent flying between Detroit and Asia each year. Detroit is the 8th largest market to Asia excluding the West Coast cities.
d) Detroit has a growing Indian population centered in Canton and Dearborn. India is now the largest air market from Detroit without non-stop service.
e) The use of the shorter polar route to Asia has made Detroit the quickest routing to Asia from the most populous areas of the USA. Flights from the East Coast fly north to Detroit and then connect to Asian non-stops which continue north until they cross the North Pole on their way to Korea, China, and Japan.

Detroit has non-stop service to Tokyo and Nagoya, Japan as well as non-stops to Shanghai, China that commenced during 2009. Delta has announced that in June 2010, DTW will gain non-stops to Hong Kong, China and Seoul, Korea as well as long-haul service to Honolulu, Hawaii

In my opinion the emergence of collaboration in business and finance has developed as the most important reason for our continued need to be interested in Asian countries and their economies. Many Asian countries offer advantages to American, Japanese and European Union business interests through collaboration that firms are not able to achieve independently. Tom Friedman in his book "The World is Flat, published in 2005" defined collaboration as the following:

What is Collaboration? "A structured, recursive process where two or more people work together toward a common goal-typically an intellectual endeavor that is creative in nature-by sharing knowledge learning and building consensus. Collaboration does not require leadership (government) and can sometimes bring better results through decentralization."

The tools of collaboration in business have an origin in technology and the use of the internet. Business has also participated in outsourcing and off-shoring as a result of collaboration, and this has resulted in labor going to the lowest most reliable cost producers in many cases outside of North America. Collaboration increases on a daily basis as nations learn how to benefit from free trade and how to compete in business using the tools of technology and prosper as a result of trade. According to the book "Sonic Boom," the result of free trade has been to lift hundreds of millions out of poverty by creating jobs in China and other developing nations. Free trade has also produced new jobs in North America, Japan and the European Union especially for knowledge and service workers. Technology and free trade have also helped to created personal freedoms in China, India, Russia and East Germany because these countries have learned that these tools provide uncontrollable information about prosperity in the western world. Learning about democracy and western culture has occurred in China and other developing countries and controlled economies without firing a single bullet.

The publication The Economist in its 2006 report "Companies without borders, collaborating to compete" (attached) analyzes why companies collaborate. While the study is focused on the responses of senior executives from British based companies, its results also apply to global corporate management. In the study, executives report that the biggest challenge involves finding suitable partners, but once partners are identified and ranked, the following is important:

Drivers of Corporate Collaboration

1. Providing a wider range of products than possible alone
2. Meeting consumer expectations
3. Keeping up with competitors
4. Expanding global reach/coverage
5. Focusing on core competencies
6. Reducing cost

Corporate Departments Most Active in Building Collaborative Relationships

1. Sales and Marketing
2. Information Technology
3. Product Research and Development
4. Market Research
5. Purchasing/Supply Chain Management
6. Finance
7. Risk Management

Author David Smick believes that a general lack of confidence in market rules, such as taxation and government regulation and the additional problems created by the lack of financial transparency in financial markets are essentially the root causes of our current economic conditions. David Smick states *"...globalization, while creating enormous wealth, has produced widespread anxiety. Job outsourcing, once limited to relatively unskilled labor, now poses the appearance of a real threat to middle class jobs. The truth is that America so far has been a massive net insourcer, not outsourcer, of jobs. Foreigners invest a half trillion dollars more in the United States than Americans invest abroad, which is one reason the United States creates a net two million new jobs every year.*

Global financial markets have also been a source, along with US markets, for financing the global entrepreneurial revolution through venture capital. In essence globalization has also helped to finance innovation in technology and business. Unfortunately, being globally interconnected makes us feel vulnerable due to a lack of control over events.

The US represents the largest and most important market for autos and other consumer goods for many Asians. This view was expressed to me on several occasions during my 2006 visit to China that Detroit's historical role in the automotive industry appears still to be revered by the Chinese. While these views represent admittedly gross generalizations of Asian thought and attitudes concerning our markets, my visit to China has convinced me of its truths.

In the book Sonic Boom, the author describes the explosive growth of Shenzhen China, a city that grew from a very small fishing village into a population of almost nine (9) million residents. Shenzhen's growth has been the fastest of any important city in the history of the world, basically in less than forty years. Shenzhen is home to the second leading manufacturer of batteries, the BYD Company, and batteries represent the most common export from the region. BYD Company did not exist until 1996, yet the company's goal is to become the world leader in manufacturing electric cars. Crain's Detroit Business reported in an article in January 14, 2008 (see attached) that BYD Auto Company displayed vehicles at the 2008 North American International Auto Show in Detroit.

The US Auto Market has now or will soon fall to China in terms of projected new vehicle sales (units sold) within its domestic market. According to an August 3, 2009 article of the Global Times only the "cash for clunkers" stimulus program may save the USA as the largest market. USA Today in its June 14, 2009 article "China's car sales boom, reshaping a way of life" predicted that China would have domestic sales of 11,000,000 vehicles versus 10,000,000 vehicles for the US market by year end 2009. To be fair I understand that there is a significant quality difference between cars produced by Chinese manufacturers selling for less than $6,000 and American manufactured products. I remember though that quality superiority was also the claim against the Japanese manufactures when they began to sell vehicles in the US and now Japan's auto makers may set today's quality standard. China, due to its size, could influence how and what autos of the future look like and what features are sold.

According to the December 31, 2009 Wall Street Journal (see attached), China is the biggest owner of US Treasury Debt, purchasing a net additional $71.5 billion through the end of October 2009 and Japan is second, purchasing $120.5 billion in the same period. US Treasury Bonds and Notes are the highest quality security in the debt market, since they are backed by the full faith and credit of the US government and tax payers. China owned almost $800 billion of the $14 trillion outstanding US debt as of September 30, 2009 and represents the largest buyer every time the US Treasury issues new debt. The bond market essentially prices a bond based upon credit quality and other factors, but also because of simple supply and demand. Therefore the prices of US Debt (interest rates) have an inverse relationship to demand for debt (see Price of Debt chart attached).

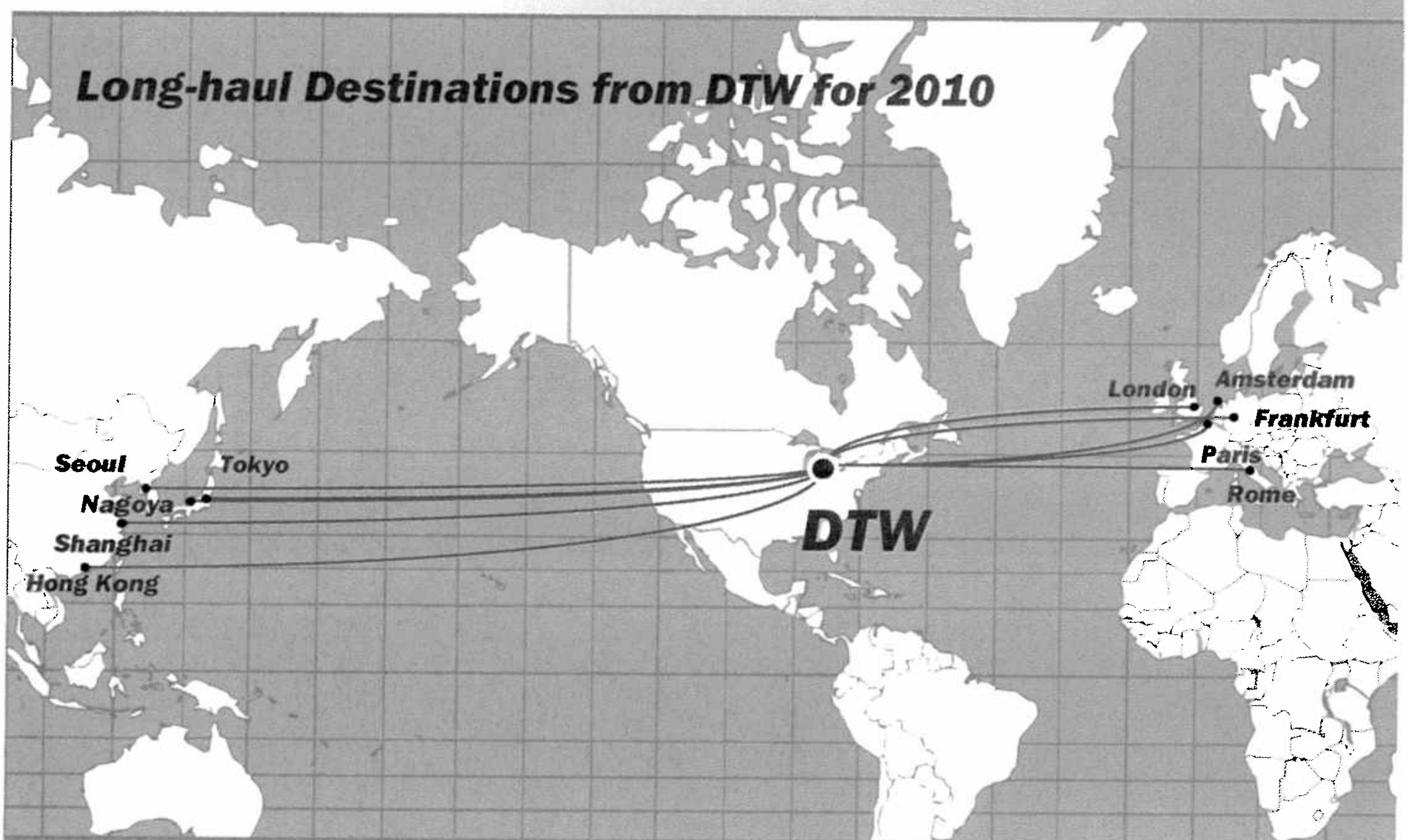
I have been asked what would happen if we refused to sell our bonds to China and only borrowed from other sources. Probably the first reaction is that China would retaliate with sanctions against America in response to our policies. But the most important impact is that the cost of our debt would go up due to reduced demand to purchase our debt. The increased cost of US Treasury debt has a direct effect on the price of the US Mortgage and consumer debt markets. Therefore not doing business with China will cost us all more and have a direct impact on our economy. Complicating the question of new foreign investment in US Treasury debt is the development of "sovereign wealth funds" and their investments in US and other western national industries and banks. According to The World is Curved the Chinese made a $3 billion investment in the private equity firm Blackstone Group L.P. in July 2007 and in December 2007 China Investment Corporation bought a 9.9% equity participation in Morgan Stanley. China is not alone in making substantial investments in the US as Dubai International Capital has also been very active by investing in hedge funds and banks. We must remember that China's investment in America is not a one way street. Any investment carries risk along with it. As one of the largest investors in the American economy, Chinese investments have also suffered with the wave of bankruptcies that have rippled through our economy. They've also felt the financial pain we've felt as their investments were wiped away in numerous U.S. companies undergoing restructuring.

We also make investments through American capital into other countries' industries, so the capital flows back and forth in search of higher earnings. I am aware that both General Motors and Ford Motor have made investments in joint ventures in China, just to mention a Michigan connection.

Realizing that there are many controversial issues surrounding free trade and the impact of the global economy, my testimony today is not to try and persuade anyone on one side or another.

Instead, I want to explain why Detroit Metro Airport and Willow Run Airport have and will continue to expand partnerships with Asia. I also want to raise awareness about how interconnected our economies have become and to provide some basis to recognize how important Asia has become. With 35 million passengers that fly out of Detroit Metro Airport alone, we will continue to develop new opportunities with Asia and the Pacific Rim.

While Serving the World...



DETROIT METRO • WILLOW RUN
WAYNE COUNTY AIRPORT AUTHORITY

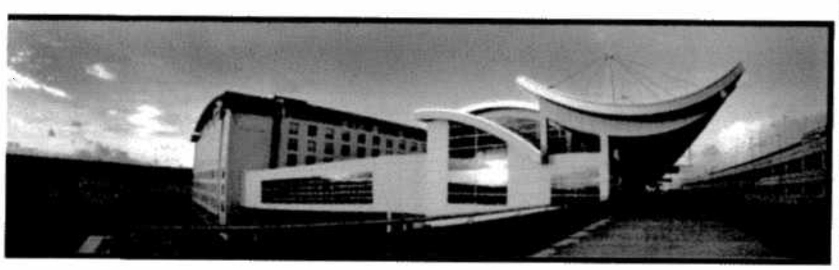
With Air Service from...

...To more than 150 nonstop destinations around the globe

Detroit Metropolitan Airport (DTW)
Vital Statistics

- Key hub for the world's largest airline (Delta), providing one of the most modern & efficient terminal / airfield facilities around the globe.
- 13th busiest airport in North America
- 35,135,828 passengers served in 2008
- 462,700 take-offs and landings (operations) in 2008
- 465,149,279 lbs of cargo in 2008
- 1,015,000 sf of cargo/hangar space
- Over 600 Wayne County Airport Authority employees
- 325 Customs and Border Protection (CBP) employees based at DTW
- More than 17,000 badged employees

- **$7.6 Billion** in Economic Impact, supporting over 71,000 regional jobs, and creating an annual payroll of approx. $2 Billion



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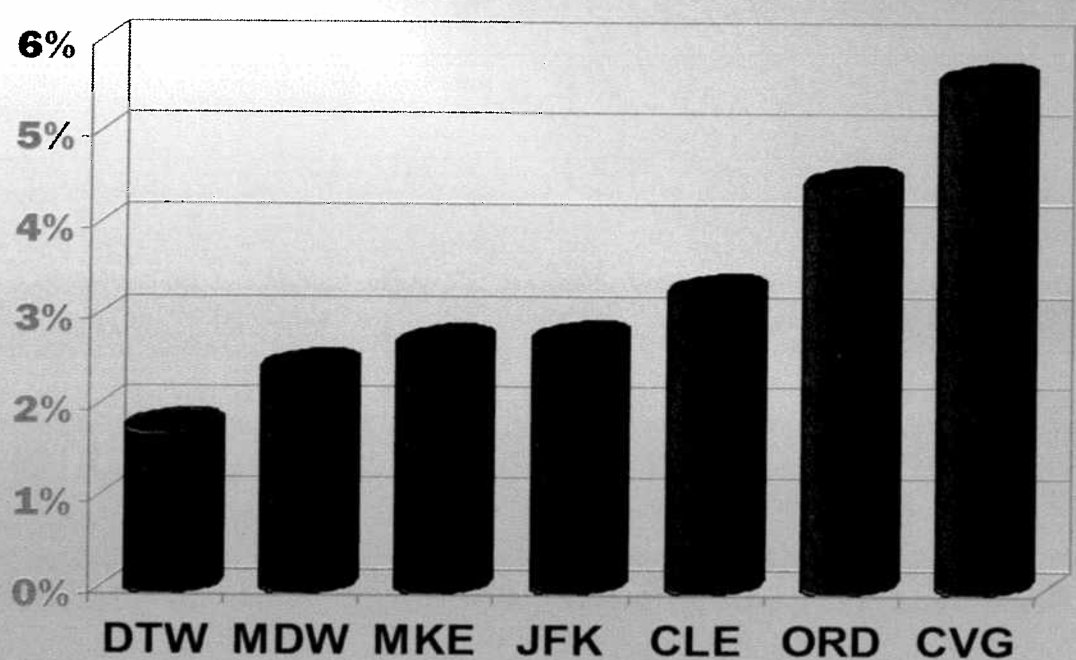
DTW Leads Area Hubs in Winter Reliability

- *Despite a hard Winter, Detroit's modern airfield translates into fewer cancellations*

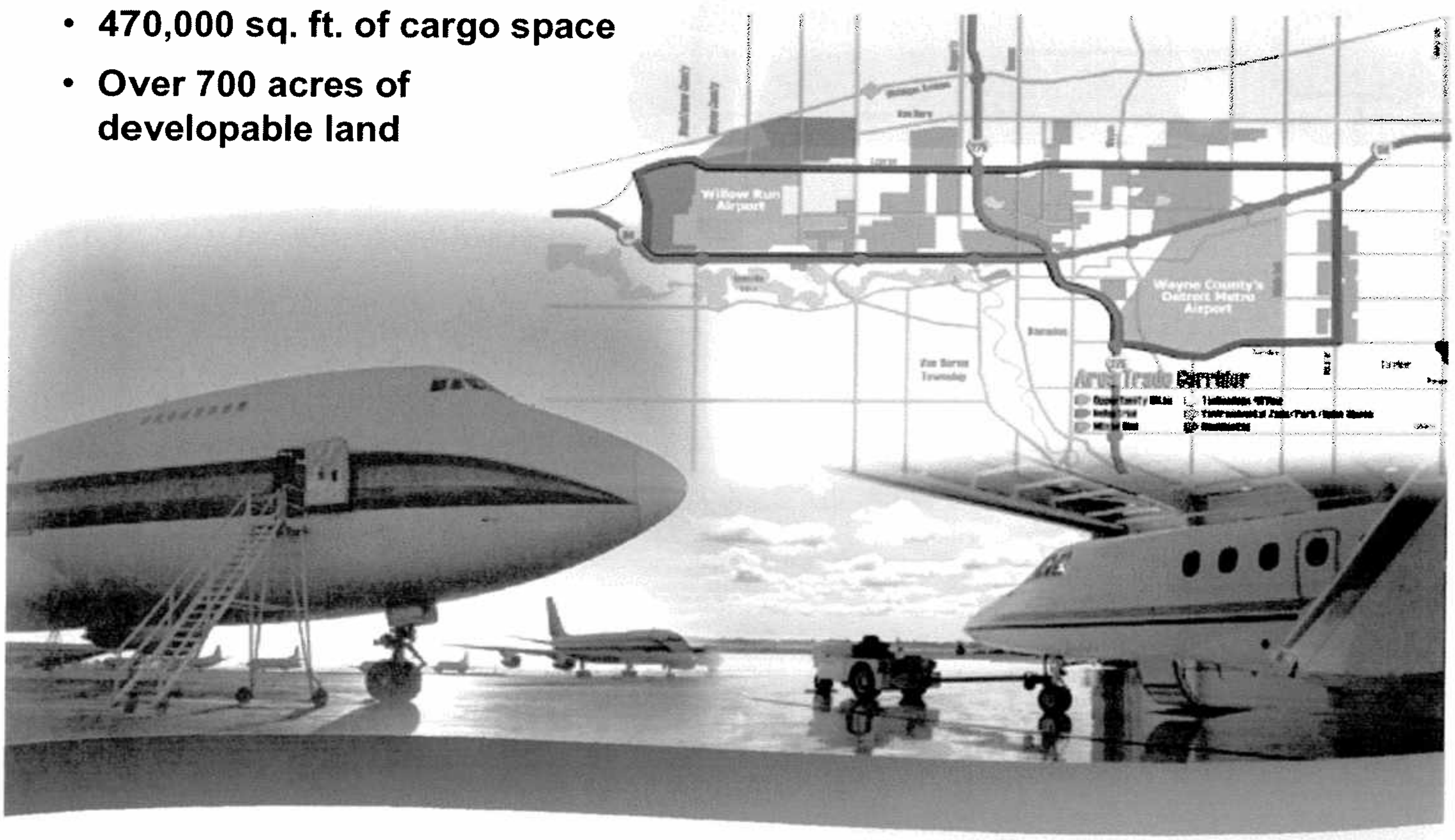
Flight Cancellation Rate
Jan 2009, DOT



Willow Run Airport (YIP)
Vital Statistics

- One of the busiest on-demand cargo airports in the country
- Designated reliever airport for Detroit Metro Airport (DTW)
- Twenty-four hour tower operations, fire and rescue, snow removal and U.S. Customs Service
- Excellent location seven miles West of DTW, with ready access to major corporations, educational institutions, freeways, waterways and rail lines

- 78,818 take-offs and landings (operations) in 2008
- Nearly 160 million lbs. of cargo in 2008
- Over 5.5 million gallons of fuel sold in 2008
- 470,000 sq. ft. of cargo space
- Over 700 acres of developable land



DETROIT METRO • WILLOW RUN
WAYNE COUNTY AIRPORT AUTHORITY

International Collaboration

WHAT IS A COLLABORATION?

"…a structured, recursive process where two or more people work together toward a common goal – typically an intellectual endeavor that is creative in nature – by sharing knowledge, learning and building consensus. Collaboration does not require leadership and can sometimes bring better results through decentralization."

HOW CAN WE COLLABORATE?

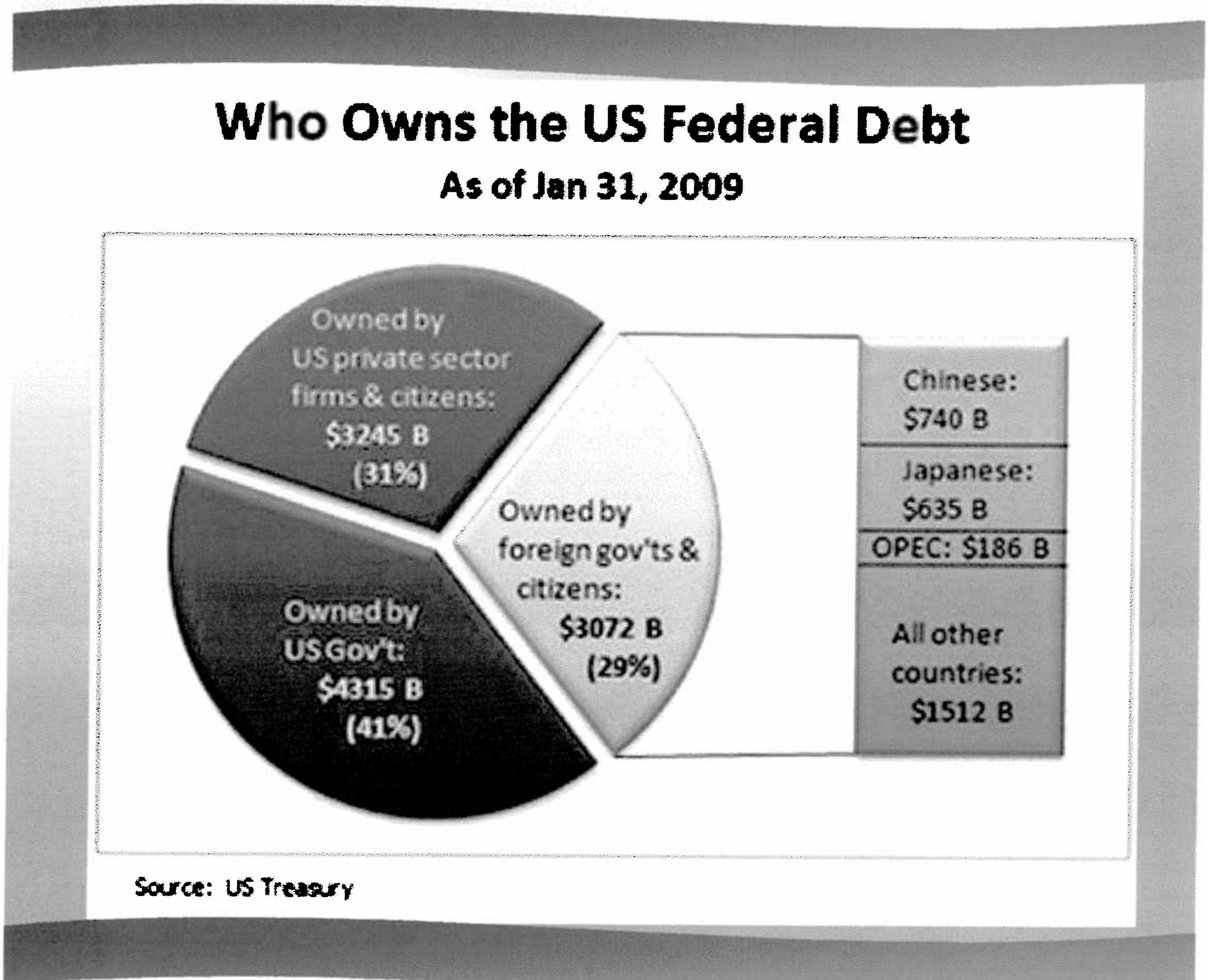
Same Time / Different Place

Audio & Video Conferencing
Screen Sharing
Instant Messaging
Text Messaging

Different Time / Different Place

Email, Voicemail, Fax,
Shared Databases,
Collaboration Tools/
File Systems

China owns more US debt than any other country



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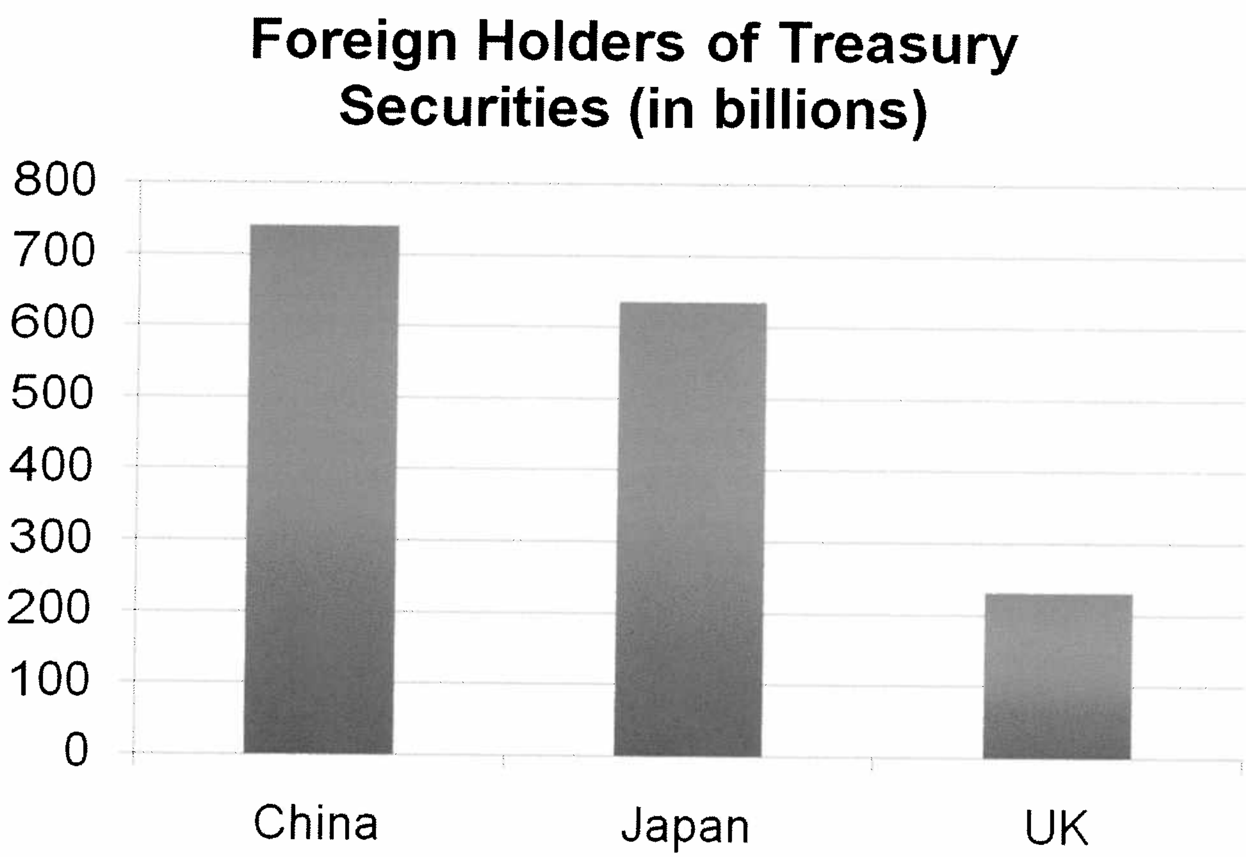

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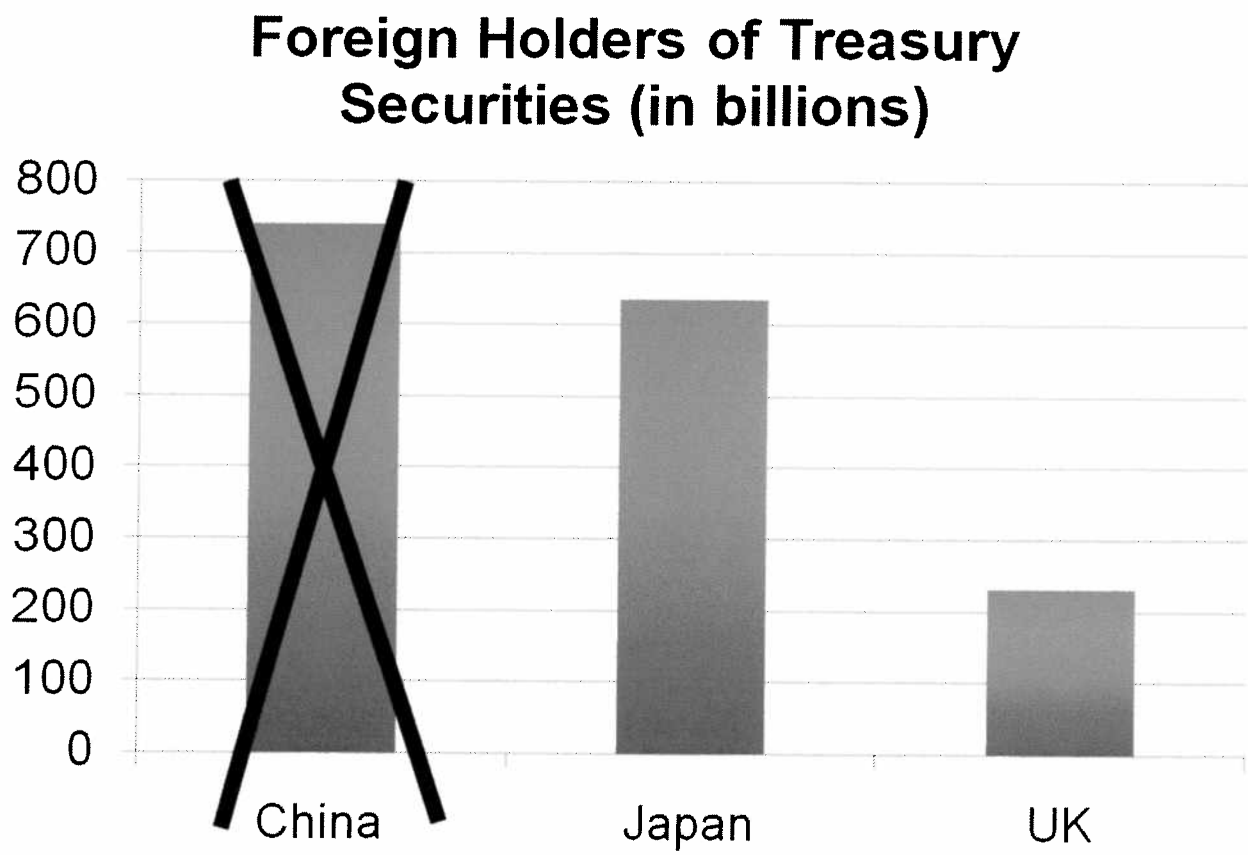
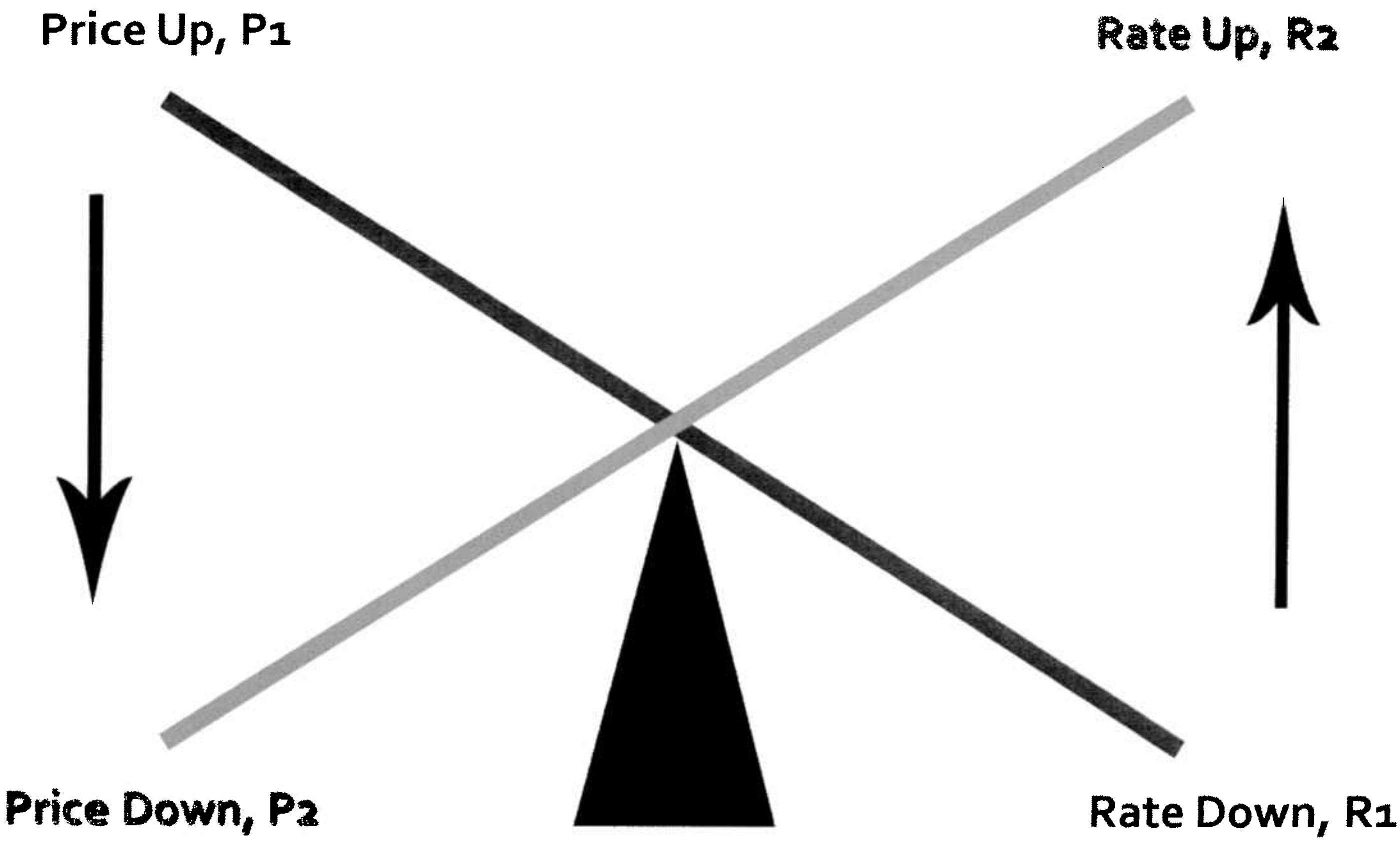


Bonds – Price & Rate



Shenzhen, China

It's the world's fastest growing city. Since the 1970s, it has grown from a rural city to a population of over 9 million people.

Shenzhen is the most active area in China, combining the cheap labor force, advanced management and convenient transportation, just a bridge away from Hong Kong.

Core industries include consumer goods like textile, furniture, toys, gifts , IT products, petrochemicals, machineries, building materials and others. More than 60% of products are for export.

Shenzhen's battery and electric car company, BYD Co, is looking to build strategic North American relationships for new vehicle energy projects, including battery production & automotive research.

For the first time in history, China sold more cars than the U.S. Without international partnerships, we risk allowing China to become the automotive leader.

BYD plans Shenzhen float

Last Updated(Beijing Time):2009-09-11 09:59

Battery and electric car producer BYD Co plans to list itself on the Shenzhen Stock Exchange next year with a 100 million share issue to raise funds for its new energy vehicle projects, according to a senior company official.

The Hong Kong-listed company, partly owned by US billionaire Warren Buffet, got the necessary shareholder approval for the public float at the annual general meeting held in Shenzhen on Tuesday.

"We expect to complete the entire listing procedure before Sept 7 next year," Wang Jianjun, deputy general manager of BYD Auto Sales Co Ltd, told China Daily.

The company had last year toyed with the idea of a mainland public float of 58.5 million shares on the Shenzhen or Shanghai bourse. The present plan to raise funds is a revival of that proposal which was put on hold after China suspended IPO approvals for nearly a year due to the global financial crisis.

Proceeds from the issue would mainly be used for funding the company's lithium-ion battery production, automobile research and development, expansion of products and parts, as well as a solar battery program, with the rest to be used for working capital needs, said Wang.

"BYD will focus on the development of electric cars in the next few years and would make further efforts to lower costs and improve the performance of BYD electric vehicles, to popularize it among Chinese consumers," he said.

BYD will also start selling its F3DM plug-in hybrid cars to individual consumers from next month.

The hybrid model also figures in the first batch of new-energy vehicles that have got regulatory approval for production and sale from the Ministry of Industry and Information Technology.

"We are applying for the government subsidy for our F3DM, which qualifies for the highest level of as much as 50,000 yuan per unit," said Wang. "The subsidy will help promote the sales of clean vehicles."

BYD's Chairman Wang Chuanfu said earlier this month that billionaire Buffett is contemplating increasing his 10 percent stake in the company. Buffett had acquired the 10 percent stake for $230 million last September.

Since the deal was announced, the automaker jumped fivefold in Hong Kong trading helped by Buffett's investment and rising demand for fuel-efficient vehicles. Buffett's Berkshire Hathaway Inc has also earned a $1 billion paper profit from its investment.

BYD aims to more than double vehicle sales this year to 400,000 units. First-half sales more than doubled to 176,814, helped by demand for the F3, China's fourth bestselling car, according to the China Association of Automobile Manufacturers.

Source:China Daily

Print

CRAIN'S DETROIT BUSINESS
Detroit and Southeast Michigan's premier local business news and information Web site

3:01 a.m., Jan. 14, 2008

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Selling Michigan: R&D pushed as reason for Chinese to locate in state

By Marti Benedetti
Special to Crain's Detroit Business

Rated Not yet rated
Rate This ☆☆☆☆☆

Southeast Michigan economic-development organizations are racking up plenty of airline miles to China.

Their mission: Develop and nurture relationships with Chinese manufacturers that could lead to more automotive research and development operations in Michigan.

Five Chinese automotive companies are participating in the **North American International Auto Show** this year — four more than last year. That means potential opportunities for economic-development organizations to promote Michigan's R&D brainpower and sell the state as a place to invest.

"Most are in need of R&D because they want to improve the quality of the cars they sell in China and eventually hope to sell in the U.S.," said Yvonne Warmbier-Ramp, director of the State of Michigan China Office. "Many of them are also looking for strategic relationships with North American automakers or parts suppliers."

Other Chinese executives are looking for management training or seek to recruit Michigan automotive engineers.

Warmbier-Ramp lives in China and has had her job with the state for 10 years. She comes back to Michigan on business twice a year, including to attend the Detroit auto show.

Coming to town

The first Chinese automaker to exhibit at NAIAS was **Geely International** in 2006.
Last year, the **Changfeng Motor Group** participated.
This year, those two will be joined by **BYD Auto Co.**, **China America Cooperative Automotive Inc.** (Chamco) and **Li Shi Guang Ming Auto Design Co.**
For *Automotive News*' take on these automakers: **www.crainsdetroit.com/naias**.

Auto show dates

Press preview: Today and Tuesday.
Industry preview: Noon-9 p.m. Wed. and 7 a.m.-9 p.m.Thursday
Charity preview: 5 p.m. Friday
Open to public: 9 a.m.-10 p.m. Saturday through Jan. 26; 9 a.m.-7 p.m. Jan. 27

Watch the Web

Check out *Crain*'s auto show coverage at www.crainsdetroit.com/naias.

Warmbier-Ramp said her office is focused on the Chinese automakers participating in the show and other Chinese original-equipment manufacturers and tier-one suppliers.

"First we educate them on what Michigan has to offer. Then we try to find out what their needs are as a developing automaker or parts supplier and try to give them more defined assistance based on their needs and its benefit to the state."

Carroll

Long courtship

The Troy-based **Detroit Auto Dealers Association**, which hosts the show, began courting Chinese manufacturers more than three years ago to participate at the Detroit show.

The first Chinese automaker to exhibit at NAIAS was **Geely International** in 2006. Last year, the **Changfeng Motor Group** participated. This year, those two will be joined by **BYD Auto Co.**, **China America Cooperative Automotive Inc.** (Chamco) and **Li Shi Guang Ming Auto Design Co.**

The increased Chinese presence has been an organizing rally for economic-development groups such as the **Michigan Economic Development Corp.**, **Ann Arbor Spark**, the **Detroit Regional Chamber**'s **Detroit Regional Economic Partnership** and Wayne and Oakland county economic-development departments.

The organizations are working apart and together with the goal of bringing Asian and Indian companies to Michigan. Meaningful progress, these economic leaders say, is made by understanding opportunities and working persistently.

John Carroll, executive director of the partnership, said industry watchers estimate there are roughly 120 Chinese automakers now, but a major shakeout over the next 10 to 15 years could leave just 10 of them standing — a situation not unlike the dozens of auto companies in Detroit in the first quarter of the 20th century.

Carroll said success in attracting investment from the stronger companies that survive requires building long-term relationships. The DREP regularly sends out e-mails with positive news stories about the region to 8,000 companies worldwide.

"We've been working the Chinese market for 10 years," Carroll said. "There's about 2,000 companies in China we've met, and there are about 200 companies we call prospects."

Finney

Working together

By working together on pitches, organizations say they are using resources more effectively.

"We've taken a look at business opportunities in China and the Middle East. We have limited resources, so we tried to be opportunistic," said Michael Finney, CEO of **Ann Arbor Spark**, which is working with both the MEDC and Wayne County.

Finney said the first priority is selling Michigan as a whole to Chinese businesses.

"If we get interest, we think they might want to locate research and development activity in the Ann Arbor area.

"We've also had meaningful discussions with Wayne County and expect more of that to come," he said.

Carroll said the partnership works with Wayne County on attracting business from Asia. A recent success story was persuading a division of Chinese supplier **Tempo Group** to open an R&D center in Canton Township last year.

Carroll said DREP also will work with the MEDC on getting Indian firms interested in doing business in the state. It aids Automation Alley on export missions, and it is in the process of formalizing a partnership with Ann Arbor Spark. It also interacts with **Oakland County Planning & Economic Development** on business attraction and a little with the **Macomb County Economic Development Corp.**

Trade missions

Warmbier-Ramp said the state plans to lead its first "State of Michigan Reverse Investment Mission" from China to Michigan in April.

During the trip, Warmbier-Ramp hopes to "showcase the state as having the type of knowledge and workers that their businesses need to succeed in the global marketplace."

In addition to Warmbier-Ramp's work, the MEDC actively works with the **Michigan Global Partnership** in organizing biannual working missions to China to recruit Chinese companies to Michigan.

The global partnership is composed of economic-development agencies throughout Michigan as well as private companies that have an interest in recruiting investment from China. It started as an MEDC initiative.

Among the MEDC's recent success stories was the October news that **NEAPCO Driveline,** a subsidiary of a company that is a North American affiliate of **Wanxiang Group,** a Chinese supplier, would invest in a $29.4 million Detroit-area manufacturing plant. The plant will create 285 new jobs at a former **Johnson Controls Inc.** -site in Van Buren Township.

Meanwhile, Carroll said DREP's Bernard Pekor, director of new markets and Asia, talks regularly with overseas business owners. He makes about four trips a year to Asia, and Carroll goes once a year. The partnership has talked with Changfeng, Geely and met representatives from BYD Auto in October at a seminar in Beijing and also is in communication with Chamco.

"We tell them if they are going to do something in the U.S., they need to be in Detroit," Carroll said.

He pointed out that Asian automakers **Toyota**, **Hyundai** and **Nissan** already have technical hubs in Michigan.

But those who are trying to woo other Chinese companies to the state said it is a long-term process that can take years. The state is working many leads, including companies the state assisted with initial visits, Warmbier-Ramp said.

"We have been in contact with hundreds of Chinese companies over the past three years," she said.

Some of the area's leading suppliers are already ahead of the game on building relationships with the Chinese.

Manley Ford, director of communications for Livonia-based **TRW Automotive Holdings Corp.**, said that while TRW does a significant amount of business in China, it is doubtful there will be many meetings with the Chinese this week at the auto show.

"We work very closely with all the Chinese automakers in China, and just about everything in our portfolio is made in China. Very little of it is exported," Ford said. "So we're already pretty well established with the Chinese companies."

Reporter Brent Snavely contributed to this story.

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CREDIT MARKETS | DECEMBER 31, 2009

Treasury Debt Sales Top $2.1 Trillion for Year

By MIN ZENG

Wednesday's successful $32 billion seven-year note auction wraps up a record year of debt sales by the U.S. government.

The Treasury sold more than $2.1 trillion in notes and bonds this year, more than in the previous two years combined, to fund a widening budget shortfall and finance programs to rescue the banking system and support the economy.

Yet, despite the supply onslaught, buyers—from foreign central banks to U.S. households and domestic commercial banks—flocked to the sales. As a result, the government's borrowing costs fell to historic lows in 2009. That provided further support to the economy because Treasury rates are the benchmark for many types of corporate and consumer borrowing.

Strong demand for U.S. debt came when the U.S. economy was in dire straits, with unemployment rising as high as 10.2% and the government's deficit ballooning to $1.4 trillion in the fiscal year to September 2009. Beside the prospect of a recovering economy, concerns that buyers could stay away from this week's record-tying $118 billion in note sales led to a sharp spike up in Treasury yields in December. Two-, five- and 10-year yields rose to their highest levels since mid-August this week.

The average yield in the two-year note auctions dropped to 1.002% in 2009, down sharply from 2.078% in 2008 and 4.307% in 2007, according to Ian Lyngen, senior government bond strategist at CRT Capital Group LLC. The average auctioned yield for the 10-year note fell to 3.262% from 3.681% last year and 4.632% in 2007, he said.

Wednesday afternoon, the benchmark 10-year note was up 6/32 point, or $1.875 per $1,000 face value, at 96 21/32. Its yield fell to 3.786% from 3.809% Tuesday, as yields move inversely to prices. The 30-year bond was up 22/32 point to yield 4.605%.

"It is a victory for the U.S. government," said Amitabh Arora, head of Citigroup Global Markets' U.S. rate-strategy group. Had the auctions not gone so well, he said, interest rates would be much higher, raising borrowing costs for homeowners and companies.

But, for investors, Treasurys weren't such a good investment as an improving economy boosted the returns on riskier assets such as stocks and corporate bonds. After a 14% return in 2008, Treasurys have handed investors a loss of 3.43% through Tuesday in 2009, putting them on pace for the worst annual return since at least 1973, according to data from Barclays. In contrast, U.S. high-yield corporate bonds have delivered a return of 57.9% this year.

Nonetheless, demand at Treasury auctions remained resilient throughout the year as the Federal Reserve held rates near zero amid the still fragile economic recovery and subdued inflation pressures. The Fed's $300 billion Treasury-buying program to support the economy also helped, while many foreign central banks bought Treasurys as a way to temper gains in their own currencies, which would have undermined their exports.


TIMOTHY GEITHNER

Foreign investors, including central banks and private investors, are forecast to buy a net $333 billion in Treasury notes and bonds this year, up from $315.4 billion for 2008 and the average of $282.9 billion from 2003 to 2007, according to a research report earlier this month by Mr. Arora and colleague Vikram Rai. The strategists expect net buying from foreign investors to be $325 billion in 2010.

China, the biggest owner of Treasurys outside the U.S., bought a net $71.5 billion through the end of October, according to the latest data from the Treasury Department. Japan, the second-largest foreign holder of Treasurys, was the biggest buyer this year, with a net purchase of $120.5 billion over the same period.

Next year, the Treasury is expected to sell about $2.45 trillion in notes and bonds, setting another record. But yields may need to rise to entice buyers, particularly as the economic recovery gathers pace. Treasury Secretary Timothy Geithner said recently the economy is growing again and that job losses are expected to come down rapidly. That makes it attractive for investors to hold riskier assets in seeking better returns.

The U.S. government also will face more competition for investors' dollars as the broader credit markets recover from the financial crisis and the sale of corporate debt and mortgage-backed securities picks up.

The Fed's decision to end its $1.25 trillion purchase program of mortgage-backed securities in March next year, as well as expectations that the central bank could start to raise interest rates again to keep inflation risks at bay, will also push up Treasury yields.

"We expect 2010 to be a tougher year for the Treasury to sell record amounts" of securities, said Adam Brown, managing director of Treasurys trading at Barclays Capital Inc. in New York.

Icahn Goes to Market

Icahn Enterprises LP is offering $2 billion in new senior bonds, its first such sale since 2005.

The notes will fund the buyback of $967 million of 7.125% senior notes due 2013 and $353 million of 8.125% senior notes due 2012 at a total consideration of just over 102 cents on the dollar.

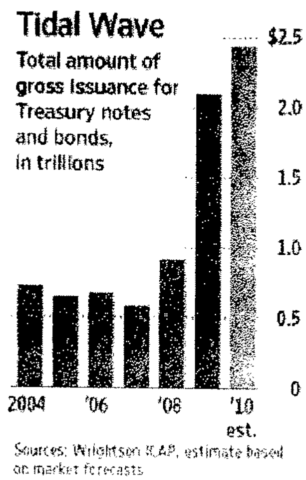
"It's nice for the bondholders, taking them out early and giving them a little extra premium above par value," said Barbara Cappaert, an analyst at high yield bond research firm KDP Advisors. "It also takes care of refinancing risks in 2012 and 2013."

The investment management firm, controlled by activist investor Carl Icahn, didn't announce the maturity of the new bonds, which is being handled through private placement, so there was no disclosure in public filings.

Chief Financial Officer Dominick Ragone on Wednesday declined to comment further on the offering.

The company also said in a statement it is in negotiations to acquire majority equity stakes in American Railcar Industries Inc. and food packaging firm Viskase Companies Inc., in each case from affiliates of activist investor Carl Icahn.

"The company will now have a good war chest to go out looking at other investments," Ms. Cappaert said, noting that Icahn Enterprises is using equity to fund the two company acquisitions and has historically been careful to maintain a large cash balance. "It will be interesting to see what sectors they see value in and decide to go after."



Many companies over the past year have bought back bonds due in the next few years and sold new, longer-term bonds to benefit from low rates now.

"It makes sense, taking advantage of the cheap capital sloshing around the system," said portfolio manager William Larkin at Cabot Money Management.

Icahn Enterprises' 7.125% notes due 2013 gained 1.35 points to 100.5 on Wednesday in thin late-December trade, according to online bond trading platform MarketAxess, which didn't list any trades for the 8.125% senior notes due 2012.

Moody's Investors Service rates Icahn Enterprises as Ba3, and Standard & Poor's puts it as BBB-, the last rung before junk status.

Mr. Icahn has taken positions in companies ranging from Take 2 Interactive Software Inc. to CIT.

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About.com US Economy

The U.S. National Debt and How It Got So Big

By Kimberly Amadeo, About.com Guide

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(Credit: Getty Images)

What the U.S. National Debt Is:

(Updated December 21, 2009) The U.S. debt is over $12 trillion, and is the sum of all outstanding debt owed by the Federal Government.

Nearly two-thirds is the public debt, which is owed to the people, businesses and foreign governments who bought Treasury Bills, Notes and Bonds.

The rest is owed by the government to itself, and is held as Government Account securities. Most of this is owed to Social Security and other trust funds, which were running surpluses. These securities are a promise to repay these funds when Baby Boomers retire over the next 20 years. (Source: U.S. Treasury, Debt to the Penny; Debt FAQ)

The Size of the U.S. Debt:

The U.S. debt is the largest in the world. How did it get so large? Purchasers of Treasury Bonds still reasonably expect the U.S. economy to recover enough to pay them back. For foreign investors like China and Japan, the U.S. is such a large customer it is allowed to run a huge tab so it will keep buying exports. (Source: CIA World Factbook)

Even before the economic crisis, the U.S. debt ballooned 50% between 2000 - 2007, growing from $6 - $9 trillion. The $700 billion bailout helped the debt grow to $10.5 trillion by December 2008.

The U.S. Debt Level:

The debt level is the debt as a percent of the total country's production, or GDP. Total economic output, or GDP, is $14.4 trillion. The debt is now 83% of GDP, up from 51% in 1988. (Source: U.S. Treasury, Debt to the Penny; Bureau of Economic Analysis)

Interest on the debt was $451 billion in Fiscal Year 2008, but dropped to $383 billion by 2009. (Source: U.S. Treasury, Interest)

The most recent budget forecast from the Office of Management and Budget (OMB) showed the budget deficit rising $1.7 trillion in FY 2009 and $1.17 trillion in FY 2010. This will easily increase the debt to over $13 trillion by 2013. This is a result of the economic stimulus package and the 2008 government bailout measures. The OMB forecast assumes the EGTRRA and JGTRRA tax cuts will not be extended and that the Alternative Minimum Tax would not be modified - both unrealistic assumptions. (Source: OMB, Federal Budget Deficit)

How Did the Debt Get So Large?:

Government debt is an accumulation of budget deficits. Year after year, the government cut taxes and increased spending. In the short run, the economy and voters benefited from deficit spending. Usually, however, holders of the debt want larger interest payments to compensate for what they perceive as an increasing risk that they won't be repaid. This added interest payment expense usually forces a government to keep debt within reasonable limits.

The U.S., however, was the beneficiary of two unusual factors. First, the Social Security Trust Fund took in more revenue through payroll taxes leveraged on Baby Boomers than it needed. Ideally, this money should have be invested to be available when the Boomers retire. In reality, the Fund was "loaned" to the government to finance increased deficit spending. This interest-free loan helped keep Treasury Bond interest rates low, allowing more debt financing.

However, it is not a real "loan" since it can only be repaid by increased taxes when the Boomers do retire.

Secondly, foreign countries increased their holdings of Treasury Bonds as a safe haven, also keeping interest rates low. These holdings went from 13% in 1988 to 28% in 2009. (Source: U.S. Treasury report "Petrodollars and Global Imbalances", February 2006)

Even during the recession, countries like China and Japan increased their holdings of Treasuries to keep their currencies low relative to the dollar. For more, see How China Affects the U.S. Economy.

Of the total foreign holdings ($3.5 trillion), China owns $800 billion (% and Japan owns $751 billion. The U.K., Brazil and the oil exporting countries own about $100 - $250 billion each. The Bureau of International Settlements suspects that much of the holdings by Belgium, Caribbean Banking Centers and Luxembourg are fronts for various oil-exporting countries or hedge funds that do not wish to be identified. (Source: Foreign Holding of U.S. Treasury Securities)

How The U.S. Debt Affects the Economy:

Over the next 20 years, the Social Security funds must be paid back as the Baby Boomers retire. Since this money has been spent, resources need to be identified to repay this loan. That would mean higher taxes, since the high U.S. debt means further loans from other countries have been maxed out. Unfortunately, it is most likely that these benefits will be curtailed, either to retirees younger than 70, or to those who are high income and therefore theoretically don't need Social Security.

Secondly, many of the foreign holders of U.S. debt are investing more in their own economies. Over time, diminished demand for U.S. Treasuries will increase interest rates, thus slowing the economy.

Furthermore, this lessening of demand is putting downward pressure on the dollar. That's because dollars, and dollar denominated Treasury Securities, are becoming less desirable, so their value declines. As the dollar declines, foreign holders get paid back in currency that is worth less, which further decreases demand.

The bottom line is that the large Federal debt is having a slowing effect on the U.S. economy.

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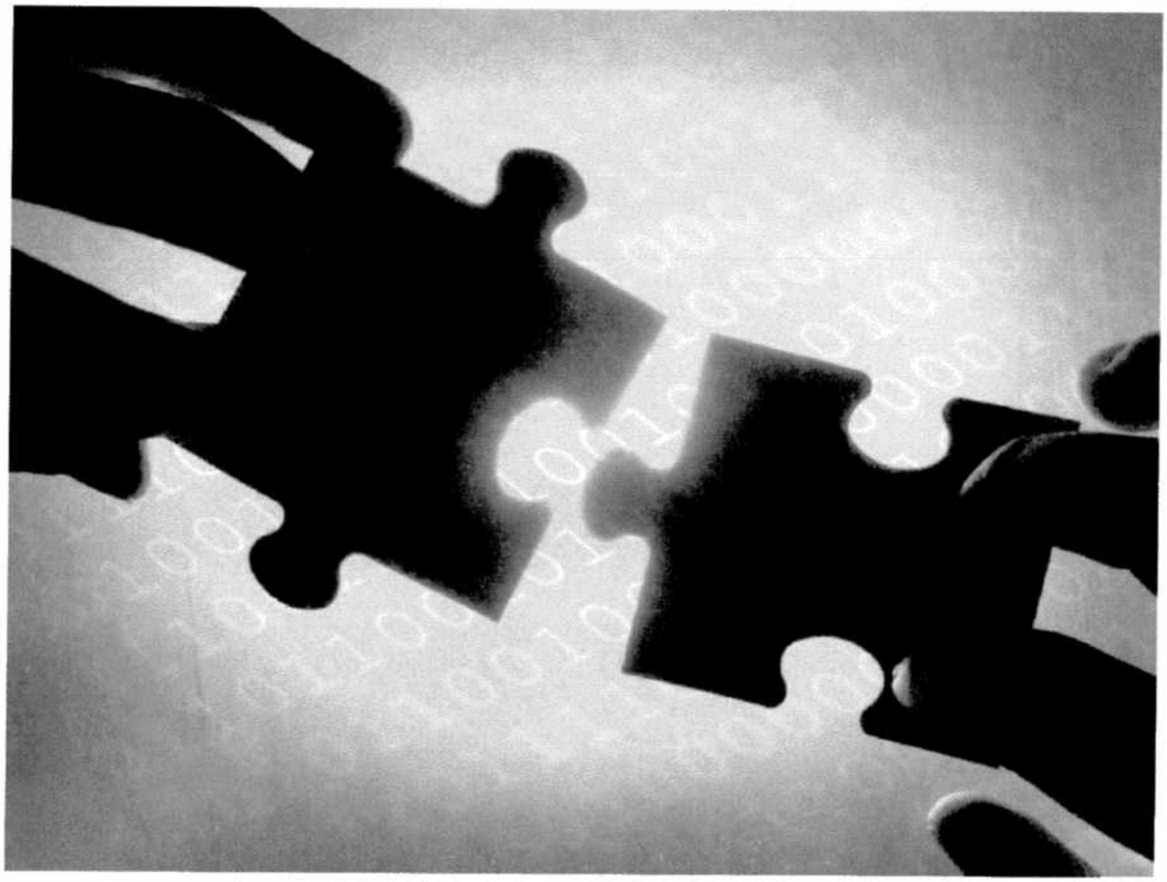
Companies without borders
Collaborating to compete



An Economist Intelligence Unit report
sponsored by BT

Preface

Companies without borders: collaborating to compete investigates the nature and extent of collaboration being undertaken between companies. The report was commissioned by BT.

The Economist Intelligence Unit bears sole responsibility for the content of this report. The Economist Intelligence Unit's editorial team executed the online survey, conducted the interviews and wrote the report. The findings and views expressed in this report do not necessarily reflect the views of the sponsor.

The research drew on two main initiatives:

- The Economist Intelligence Unit carried out a wide-ranging online survey of senior executives in the UK during August and September 2006. In total, 187 executives took part.
- To supplement the survey results, the Economist Intelligence Unit also conducted in-depth interviews with ten senior executives in the UK involved in collaborative ventures from a range of industries.

Kim Thomas was the author of the report, and James Watson was the editor. The following researchers conducted interviews with executives around the world: Daniel Ilett and Aviva Freudmann.

We would like to thank all the executives who participated in the survey and interviews for their time and insights.

November 2006

Executive summary

Collaboration between firms is not a new concept. But the breadth and depth of collaboration has changed in recent years, with companies now co-operating on everything from sales and marketing to basic product research and development. This has been spurred on in part by the pressures of globalisation and increased competition, and aided by recent advances in information and communication technologies. But why do firms seek to partner with others, sometimes even rivals? And what do they hope to get out of it?

To find out, the Economist Intelligence Unit conducted a wide-ranging survey of 187 senior UK-based executives from a mix of British and multinational businesses, representing a range of industries. The key findings from the research are highlighted below.

Five tips for successful collaboration

1. **Aim for neutrality**. Collaborations can work only if there is trust on all sides. One way of achieving this is to engage a neutral third party to chair meetings or arbitrate on areas of disagreement.
2. **Do your research**. Due diligence is essential, particularly when choosing an overseas collaborator. Regulatory requirements about the privacy of personal data vary widely, for example, and in some countries there is no guarantee that intellectual property will be respected.
3. **Choose people carefully**. According to our respondents, even in this modern, technologically driven world, it is human relationships that make a collaboration work. The key personnel involved in managing the relationship need to have the personal skills to make collaboration successful.
4. **Make sure the whole organisation is aligned behind the collaboration**. Two research and development teams may work well together, but the collaboration will run into trouble if the marketing teams are at war.
5. **Be sensitive to cultural differences if collaborating overseas**. In India, for example, agreements based on good faith are preferred to detailed contracts. Be prepared to compromise.

Collaborating with other firms is now the norm for nearly all businesses... The vast majority of executives surveyed for this report say that their firm is engaged in some kind of collaboration with another organisation, from sharing supply chain data to establishing collaborative sales agreements. Only 5% of firms have not developed any kind of relationship at all. The majority (64%) engage with up to ten partners, although some have established agreements with more than 100. And nearly all firms expect the average number of partnerships they hold to rise over the next three years.

... and is an increasingly important part of their competitive advantage. Companies are increasingly viewing collaboration as a fundamental part of their long-term survival and a defining feature of the firm's future shape. More than one-half of all executives polled say collaboration will either form an important part of their firm's competitive advantage or will actually be central to its survival over the next three years. In fact, strong relationships with external partners look to be an increasingly defining feature of companies in the future.

Most collaboration centres on sales and marketing. Firms collaborate for a number of reasons: to provide products they are unable to deliver alone, to keep up with competitors or to expand their global reach, among others. These partnerships are typically being driven by the sales and marketing departments. And this effort is generally delivering the goods: 28% of respondents agree that their biggest collaborative ventures have delivered either more or much more value than expected.

The biggest challenge involves finding suitable partners. About one-third of executives polled for this report say the biggest impediment to collaboration is simply being able to find an appropriate partner. And when they do, overcoming any cultural clashes between the two organisations is a major concern, along with more practical issues, such as getting system integration right or dealing with data security concerns.

Successful collaboration hinges primarily on people skills. Making partnerships work relies more on people than anything else. Survey respondents identified the skills of the personnel assigned to a relationship as the single most critical factor for the successful management of the partnership. Many of the executives interviewed for this report highlighted the importance of strong people skills as a crucial means of ensuring that the collaboration as a whole is successful.

Companies engage in partnerships with others all the time, whether it is within their supply chain or even with their customers. Sometimes the goal is to increase the overall size of the business or to attract new kinds of customers—Apple's recent collaboration with Nike to target running enthusiasts is just one example. Whatever the reason, both the frequency with which firms collaborate and the number of firms they collaborate with seem likely to increase. However, as firms begin to rely increasingly on these partnerships for their competitive success, more attention and investment will be required to ensure that these collaborations are successful.

Introduction

Firms have always collaborated. It is impossible to do business without, at some level, a degree of collaboration with either suppliers or customers. Complex forms of collaboration have also been around for a long time. The International Group of P&I Clubs, for example, is an organisation representing 13 protection and indemnity clubs for shipowners. The members of each club mutually reinsure each other's liability risks, up to a limit of US$6m per accident, above which limit the liabilities are pooled between the member clubs of the group. Founded in 1855, the Group defines and refines the scope of cover for pool claims, and the rules and guidelines under which the claims are shared at the Group level.

The P&I clubs represent the essence of collaboration: an agreement to put aside differences with competitors for the benefit of all. "The member P&I clubs compete among themselves for business, but they co-operate in terms of sharing the cost of liabilities," explains Andrew Bardot, secretary and executive officer for the International Group of P&I Clubs. This kind of collaboration, in which businesses work with external parties towards a specific business goal, whether by sharing information or creating strategic alliances, is increasingly common.

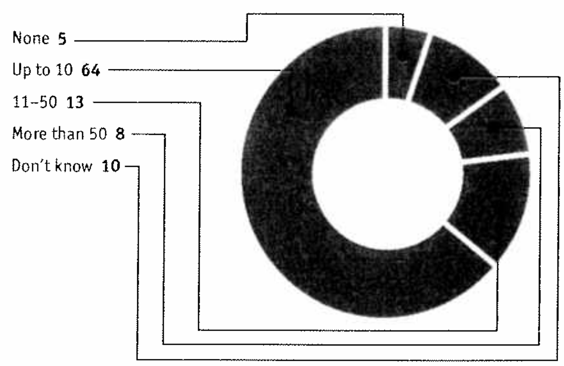
So if collaboration is a long-established practice –at least in place since the free-market economy – what is new about it today? One difference is the extent of collaboration. The majority (64%) of firms surveyed for this report have collaborative relationships with between one and ten third parties; others have anywhere between 11 and more than 100. Only 5% have none. Moreover, nearly eight out of ten of these firms expect the number of these partnerships to increase over the next three years. In many industries, collaboration between firms is now the norm.

In part, this surge in the number of collaborations is being driven by technology. As Jeffrey Mann, a

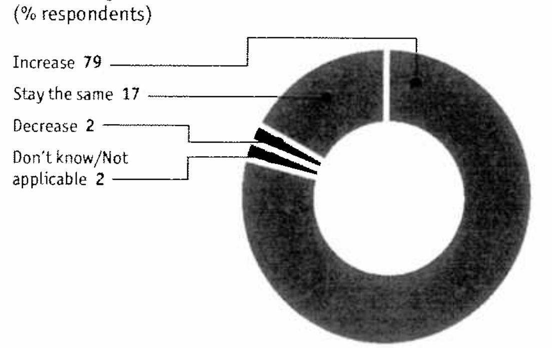
Defining collaboration

For the purposes of this report, collaboration describes co-operation with external parties towards a specific business goal or goals that goes beyond the simple exchange of goods, services and money. It does not include order fulfilment at one end of the scale, or a merger at the other, but does encompass various forms of co-operation between distinct companies from information sharing to strategic alliances.

Approximately how many third parties has your company developed a collaborative relationship with?
(% respondents)



How do you expect the number of collaborative relationships your company holds with third parties will change over the next three year?
(% respondents)



Source: Economist Intelligence Unit survey, October 2006.

research vice president at Gartner, an analyst firm, puts it: "What is new is the supply side, the technology side, because it is making things easier. Email is just about universal, broadband is everywhere and a lot of consumer grade collaborative tools are bleeding over quite quickly into the enterprise market."

Another key difference is the competitive advantage that collaboration can deliver. One-third of executives polled for this report say their company gains an important part of its competitive advantage from its collaborative relationships, while one in ten believes their company's survival actually depends on the success of its collaborations. The general sentiment is that collaboration is likely to become more important in the future. This correlates with other research: Foresight 2020, an Economist Intelligence Unit report[1], identified increased collaboration with suppliers, customers and other partners as a defining feature of the company of 2020. In the report, executives rated high-quality relationships with their customers, suppliers and other outside partners as their second most important source of competitive advantage—and more than one-half believed it was likely to increase in importance over the next 15 years.

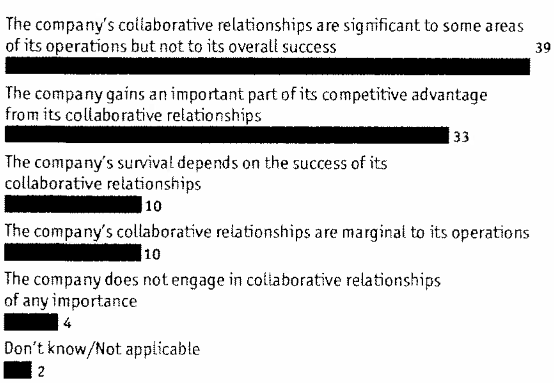
While collaboration may be necessary in an increasingly competitive business environment, the growth in corporate social responsibility (CSR) departments has driven a quite different trend – an increase in ethical collaborations, such as that between Shell and the World Conservation Union (see box: A new CSR: collaborative social responsibility?). While these types of collaboration show an increased willingness by corporations to respond to public demand for ethically sourced products, they also provide a new challenge for businesses unused to dealing with culturally different organisations.

The final change is in the range of collaborations. The most common form between companies, named by more than one-half of our survey respondents, is information sharing (making sales and supply chain information available to partners, for example). A high proportion (43%) say they are involved in strategic alliances that encompass several types of collaboration, such as research and development (R&D), shared information, franchise agreements or product licensing, while 36% say they are collaborating on R&D.

Who took the survey?

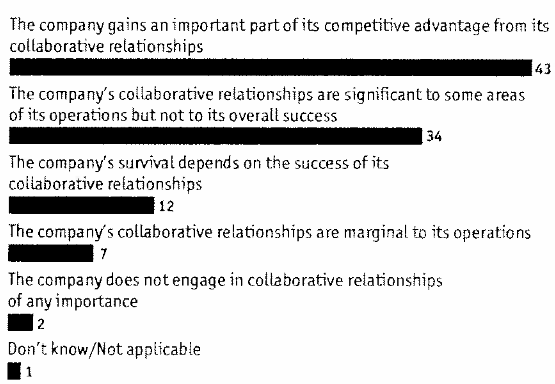
A total of 187 executives from the UK responded to the survey, from a wide array of industries, including financial services, professional services, IT and technology and manufacturing, among others. The survey was very senior: 50% of all respondents are C-level executives, representing a range of functional roles. These executives hail from companies of all sizes, with about half reporting revenue in excess of US$1bn. One in five firms has revenue of US$10bn or more.

Which best describes your company now?
(% respondents)



Source: Economist Intelligence Unit survey, October 2006.

Which best describes your company as you think it will be in three years time?
(% respondents)



Source: Economist Intelligence Unit survey, October 2006.

[1] *Foresight 2020*, Economist Intelligence Unit, sponsored by Cisco Systems.

Why firms are collaborating

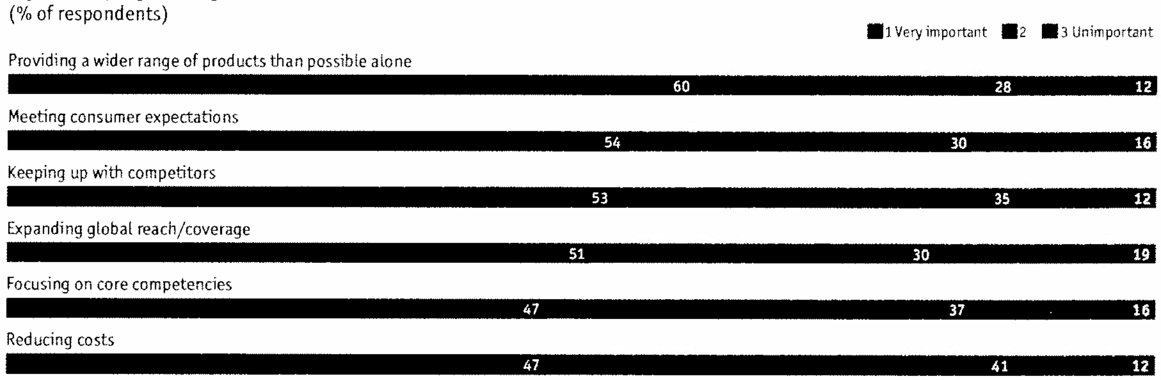
The ability to provide a wider range of products is the reason most commonly cited by respondents as a driver for collaboration, with 60% describing it as "very important". But other drivers are also frequently cited: 53% say keeping up with competitors is "very important", while 51% agree that expanding their global reach is "very important".

Mr Mann at Gartner argues that external collaboration is a natural intensification of the trend, at least in the last 10-15 years, for businesses to focus on core competencies and outsource non-core functions. He believes collaboration is being driven by a desire to find new ways of gaining competitive advantage. Early Internet-based technologies enabled businesses to automate key processes, such as putting suppliers' catalogues online, bringing big returns to the first adopters, although these have now been so widely adopted that competitive advantage from this is now limited. Instead, collaboration with organisations that can provide a different skillset is one way of regaining that competitive advantage. At the same time, adds Mr Mann, a range of technologies, from e-mail and instant messaging to Internet-based telephony and video conferencing, have made such collaboration easier.

"The pressure of the market is driving companies like ours to form alliances," says Grant Rosewarne, managing director of Douwe Egberts UK, a coffee supplier. "You want to be first, you want to have something ground-breaking, but you don't have every expertise and every resource within your own company so you're forced to form partnerships or be left behind." In 2001 Douwe Egberts entered into a collaboration with consumer electronics giant Philips to produce and market the Senseo coffee-maker and coffee brand. By 2005, worldwide sales had reached 10 million units, a figure that Mr Rosewarne believes would not have been reached without Philips's expertise in product design and its network of distributors.

Other firms are spotting the opportunities in emerging markets: a knowledge economy such as India's, for example, provides openings for many Western firms to work with organisations that

How important are each of the following drivers in moving your company toward increased collaboration, if your company is doing so?
(% of respondents)



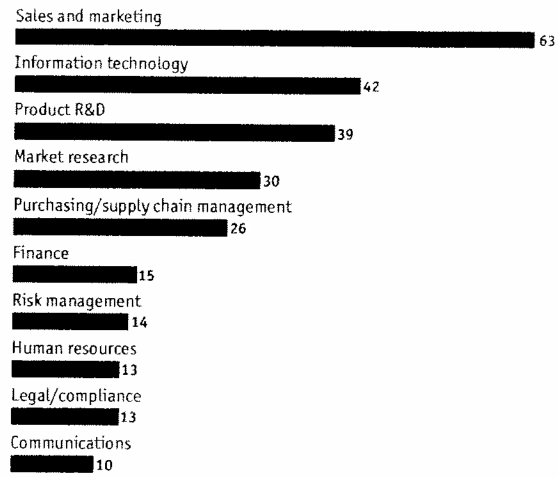
Source: Economist Intelligence Unit survey, October 2006.

combine a high level of expertise with low costs. In some emerging economies, such as Indonesia, a joint venture with a local company is still the best way to break into the market. Fully 85% of survey respondents either agree or strongly agree with the statement, "Collaborative relationships with companies in other countries are essential in a globalised world".

While it is clear that firms have been engaging in collaboration across every aspect of their business, it has been far more prevalent in certain functions than others. The majority of executives polled (63%) say sales and marketing are the departments that have been most active in building collaborative relationships over the past three years, while IT was cited by 42% and product R&D by 39%. When asked which departments were least likely to collaborate, 36% named finance and 31% named the legal and compliance functions.

One example of marketing-based collaboration is university-technology.com, a web-based portal where all the Scottish universities have collaborated to market R&D projects and products to entrepreneurs who want to invest in them. Similarly, the Connection consortium, an organisation made up of marketing services companies, was created by Graham Ede, the CEO of Moon River Group, as a way of breaking into new areas. "Our strategy didn't allow for that with the skills we had in-house," he explains. "This allows us to broaden our brush and paint a different landscape very quickly."

Which departments in your company have been most active in building collaborative relationships in the past three years?
(% respondents)



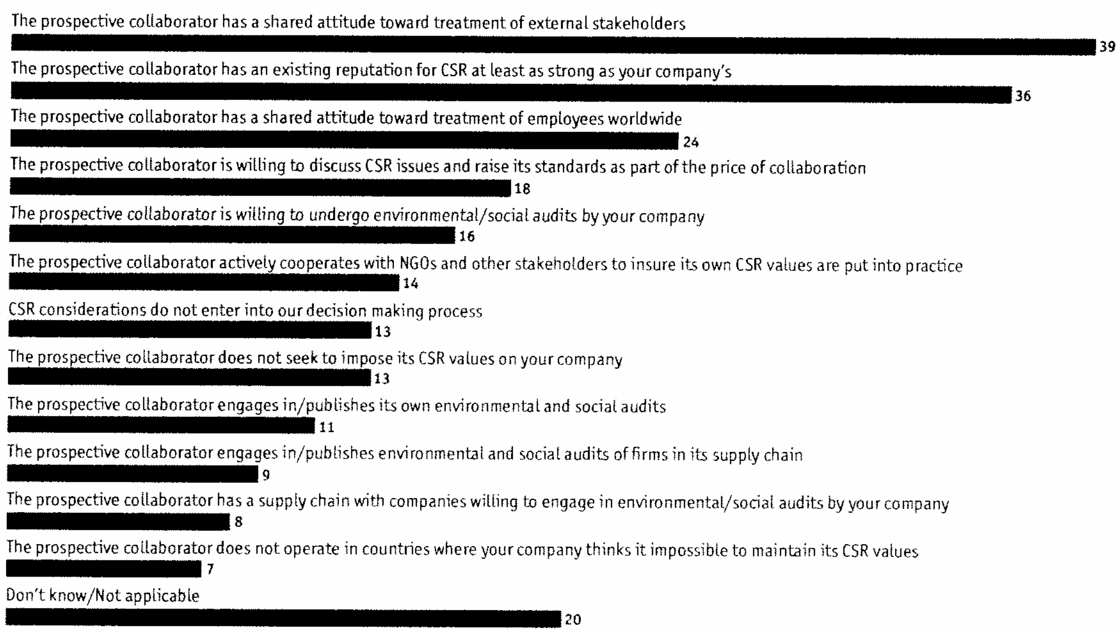
Source: Economist Intelligence Unit survey, October 2006.

A new CSR: collaborative social responsibility?

The rise in public concern about ethical issues, such as the sourcing of products and damage to the environment, has seen a new trend emerge, in which businesses collaborate with public-sector agencies and non-governmental organisations (NGOs) for social and ethical reasons.

Shared ethical values is not typically a critical factor for choosing a firm to collaborate with (although 16% of respondents to our survey say it is). In general, firms look for partners that have a similar amount to gain from a relationship (46%) and that have a good cultural fit (42%). But corporate social responsibility (CSR) enters into most companies' choice of a collaborator to some extent. Only 13% of survey respondents say that CSR has no impact on their choice of collaborator, while 35% say their collaborator's reputation in CSR has to be at least as strong as their own. About one in four firms agree that the collaborator should have a shared attitude towards

In a globalised world, corporate social responsibility (CSR), ethical and reputational risk issues are increasingly intertwined and know no geographic boundaries. In deciding on which companies to collaborate with, especially those based in other countries, which of the following are most important for your firm?
(% respondents)



Source: Economist Intelligence Unit survey, October 2006.

employees worldwide.

What drives organisations to seek out ethical collaborations? Shell has been collaborating with the World Conservation Union (IUCN) for six years. According to Sachin Kapila, group biodiversity adviser at Shell, it was prompted by a recognition of the concerns of governments, financial organisations, NGOs and the public about environmental issues: "Given our global presence, and our environmental footprint, ignoring biodiversity is clearly a risk to our operations, including our licence to operate."

Under the terms of the collaboration an employee from each company was seconded to work with the other. Within this arrangement, the IUCN has provided Shell with biodiversity guidance on projects, such as Sakhalin in Russia and Val D'Agri in Italy, while Shell has advised IUCN staff in Asia on business issues such as human resources management and financial development.

"It's given us an inroad into some of the public policy debates, some of the things that are going on in terms of decision-making at the Convention on Biological Diversity, and it's given us direct access to on the ground assistance on some projects," states Mr Kapila. "It's also given a level of independence to our work. IUCN comes with strong credibility and a strong brand."

For private-sector organisations, working with a non-profit, humanitarian organisation provides a new set of challenges. Douwe Egberts, a global coffee supplier, worked with Utz Kapeh, the worldwide certification programme that sets a standard for responsible coffee production and sourcing, to launch its *Good Origin* range of coffee. Although the collaboration has worked well, notes Douwe Egberts's UK managing director, Grant Rosewarne, the two organisations have different approach, for example to branding. In one instance, Douwe Egberts wanted Utz Kapeh to develop a logo that communicated the 'sustainable positioning' of the Utz Kapeh organisation to the consumer in a simple, shorthand manner. However, Utz Kapeh wanted to put their effort and resources into farm management and making their traceable supply chain very robust. A new, easily understood logo was not a priority. "There were not enough resources to do both so we had to make choices and move on," says Mr Rosewarne.

There is also a movement towards multi-member collaborations, in which private- and public-sector organisations group together for a common ethical goal. In 2005 members of the World Economic Forum (WEF) launched the Logistics and Transportation Industry Humanitarian Workstream (LTHW) – a means by which major logistics companies such as TNT, DHL and Exel can co-ordinate their efforts more effectively in the event of a humanitarian disaster. While such companies already have bilateral partnerships with NGOs, the LTHW ensures that teams from different companies are ready on the ground in the disaster-prone areas of the world.

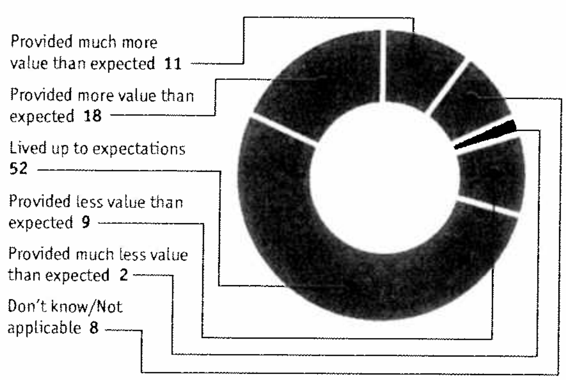
"There were stories about CEOs calling senior UN representatives the day after the tsunami and not being able to figure out the right thing to do," recalls Shruti Mehrotra, the WEF's programme manager for LTHW. "So what we found was that the best way for the private sector to leverage its resources and competencies was to get into partnerships in advance of events, rather than be reactive." The LTHW is now part of a wider Humanitarian Relief Initiative (HRI), in which WEF members in other sectors are setting up an infrastructure to respond to humanitarian disasters.

The benefits of collaboration

A successful collaboration can provide a competitive advantage by combining the best skills of two or more organisations. Firms engaged in collaborative exercises find that that experience is living up to expectations, and often exceeding it. More than one-quarter (28%) of survey respondents confirm that their company's collaboration with others has provided more value than initially expected, compared with 52% who agree that it met expectations. Just one in ten firms say that their overall experience in collaboration has failed to deliver the expected value.

Collaboration between Channel Dynamics, a technology distribution company, and Ranieri PR, a public relations firm, resulted in benefits for both companies and their clients. Ranieri PR's problem was that, although it was often able to get good coverage for its clients' products in the press, consumers were frequently unable to buy the product because distribution was poor. For its part, Channel Dynamics was experiencing difficulty placing a product with a retailer if it had not received good press coverage. The two organisations informally recommend each other to clients, with the result that when they work together on a project, they are able to get better coverage and improved distribution.

Which of the following best describes your company' overall experience with its biggest collaborative relationships?
(% respondents)



Source: Economist Intelligence Unit survey, October 2006.

For example, in the case of iHome, a third-party iPod accessory, Ranieri PR generated the coverage that helped Channel Dynamics to convince retailers like Dixon's to adopt the product. Tim Noyes, business development manager at Channel Dynamics, says the two firms now collaborate on about seven or eight products. Partly as a result of the collaboration, Ranieri PR has seen business double in the last two years, while Channel Dynamics's business has grown by 50% in 18 months.

Overall, sales and marketing are the areas of the business that the majority of executives (63%) expect to benefit from most over the next three years. Product R&D, the next most common area that firms expect to benefit from, comes as firms seek to reduce the risks associated with R&D, as well as trying to lower costs. In fact, one of the features of globalisation – the much lower labour costs available in emerging markets, facilitated by advances in information and communication technology – is helping smaller Western firms compete on a level playing field with larger ones.

According to Scott Maguire, chief executive of Lipoxen, a biopharmaceutical company, this is particularly the case in the pharmaceutical industry, where smaller companies are starting to punch above their weight. Lipoxen, with only 22 employees, has entered into an agreement with the Serum Institute in India to manufacture its vaccines and drugs. "It would have cost us tens of millions of pounds to put that infrastructure in place on our own," says

Mr Maguire. The agreement means that the Serum Institute will have the right to market the products in the developing world, while Lipoxen will market them in the developed world. For the Serum Institute, adds Mr Maguire, it is an opportunity to become a global player in the biotech arena.

Even ethical collaboration can ultimately bring concrete business benefits by improving profitability. Abel & Cole, which supplies organic food to consumers, was founded in 1988 and has seen explosive growth since 2000. It now has 240 employees and 30,000 customers. "We pride [ourselves on running] the business ethically from top to bottom," says Keith Abel, the firm's founder. Its policy of fairness to suppliers has included giving them interest-free loans to extend their range of products.

As an example of how the three-way collaboration benefits Abel & Cole, its suppliers and its customers, Mr Abel cites a dairy farmer who was ready to slaughter his herd of Guernsey cows because he was facing bankruptcy as a result of being forced to produce milk below the cost of production for two years. "We took him on as a supplier and we paid him way above the market price for milk. But we then told our customers, 'We've got this guy coming out of bankruptcy, will everyone support him – and the milk's not homogenised'." As a result, Abel & Cole's milk sales doubled overnight, the farmer's livelihood was saved, and customers benefited from having better-quality milk.

The barriers to collaboration

While the benefits of collaboration are clear, the path to a successful collaboration is not always smooth. The drivers for collaboration (greater competition and globalisation) may be new, but the barriers tend to be old-fashioned, with issues of trust, intellectual property and different cultures frequently cited. Kevin Cullen, commercialisation director of university-technology.com, puts it succinctly when he describes a typical public-sector partnership as "the suppression of mutual loathing in pursuit of government funding".

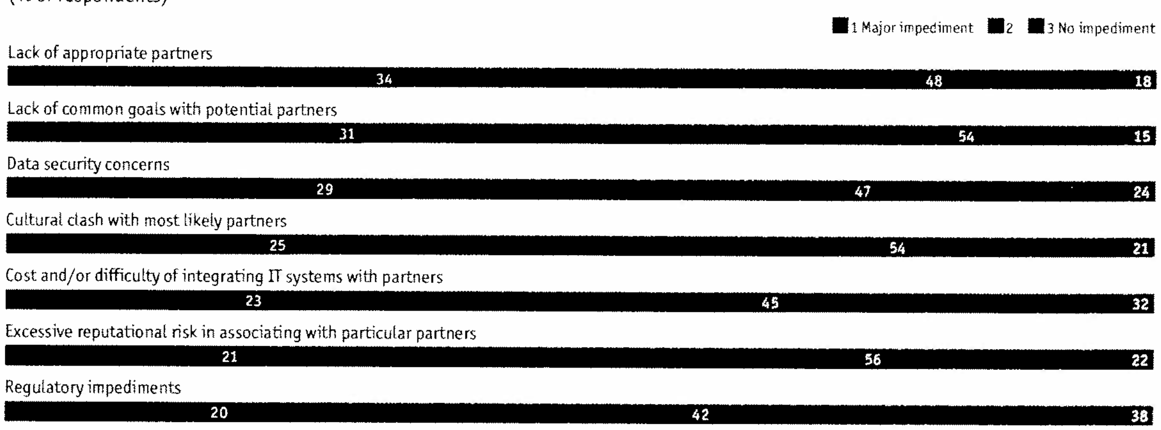
When asked to name the major impediments to forming collaborative relationships, around one-third of respondents cite a lack of appropriate partners, while one-quarter mention a cultural clash with the most likely partners. About one in five firms note concerns about excessive reputational risk in associating with certain partners. Other concerns were at a more practical level: 29% highlight data security issues, while 23% raise the cost or difficulty of integrating IT systems with partners.

Intellectual property is one of the biggest concerns for collaborators. In answer to the question about what posed the greatest risks to a collaborative relationship, nearly one-half of all executives highlight the loss of intellectual property as a major risk.

Inevitably, intellectual property is a particularly strong concern when it comes to collaborating with partners in other countries, especially those in the emerging markets. The World Trade Organisation (WTO) has attempted to address this problem with its agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). Mr Maguire believes that India's decision to sign up to TRIPs in 2005 has made it a more attractive country for Western firms seeking collaborators, particularly in the pharmaceutical sector.

The issue of intellectual property is not confined to collaborations in other countries, however. It was a major bone of contention for Douwe Egberts

How much of an impediment are each of the following for your company in forming collaborative relationships?
(% of respondents)



Source: Economist Intelligence Unit survey, October 2006.

in its collaboration with Philips, which was finally settled with an agreement that Philips would hold the intellectual property for the coffee machine, while Douwe Egberts would retain it for the coffee.

This particular collaboration also illustrates another common problem, that of two partners with very different sets of business goals: Philips is used to making short-term investments in a product, while Douwe Egberts makes long-term ones. "We do have arguments in which we say, 'How come we've invested two, three or four times in this particular country what you've invested?'" says Mr Rosewarne of Douwe Egberts UK. "Then they say, 'We sell a machine, if we're lucky, once to a consumer in their lifetime – and you're selling a pack of coffee every week'." Keen for Philips to see the Senseo as a longer-term proposition, Douwe Egberts addressed this by allowing Philips a share of royalties in the Senseo coffee brand.

Mr Rosewarne also says that getting internal alignment when working with third parties can also be a problem – while R&D might be working well with a collaborator, the commercial side might be less ready.

Regulatory barriers, such as the differences in data protection laws, can also be an impediment to collaborative relationships: the EU member countries, on the whole, have much stronger data protection and privacy laws than countries outside the EU, such as the United States. For example, as part of an ongoing drive to improve the quality of merchant shipping operations, the International Group of P&I Clubs, together with other stakeholders, is exploring new ways to share ship survey data between member clubs. However, some restrictions on the free flow of information remain, because of confidentiality and privacy regulations in some countries, says the Group's Mr Bardot.

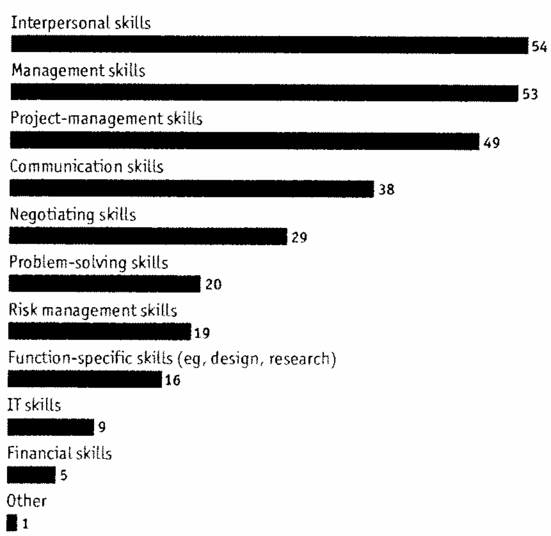
While these barriers are not to be underestimated, there are enough successful examples of collaborations between firms to demonstrate that they can be overcome.

Making collaboration work

"Companies enter a partnership", says Mr Mann of Gartner, "asking questions such as, 'If we collaborate together, who owns that shared content, and what the other party do with it? Can they take what we've done collaboratively and use it with one of my competitors also? Or do I own all of it, and if so how do I protect it?' That can get murky, and undermines trust and the ability to be able to expand on those kinds of things."

Issues such as this can be partly resolved by having formal procedures and agreements in place. When Apacs, a trade association that facilitates collaboration between all of the UK's high street banks on payments services issues, started working with retailers in 2001 to introduce a chip-and-PIN system for credit and debit cards, it had to make sure that no favouritism was given to banks. The steering committee that oversaw the implementation was composed of eight representatives from banks and eight representatives from the retail sector, with a completely independent chairman. "It would have been impossible even to get to square one if we hadn't built in something that made it absolutely clear that this was an organisation that was independent of both sides," explains Gary Hocking, deputy chief executive of Apacs and director of the chip-and-PIN implementation.

Which personnel skills do you think are most important for your company in making collaborative relationships successful?
(% respondents)



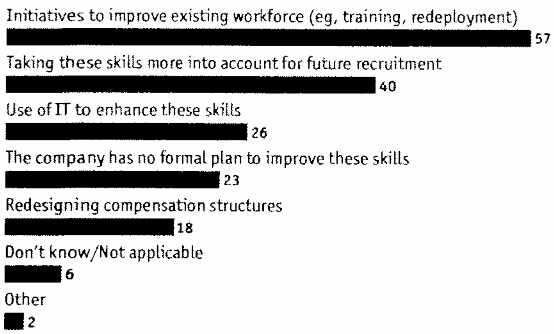
Source: Economist Intelligence Unit survey, October 2006.

The key to a successful relationship, however, seems to come down to straightforward people skills: when asked which skills were most important in making collaborative relationships successful, the majority of respondents (54%) chose interpersonal skills. Management and project management skills are the next two most important skills, selected by 53% and 49% of respondents respectively.

For those firms that see a shortfall in these skills, providing training for relevant staff (57%) and altering recruitment preferences to bring in appropriate people (40%) are the two most popular ways of addressing the issue. However, a significant minority (23%) say their companies have no plans to improve these skills.

According to Mr Rosewarne, Douwe Egberts's collaboration with Philips improved enormously when Philips appointed a new managing director in the UK. "Our processes of managing partnerships also needed strong interpersonal relationships to make them work. When the new Philips team came in, with a combination of good processes and excellent relationships we saw a complete shift and things worked that hadn't always worked before. Having good personal relationships, having people who see the broader picture, who seek to understand your

How does your company intend to improve the most important skills required for collaborative relationships?
(% respondents)



Source: Economist Intelligence Unit survey, October 2006.

business and have some empathy for you really helps to make alliances strong."

Mr Rosewarne suggests that an "open book" accounting policy with a partner, where both parties see how much money is being made by the other and agree an appropriate split out of the joint return, would help to reduce suspicion or lack of understanding in the relationship.

In some industries, the ground rules for collaboration are still being established. In others, the prevalence of collaboration is beginning to change the nature of the market. In the pharmaceutical industry, for example, the type of collaboration between Lipoxen and the Serum Institute is already common. "Pharmaceutical companies are mining the small biotech companies for valuable product candidates," says Mr Maguire of Lipoxen. "Their pipelines are getting thinner and thinner and they're really relying on the small biotech world to supply them with products."

Mr Maguire believes the model will eventually be widely adopted throughout the pharmaceutical industry: "It will change the speed with which products get to the market. It will change completely the cost dynamics, and since the cost of production, the clinical cost, the development cost will be much less, companies will be able to run more product candidates in parallel."

Conclusion

Companies are collaborating more and more. While most businesses engaged in collaboration have benefited from it, there are problems too, ranging from a lack of trust, concerns about the sharing of intellectual property and difficulty in managing the personal relationships between competitors.

The drivers of collaboration are so compelling, however, that firms are prepared to work hard to make the collaboration successful. One striking feature is that, regardless of how bumpy the road, a collaboration can make a real difference to the bottom line.

Globalisation has fundamentally altered the world economy, making it more competitive and fast-moving than ever before. Much of this has been facilitated by the widespread adoption of enabling technologies, such as broadband internet and collaborative tools, which are allowing companies of all sizes to collaborate easily with other partners anywhere in the world, at low cost. The emergence of global players from emerging markets can be an opportunity as well as a threat, as companies like Lipoxen have found.

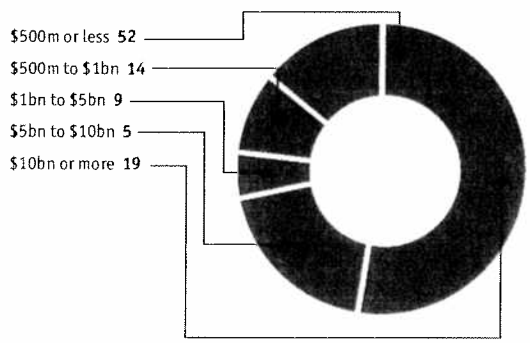
An imaginative approach to collaboration, and a willingness to bury differences, can bring in substantial benefits to all parties. As Mr Hocking of Apacs puts it, "With trust and co-operation, almost anything is possible."

Appendix

The Economist Intelligence Unit surveyed 187 executives from the UK, from a wide array of industries, including financial services, professional services, IT and technology and manufacturing, among others. Please note that not all answers add up to 100%, because of rounding or because respondents were able to provide multiple answers to some questions.

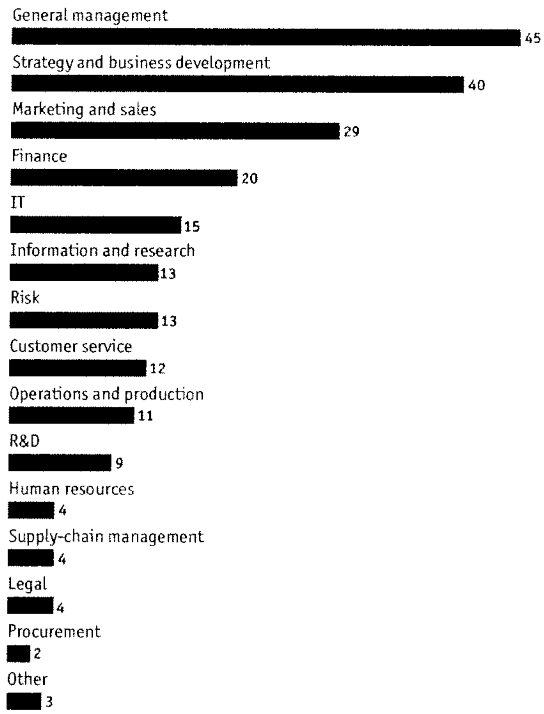
What is your primary industry?
(% respondents)

What is your company's global annual revenues in US dollars?
(% respondents)

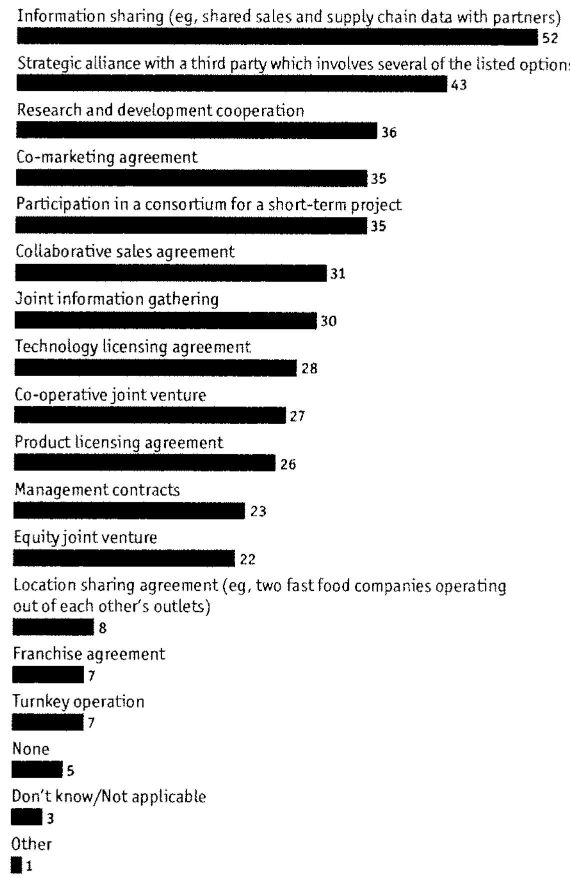


Which of the following best describes your title?
(% respondents)

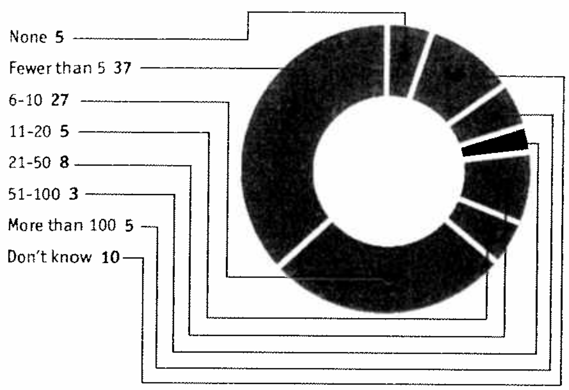
What are your main functional roles?
Please choose no more than three functions.
(% respondents)



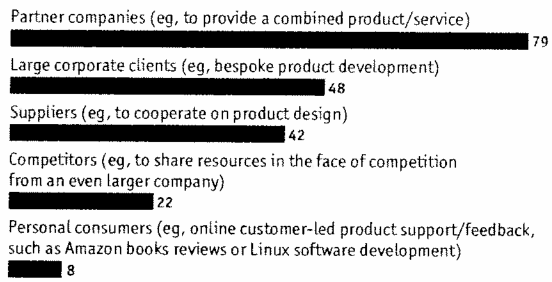
Which types of collaborative relationships does your company have with other firms?
(% respondents)



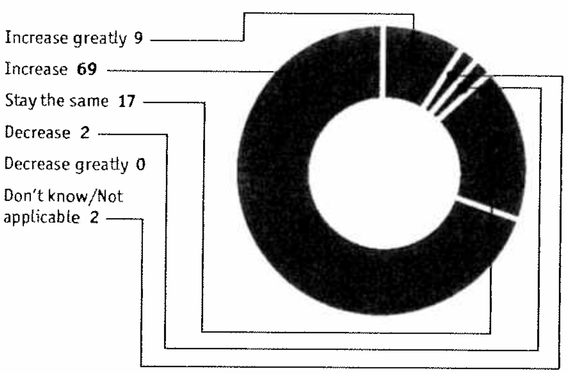
Approximately how many third parties has your company developed a collaborative relationship with?
(% respondents)



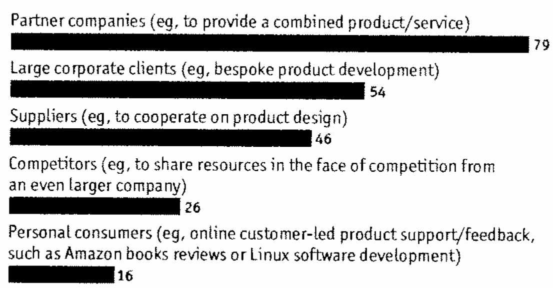
With which of the following has your company entered into collaborative relationships over the last three years?
(% respondents)



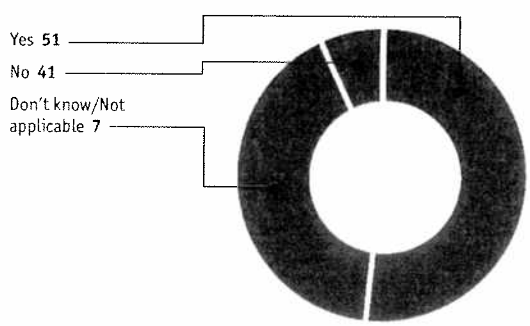
How do you expect the number of collaborative relationships your company holds with third parties will change over the next three year?
(% respondents)



With which of the following does your company expect to enter into collaborative relationships over the next three years?
(% respondents)



Has your company changed its business model in the last three years to take greater advantage, or increase the number, of collaborative relationships in its value chain?
(% respondents)



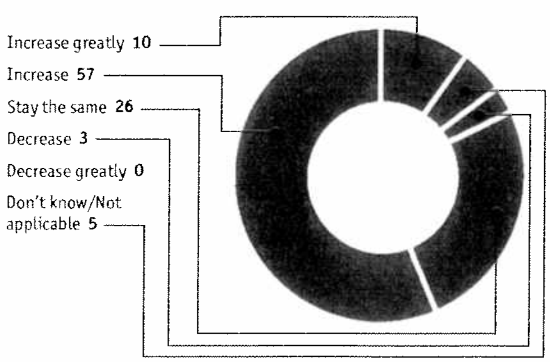
Which best describes your company now?
(% respondents)

The company's collaborative relationships are significant to some areas of its operations but not to its overall success	39
The company gains an important part of its competitive advantage from its collaborative relationships	33
The company's survival depends on the success of its collaborative relationships	10
The company's collaborative relationships are marginal to its operations	10
The company does not engage in collaborative relationships of any importance	4
Don't know/Not applicable	2

Which best describes your company as you think it will be in three years time?
(% respondents)

The company gains an important part of its competitive advantage from its collaborative relationships	43
The company's collaborative relationships are significant to some areas of its operations but not to its overall success	34
The company's survival depends on the success of its collaborative relationships	12
The company's collaborative relationships are marginal to its operations	7
The company does not engage in collaborative relationships of any importance	2
Don't know/Not applicable	1

How do you think that the percentage of your company's employees whose work regularly involves some role in your company's external collaborative relationships will change over the next three years?
(% respondents)



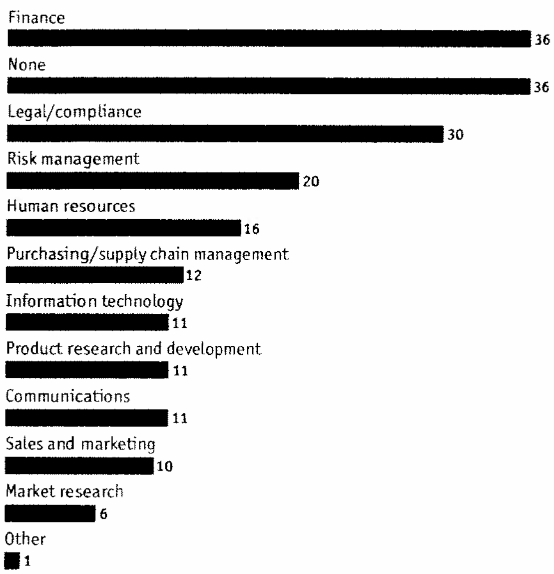
Which departments in your company have been most active in building collaborative relationships in the past three years?
(% respondents)

Sales and marketing	63
Information technology	42
Product R&D	39
Market research	30
Purchasing/supply chain management	26
Finance	15
Risk management	14
Human resources	13
Legal/compliance	13
Communications	10

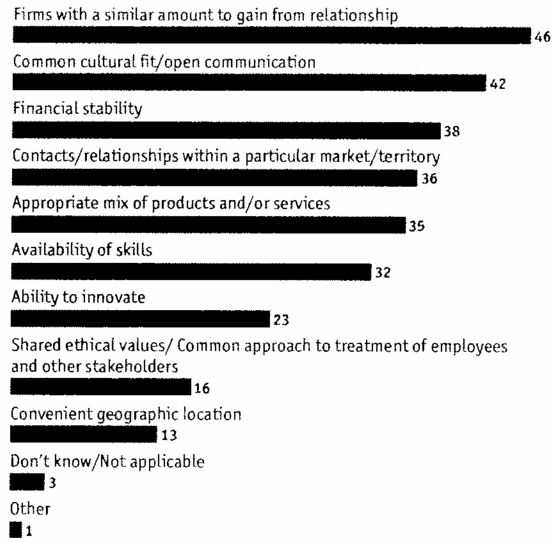
Which departments in your company are likely to be most active in building collaborative relationships in the next three years?
(% respondents)

Sales and marketing	66
Product R&D	48
Information technology	45
Market research	41
Purchasing/supply chain management	28
Finance	18
Human resources	18
Risk management	18
Legal/compliance	18
Communications	16

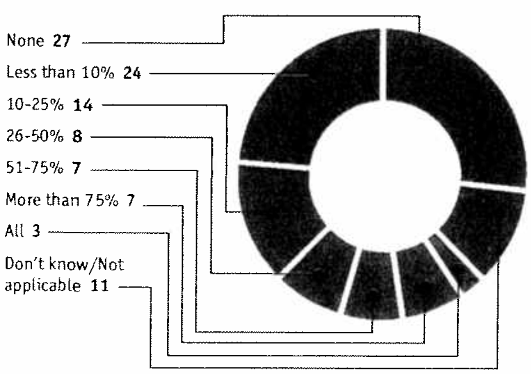
In your opinion, which of the following areas is your company likely to refuse to consider entering into a collaborative relationship with another firm?
(% respondents)



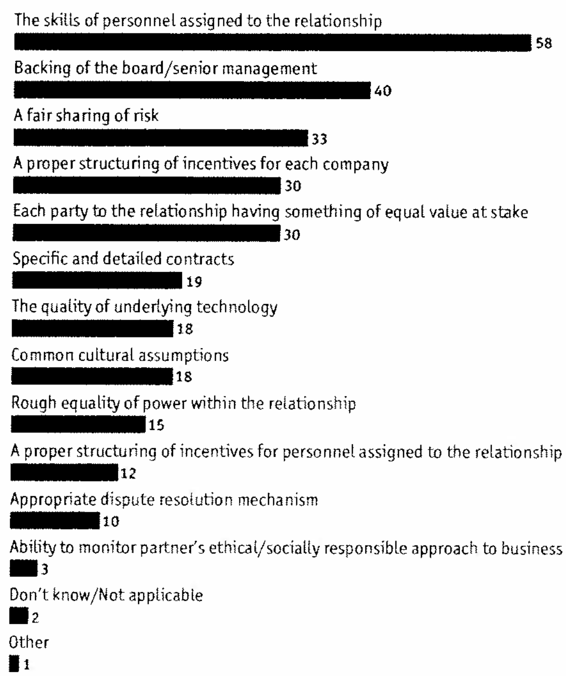
Which factors are most critical for selecting a firm to collaborate with?
(% respondents)



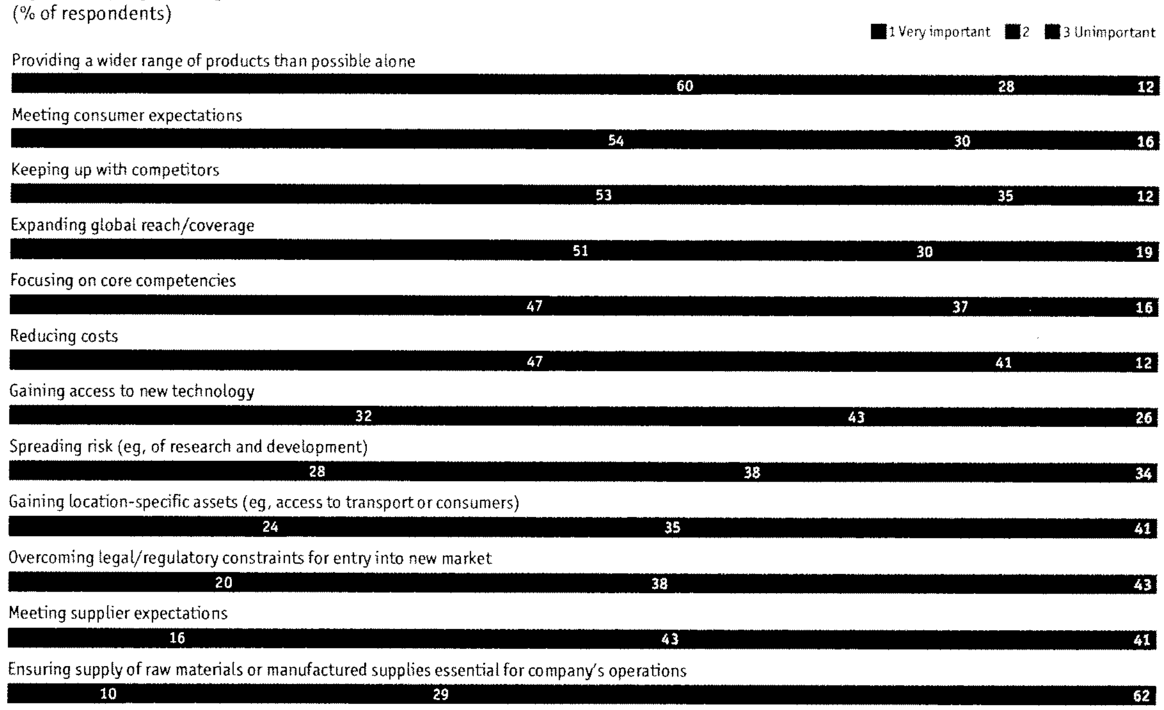
Approximately what proportion of your collaborative relationships are with partners operating in countries in which your company does not operate?
(% respondents)



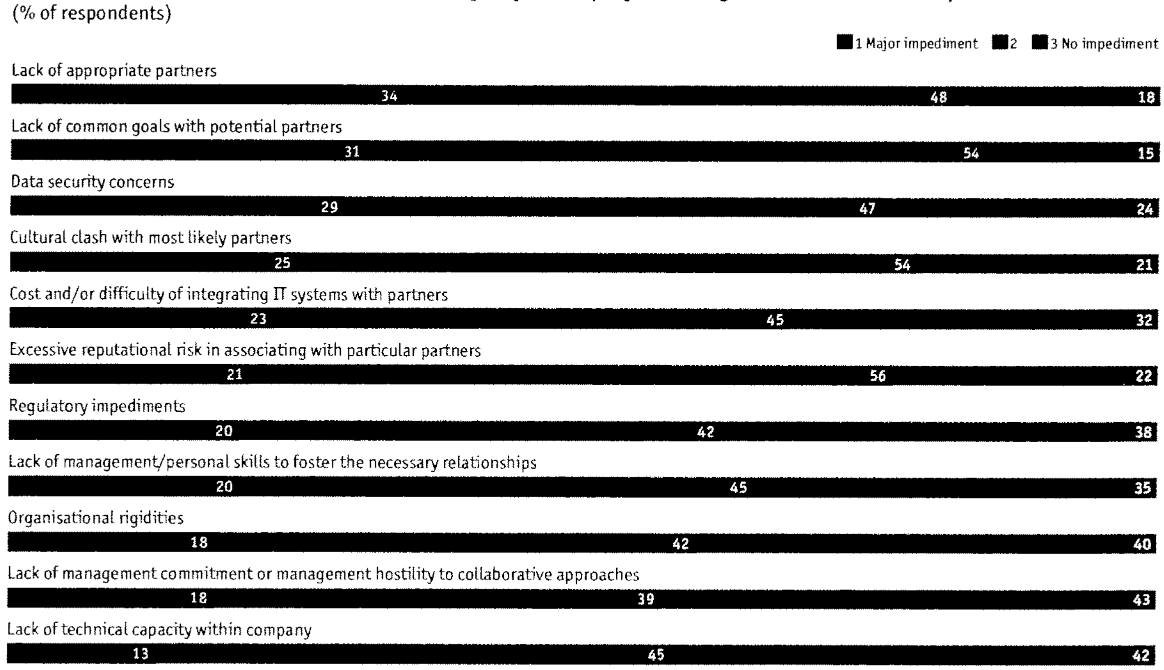
Which factors are the most critical for managing a successful collaborative relationship?
(% respondents)



How important are each of the following drivers in moving your company toward increased collaboration, if your company is doing so?
(% of respondents)



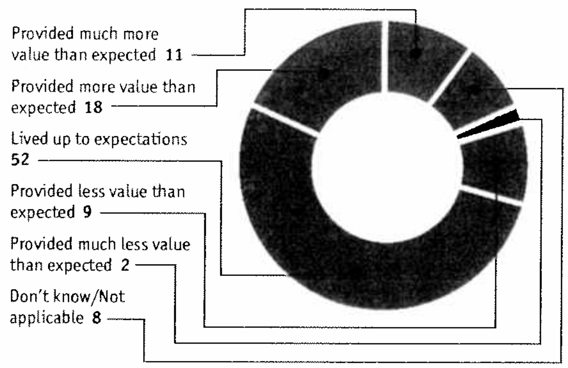
How much of an impediment are each of the following for your company in forming collaborative relationships?
(% of respondents)



In a globalised world, corporate social responsibility (CSR), ethical and reputational risk issues are increasingly intertwined and know no geographic boundaries. In deciding on which companies to collaborate with, especially those based in other countries, which of the following are most important for your firm?
(% respondents)

The prospective collaborator has a shared attitude toward treatment of external stakeholders	39
The prospective collaborator has an existing reputation for CSR at least as strong as your company's	36
The prospective collaborator has a shared attitude toward treatment of employees worldwide	24
Don't know/Not applicable	20
The prospective collaborator is willing to discuss CSR issues and raise its standards as part of the price of collaboration	18
The prospective collaborator is willing to undergo environmental/social audits by your company	16
The prospective collaborator actively cooperates with NGOs and other stakeholders to insure its own CSR values are put into practice	14
CSR considerations do not enter into our decision making process	13
The prospective collaborator does not seek to impose its CSR values on your company	13
The prospective collaborator engages in/publishes its own environmental and social audits	11
The prospective collaborator engages in/publishes environmental and social audits of firms in its supply chain	9
The prospective collaborator has a supply chain with companies willing to engage in environmental/social audits by your company	8
The prospective collaborator does not operate in countries where your company thinks it impossible to maintain its CSR values	7
Other	1

Which of the following best describes your company' overall experience with its biggest collaborative relationships?
(% respondents)

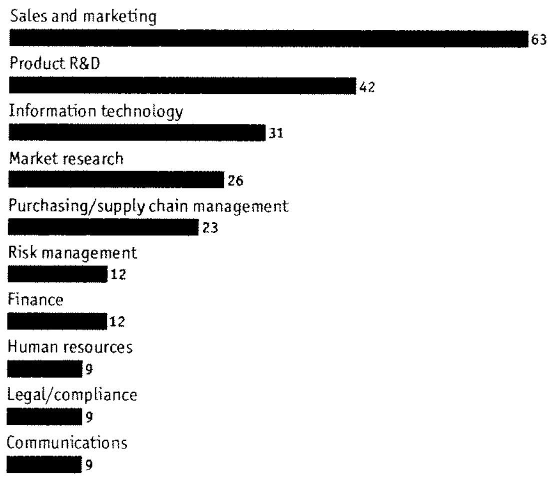


In which area has your company benefited most from collaborative relationships in the last three years?
(% respondents)

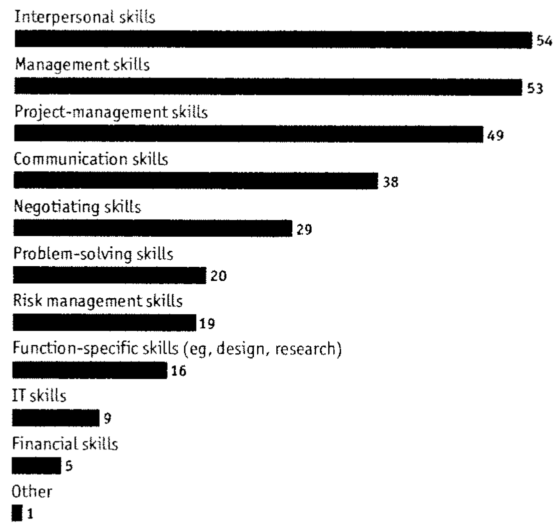
Sales and marketing	64
Product R&D	37
Information technology	32
Market research	25
Purchasing/supply chain management	20
Human resources	10
Finance	10
Communications	10
Risk management	9
Legal/compliance	6

Appendix
Companies without borders
Collaborating to compete

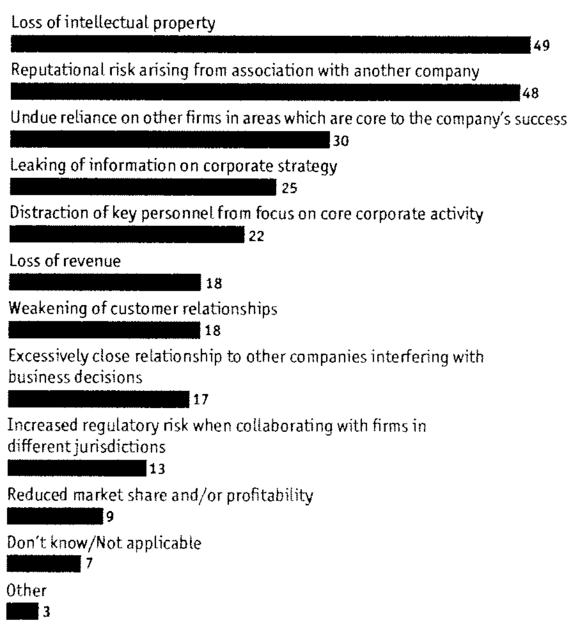
In which area do you expect your company to benefit most from collaborative relationships in the next three years?
(% respondents)



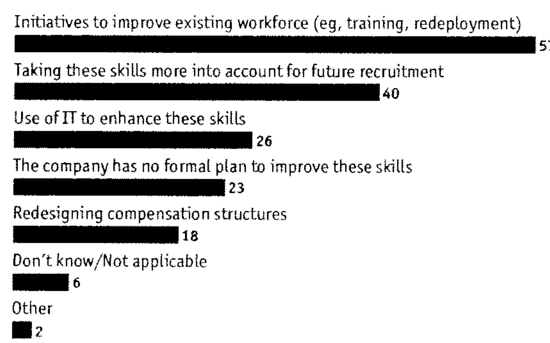
Which personnel skills do you think are most important for your company in making collaborative relationships successful?
(% respondents)



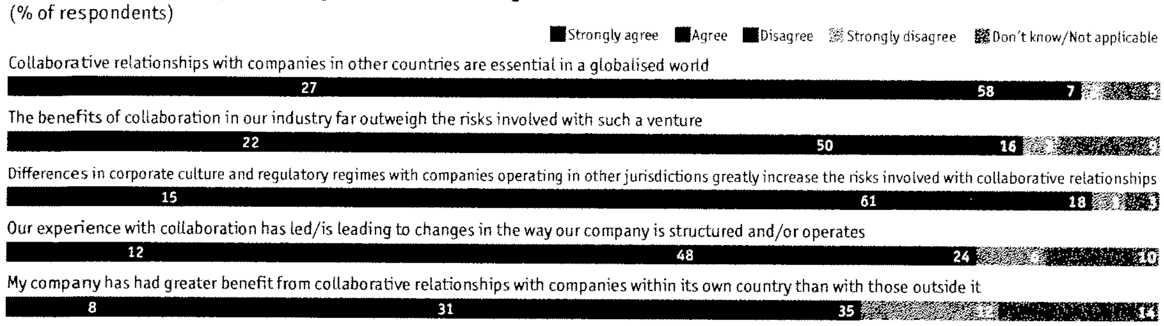
In your company's experience of collaborative relationships, which of the following pose the greatest risks?
(% respondents)



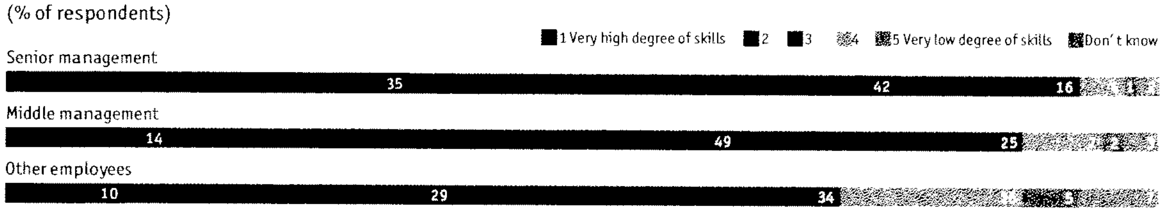
How does your company intend to improve the most important skills required for collaborative relationships?
(% respondents)



To what extent do you agree or disagree with the following statements?
(% of respondents)



How would you rate the abilities of the following groups within your company with respect to the skills selected in the previous question?
(% of respondents)



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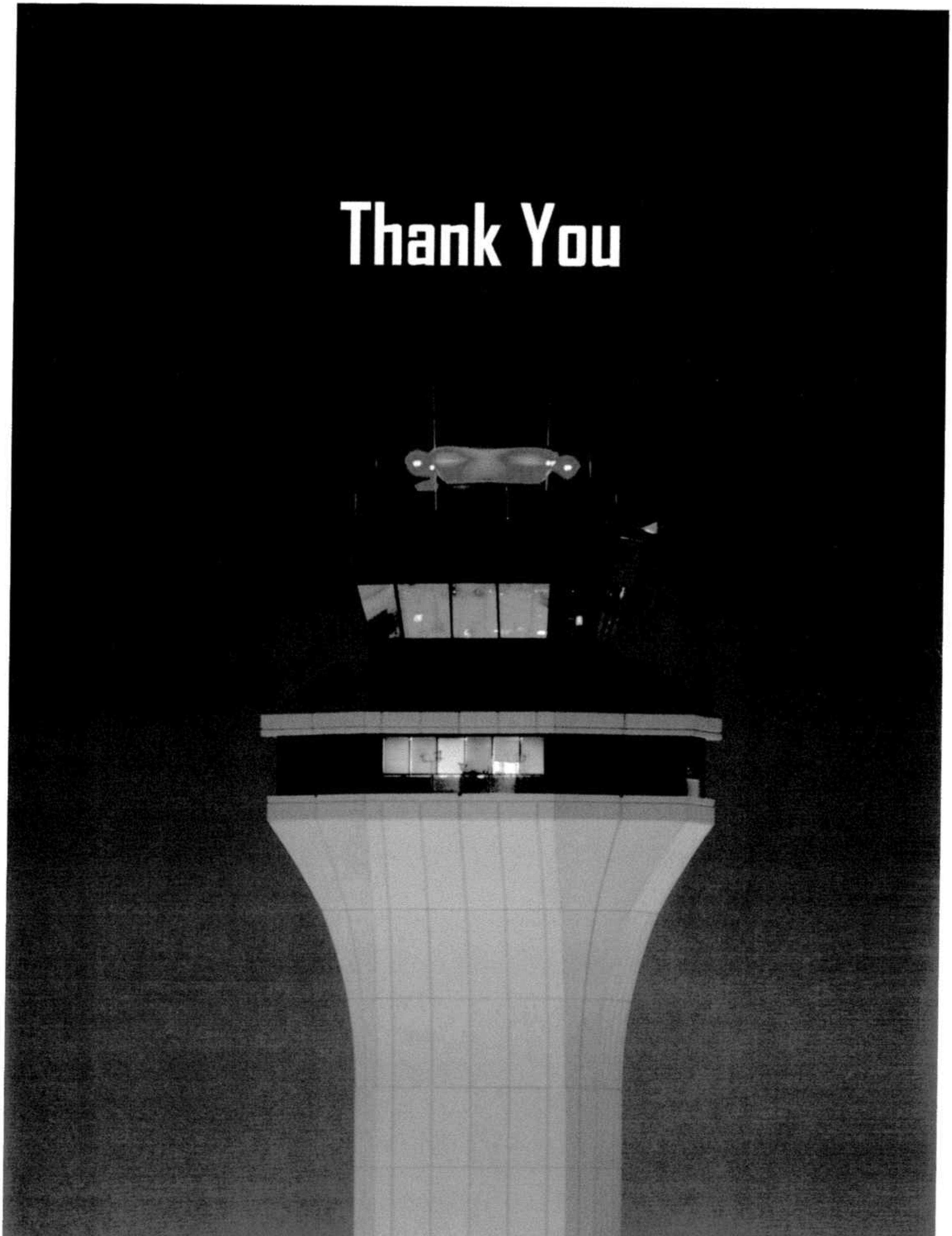
Thank You