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THE NEW CAPITALISM

An eye-opener for Asia?

By Joergen Oerstroem Moeller

THE world is moving away from the textbook edition of capitalism towards a new paradigm. Funds are now transferred from place to place seamlessly. Reputable economies benefit. Economies not living up to the expected and/or required scoreboards are penalised by dwindling investments, auguring the prospect of an economic backwater in the making. Stock markets are at record levels and, judging by traditional theories, out of line with reality.

According to the financial dailies, the activities of investment funds form a major reason for the rising stock market indices in the United States and Europe. These funds are on the prowl to buy, often through unfriendly takeovers of what used to be profitable, viable and well-managed enterprises. The bids are consummated through offers of 30 per cent to 40 per cent above current market prices.

The willingness of institutional investors to pay a higher price makes stock market prices well above the historical average for price/earnings ratios of about 17 irrelevant.

This gives rise to some naive, simple, albeit fundamental, questions: Why do institutional investors think they can manage the enterprise in question so much better than the existing professional managements and boards, both of which presumably know their business quite well?

The answer to that simple question is worrisome. Normally, the typical 'New Capitalism' transaction works in such a way that, right after the purchase, the fund mortgages an enterprise through the roof, after which a large dividend is paid, compensating the fund for a part of its investment. This manoeuvre suggests the predator has limited its potential loss and is able to boast a short-term gain flowing from the takeover, regardless of the capital outlay.

Now comes the tricky part of such deals, of which there are essentially two models.

First, the newly acquired enterprise may be broken up and its constituent components sold separately for a high price to other companies able to or expecting to generate higher revenue and profit. This model is on the table in the competition between Barclays Bank and the Royal Bank of Scotland to take over the Dutch bank ABN-Amro. Much of the interest revolves around the fate of ABN-Amro's American subsidiary Lasalle Bank.

The second option involves investing upfront with a view to increasing market share and profits in the years to come by running a higher risk than the previous management. Such a model is pursued by the various American funds that have taken over English football

clubs such as Manchester United, Liverpool and Aston Villa. To generate higher revenue and profits, these clubs need to win some title every year.

But even an amateur investor knows that only one club can win and second place could well lead down a road towards bankruptcy. The argument runs that audio-visual channels are a big market, opening the window for virtual spectators and a larger fan base. This is correct, in that these people support winning clubs. But often, the overwhelming supporter base is limited to diehard fans, thus not necessarily generating more revenue than before.

In 2001, the English club Leeds United mortgaged itself to try to dominate at home and win the European Champions League. But it failed and had to sell its best players (assets in the business vocabulary) to pay back loans, and is now largely forgotten - all in the space of a few short years.

New capitalism, at least in the US and Europe, dictates that a considerable part of a business be mortgaged to generate a rise in revenue and profits on the back of anticipated economic growth. In doing so, higher risks are accepted. If the US and European economies start to slow down, somebody down the financial chain will face heavy losses.

Even with strong growth, the question remains: How do takeover funds plan to squeeze more profits out of an enterprise than it made when it was probably running optimally under its incumbent management.

Lesson No.1 of new capitalism is not so much about economics but the social, sociological and political dimension. In 1965, private investors owned about 80 per cent of US shares, with 20 per cent in the hands of institutional investors. The owners of such enterprises and employees were average Americans. Their interests were congruous.

This is no longer so. Private investors now account for less than a third and institutional investors for more than two-thirds of total shareholding. The bond between owners and employees has been cut; they are not the same group of people any more.

Lesson No.2 is that the relationship between owners and employees has become asymmetrical, no longer working in the same direction. This growing dichotomy may not be visible during periods of high growth, but will certainly surface when an economic slowdown calls for burden-sharing. Lopsided distribution of benefits is one thing, unequal burden-sharing another.

New capitalism portends stringent rules about the origins of money channelled into funds. New capitalism tends to make capital-tracing difficult. Although financial surveillance and vigilance are believed to prevent whitewashing through these funds, global money can be earned in dubious ways without breaking rules or contradicting legal guidelines.

Regardless of whether this is the case or not, the point remains that anonymous owners take control of enterprises with the sole objective of making more money without really

bothering about the economic impact on nation states or employees in affected companies. Sometimes, a legal framework is created to permit risks at odds with good corporate governance.

The spread of capitalism in Asia and the liberalisation of its financial markets, accompanied by the rise of regional business, may make it worthwhile for Asian policymakers to look at European and US experiences to pre-empt what may be classified as unexpected, and sometimes unwanted, behaviour in their markets. For these may have knock-on effects in the economic, social and political realms.

If not, future operations undertaken by respectable and reputable investment funds, in many cases furthering growth in Asia, may well be looked upon with suspicion by the domestic population.

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