EXECUTIVE INSIGHTS:
CONFRONTING CONTEMPORARY EUROPEAN BUSINESS CHALLENGES
The Hudson Highland Group Thought Leadership Series addresses timely, relevant topics and issues surrounding human capital management and workplace performance. Published periodically by the company, these articles showcase the perspectives and insights of our industry experts around the world. Their content is intended to spark new ideas—and ultimately innovation—for business leaders and managers.
run a business under extraordinary government regulations? How do you run a business in a common market where there is free trade across countries, but that still have different regulations?"

Zonis pointed out that prospective members of the European Union have to adopt a body of law that is now 80,000 pages long. "In many cases the regulations are less favorable to business than the ones they already have."

Employment laws in Europe limit companies’ flexibility in hiring and firing. For example, in Germany, companies may dismiss an employee only if they can prove an economic necessity for the action, such as a shutdown of a production site or a general reduction. Only in extreme cases can a dismissal be based on poor performance. Laws requiring notice of dismissal are strict in the European Union countries. Notice periods range from two weeks for newer full-time employees to one year for older, veteran workers. In addition, most of the EU member countries, including Germany, France and the United Kingdom, require employers to have a written contract with every employee.

Jeremy Lester, European COO of Jones Lang LaSalle, pointed out, “In Europe, people give notice and they have three to six months worth of contract to work out. Sometimes it can be up to a year. [If] you want to give someone notice, or someone wants to give the company notice, there can be effectively six months where that individual can’t go and work somewhere else.” Jones Lang LaSalle is a Chicago-based real estate services company that helps customers buy, sell and manage property around the world.

Annette Messember, SVP for Europe of JPMorgan Chase, a global financial services company, concurred that employment regulations “make it more expensive for companies or banks to hire. It’s very cumbersome to fire people here [in Germany]. It’s very inflexible. France and Italy have the same problem.”

As a result of strict employment regulations, more companies are hiring workers informally and not paying taxes, so it is easier to lay them off, Zonis said. He doesn’t

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**THE CENTRAL PROBLEM IS, HOW DO YOU RUN A BUSINESS PROFITABLY IN A HIGH-TAX, HIGH-LABOR COST ENVIRONMENT?**

On the eve of the 2004 expansion of the European Union from 15 to 25 members, and with economic recovery in Europe stalled, the University of Chicago Graduate School of Business and the Hudson Highland Center for High Performance invited a virtual panel of top-level European executives and University of Chicago business school professors to discuss the challenges facing European businesses. These challenges include regulatory barriers, increasing competition, balancing short- and long-term demands, and managing in an economic downturn.

Participating companies included global, regional and niche players in the financial services, energy, airline, pharmaceutical, office equipment and real estate industries.

Dominating the concern of corporate executives are the barriers that make doing business in Europe difficult. “The central problem is, how do you run a business profitably in a high-tax, high-labor cost environment,” noted Marvin Zonis, professor emeritus at the University of Chicago’s Graduate School of Business. “How do you
think it’s likely that Europeans will soon adopt more rational employment legislation. “How you run a business with the restraints European governments impose on businesses is a phenomenal problem,” he said.

The U.S. Sarbanes-Oxley Act of 2002 is creating additional complications. “Increasingly, European companies will find themselves having to conform to Sarbanes-Oxley, partly because they will seek to list in or raise capital in the U.S. and partly because Europe will clearly move to more stringent corporate governance rules. That will make it tough for small companies,” said Zonis. He noted that the minimal costs to a small company of adhering to Sarbanes-Oxley is $2 million per year.

Among other things, Sarbanes-Oxley requires public companies to establish an independent audit committee and prohibits personal loans to executives. It also requires the CEO and CFO to prepare a statement certifying the appropriateness of all company financial statements.

Lester, of Jones Lang LaSalle, believes that the underlying principles of Sarbanes-Oxley are what “you should have in running any well-managed organization.” He added, however, “I think what we’re seeing to an extent is an overreaction, given the experiences in the U.S.” He acknowledged that there have been similar issues and challenges in some European countries. “Nevertheless, there is a risk that Sarbanes-Oxley creates a greater level of governance for European countries than is really necessary.” He noted that the Institute of Directors, a prestigious membership organization representing English businesses, has challenged its members to carefully consider the value of their NYSE listings in light of the cost of becoming fully compliant with Sarbanes-Oxley.

Pricing differences throughout Europe also make it difficult to do business. In the pharmaceutical industry, for example, prices vary widely from country to country. Unlike the United States (which has no price controls on pharmaceutical companies and the highest drug prices in the world), European countries all have some form of price control, but each country has its own system for regulating the industry.
“When it comes to drug reimbursement, it’s at the country level and it differs dramatically among countries,’’ said Paul Levesque, VP of Marketing for Pfizer Paris. Pfizer, headquartered in New York, became the world’s top pharmaceutical company with its 2003 acquisition of Pharmacia.

The U.K., for example, sets a maximum profit level for drug companies. France and Italy allow companies to sell pharmaceuticals at any price, but their national health care systems will not reimburse for pharmaceuticals sold above a certain price. In Germany, reimbursement for drugs is done through insurance funds. The government places no restriction on prices for innovative drugs for five years, but the insurance funds can negotiate a lower price with the drug manufacturers. If a new drug is similar to an existing drug, prices are regulated right away. The consequence of different prices in each country is “there is going to be pressure on exportation and importation,” noted Levesque.

Similarly, securities regulations are very different from one country to the next, according to Jean-Pierre Pinatton, co-CEO of Oddo-Pinatton, a niche financial services company headquartered in Paris. Pinatton said he is looking forward to a unified European securities market for the 25 EU countries. “The concept is based on totally open competition. Today we have to bring the orders of our clients to the market where the stock is listed. In the future, we are going to have competition with exchanges and between exchanges,’’ he said. “It’s going to change Europe.”

While the European Union doesn’t have a specific timeline to create a centralized securities exchange, it appears to be heading in that direction. The adoption of the euro has eliminated exchange rate risk and reduced the cost of transactions, leading to a freer investment climate, according to experts. This has paved the way for a proposal by the influential European Council that would allow investment firms to operate throughout the European Union if they are authorized in their home state.

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INCREASED COMPETITION

Companies doing business in Europe face competition from everywhere. Messemer, of JPMorgan Chase, noted, “I compete against other American firms.
I compete against other European players and big British companies or French or Swiss, you name it. It’s definitely international.

The most difficult competition comes from U.S. companies because of their scale. In the financial services industry, for example, “Consolidation has left the American banks in a very dominant position—partly because their own home market is so vast that it gives them scale with which to expand to the rest of the world,” said Andrew Tucker, partner of New York-based investment services firm Brown Brothers Harriman and chairman of its European subsidiaries. While consolidation is coming, he said, Europe is “still a very fragmented marketplace. France is still very different than Germany and it’s different than England. [For] indigenous players in those markets—their whole market is not as big as the United States so they don’t have the same scale,” Tucker added.

To compete, European companies may have to serve all of Europe. “We have to face the fact that in the future the financial services and insurance companies that are able to have a European dimension will obviously have an advantage over the others,” commented Edmond Alphandery, chairman of the Supervisory Board of Paris-based CNP Assurances.

Zonis pointed out that the problem of scale is not particular to the financial services industry. “This ought to be a huge problem for everybody in Europe because now we’re beginning to see cross-border mergers and we’re beginning to see hostile takeovers. The whole question is, ‘What is the scale that a business needs to have to be successful in the European Union, and what are the implications for companies that don’t have that scale?’” Zonis cited automaker Fiat as a hugely successful company that is not big enough to compete any more. “The ability to compete in a vastly expanded single European market is getting harder and harder,” he said.

Several niche players noted that businesses need to stake out their territory as either a mega-company or a niche player. Pinatton, of Oddo-Pinatton, concluded that there is only room for two types of intermediaries—the huge ones, primarily American, and specialists. “But, you should never be in-between.” Brown Brothers Harriman has chosen to specialize. “We have competitive advantages or dominant positions and focus on those,” said Tucker. The debate is beginning to shift, he
observed. “Even the big guys who have trillions of assets under management are starting to focus on the parts of the business where they already have a dominant or competitive position.”

Other companies have addressed increased competition and globalization by sharing best practices throughout the company. Jones Lang LaSalle, for example, aggressively exports ideas and client solutions from region to region. “It’s one of our underlying strengths,” said Lester.

The Bank of Ireland shares best practices by infusing high-performers into new business units to jumpstart performance. “Some of our best people have [permanently] gone into new areas,” said Padraig Langan, a manager in the bank’s Operations & Payments division, which was identified as one of the “Best Companies To Work For In Ireland – 2003,” according to Discovery Research.

Panelists agreed that many of the factors that gave companies a competitive advantage in the past no longer work today. “We’re seeing in many industries a shift at the fundamental level in what’s required to compete successfully…and this poses huge challenges to leaders of organizations,” said Harry Davis, a professor at the University of Chicago’s Graduate School of Business.

Davis pointed out that in the European and American markets, competitive advantage is not going to be from low labor costs, “it’s going to be [from] our innovative capabilities and the intellectual capital that we generate.” Intellectual capital cannot come only from the top of the organization; leaders must understand that they can’t have all the answers, he added.

Faced with the need to adapt quickly to disruptive forces that are out of their control, today’s leaders need to inspire everyone to do their best work. “I think we’re looking for a much more nuanced leadership style. Often the qualities that we need are seemingly paradoxical: sometimes it’s important to be very open minded and
sometimes it’s important to be closed minded and focused. Sometimes it’s important to be optimistic and idealistic and other times it’s important to be realistic and hard-nosed,” Davis said.

Good leadership is like jazz, he added. You set some boundaries that people have to operate within—but not very many—and then allow them to improvise and create within those boundaries.

Although there’s a lot of talk about empowerment, there’s still very much a top-down view both among leaders and employees, Davis said. “It’s a lot easier to blame leaders—to go back to the old ways—when you’re under stress.”

Tucker, of Brown Brothers Harriman, agreed that in an increasingly complex environment, different kinds of leadership skills are necessary. “It’s easy to lead when you have direct ownership and management of the people who are working for you because you tell them what to do. If they don’t do it, you can fire them,” he said. However, a lot of complicated projects fail because they require buy-in and input from other parts of the organization to be successful. “You can’t order them to [do things]. You have to persuade [them].” Interacting with people in these situations is “a very important skill set,” he noted.

Many of the panelists said that leaders must continually upgrade their skills to be effective managers. “Intellectually, we are still curious to learn. You have to be. Things are changing all the time and we need to keep up;” said Thomas Eckert, managing director/Capital Markets of Dresdner Kleinwort Wasserstein in Frankfurt. The firm, headquartered in London, provides investment banking services to corporate, institutional and government clients worldwide.

Eckert noted that a lot of managers who went to business school 15 to 20 years ago “need to see the bigger picture once in a while again.” He looks for opportunities to interact with a “heterogeneous group of people with different experiences. Bring someone who’s with Procter & Gamble or Nike—just a very different mix of people.”

Lester, of Jones Lang LaSalle, said that for him the most valuable gatherings are “the ones where you get time to meet and share with like-minded people.” He said it is particularly helpful to build relationships with individuals who operate in a slightly different sector but face the same business challenges.

JUGGLING ACT

For many of the companies, balancing conflicting demands is a continual struggle. Asked about challenges facing his company, Shell UK Chairman Clive Mather said, “The first thing I would always point to is the tension between the long-term and the short-term. I wouldn’t claim that it’s unique to our sector—but it’s certainly very evident in the energy business. I mean, we are required—all major corporations are—to jump through hoops every quarter.”

Yet, on the other hand, long-term, large-scale projects in the oil industry can require investments of 30 years or longer. “You are looking at billions and billions of money at risk. It doesn’t easily sit with a quarter-to-quarter [approach]. I think that’s a dichotomy which is real in our sector,” Mather added.

Mather noted that corporations must explain the importance of a long-term focus to their shareholders. However, he recognizes that a large corporation, such as Shell, must remember that a lot of people depend on dividends from the company. “I doubt there is a major pension fund that doesn’t own a block of Shell shares,” he said.

In the context of investment in renewable energies, Mather said, “You can’t go to the community and say, ‘Hey, the good news is that we are going to solve all the world’s environmental problems and the bad news is you don’t get dividends for the next 10 years.’ That’s not going to work.” The solution is to make prudent capital investments gradually, and see how best to develop a commercial business over time, he said. “Then as returns improve you can increase your capital spending, in line with your experience. I think that’s how you do it. But it’s certainly a challenge.”

Lester, of Jones Lang LaSalle, acknowledged that one of his personal challenges is to “maintain the long-term, short-term balance. I do struggle every so often with some of the implications of the long-term decisions. I just want to be sure that we’ve communicated those properly to our own people and our shareholders so
that our key stakeholders understand [the] consequences.” Lester said his company also must balance the needs of clients, employees and shareholders. “It is easy to overservice clients with all the best of intentions,” he added.

Several panelists noted that many companies sometimes avoid addressing important problems because they know they can’t get payback in one quarter. For example, since they can’t afford to take a charge in a single quarter for the cost of firing non-performers, they do nothing. Quarterly reporting drives how they run their business.

**ECONOMIC DOWNTURN**

Not surprisingly, the economic downturn of the past several years has created a significant challenge for European businesses.

While the U.S. economy appears to be recovering, growth in Europe has stagnated. For example, in the third quarter of 2003, the gross domestic product (GDP) in the U.S. grew at an annualized rate of 8.2 percent, the highest jump in nearly 20 years, while the average growth in the European Union was 0.4 percent. The strength of the euro accounts for some of the gap, but even in 2001 and 2002, when the euro was much weaker, the European economy did not keep pace with the U.S.

For Eckert, the situation is frustrating. “It’s ridiculous—no growth and no growth. When you compare to the U.S. GDP growth, we’re dead last here.” Dresdner Kleinwort Wasserstein has been hit hard by the slow economy.

It is not alone. Tucker, of Brown Brothers Harriman, called the last three years “a perfect storm” in the financial services industry. “You had this unusual combination of recession combined with low inflation and, therefore, low interest rates. That, for most financial services, has been a little bit of a double whammy.” Tucker added, “Clearly, you have to take steps to adjust to the current economic environment. I don’t necessarily see this as having fundamentally changed the way business is done; it is more a part of the economic cycle.”
Tucker argued that companies overreacted to the downturn because of the long bull market that preceded it. “[People] think that the sky is falling. Therefore, [they] take severe measures to reduce expenditures and headcount, stop doing forward-thinking projects, and just focus on daily survival. I think that as people realize that, in fact, we are not faced with another Great Depression or things are not as bad as they first seemed, they start to loosen the purse strings.”

Tucker pointed out that it takes a while to see an increase in jobs. “It’s a little bit of turning the tanker around in the ocean. It tends to happen slower than some of the economic indicators suggest,” he said. Consequently hiring freezes last longer than might be necessary. However, after a period of having fewer people do more and more, “eventually you reach a point where that is no longer tenable. Profits start flowing back into the business, so you take your foot off the brake and start selectively hiring people to do some projects that you have deferred for the last two or three years.”

It is more difficult to manage in a downturn “particularly when people are used to ever-increasing bonuses and constant salary increases,” Tucker said. But unlike many other companies, Brown Brothers Harriman did not resort to across-the-board layoffs.

Referring to a large competitor that eliminated 10 percent of its workforce, he observed, “By the time they actually achieve the savings from that draconian measure, which typically is about 18 months, the economy has turned and they’re starting to hire again. In the meantime, they have the cost of rehiring and the morale cost of the survivors wondering if they are going to be next,” Tucker said. Instead, Brown Brothers Harriman sharpened its performance measures to make firing decisions on an individual basis. “[People] are not just numbers or names on a company directory. It’s smarter to try to manage in a more benign fashion as opposed to resorting to this sort of hire and fire approach,” he commented.

Oddo-Pinatton takes a similar view. “When we do fire it’s because something has gone wrong. Plus 20 percent; minus 20 percent—it’s not our style,” said Pinatton.

Nevertheless, firing people who are not performing is critical. Noted Tucker, “Not only are they costing you money but they are demoralizing workers around them who say, ‘Why should I work as hard as I do when this person is not performing.’”

Retaining good employees in a down economy is another challenge. “How do you create progression opportunities for the ambitious in low growth environments?” Lester, of Jones Lang LaSalle, asked rhetorically. Added Eckert, of Dresdner Kleinwort Wasserstein, “For the best employees there is always a market. We continuously run the risk of losing them.”

To create a competitive advantage in recruiting employees, companies can no longer depend solely on brand recognition, Eckert said. Instead, they need to create an environment where employees’ personal needs, as well as their professional needs, are met. The emotional and interpersonal dimension of investment banking hasn’t changed in very large companies, he said, “but in places like Dresdner Kleinwort Wasserstein it has ... [I’m] a lot more social in terms of inviting [employees] to my home, going out for a beer with them, caring about their personal problems. I do a lot more of that ‘work’ with these issues relative to my overall agenda than I ever did before.”

Companies are looking for people who can adapt to the culture of the country in which they will work. “I think that Americans can blunder in Europe by being very American and not having cultural sensitivity,” said Tucker.

Several of the panelists noted differences in attitude between European and American workers. Mather, of Shell UK, said that workers’ expectations that employers and the government will take care of them are much higher in Europe than in the United States. “I think the psyche of the nation (is different). Americans are much higher risk-takers around personal finance and retirement than here,” he said.

For example, Mather said that when he talks to people in Houston who lost everything post-Enron, they say, “We just have to work until age 75 or 85.” They don’t despair. [They] just say, ‘Well, that’s the way it is. Hitch up the wagons, here we go again.’ You think—wow, what an extraordinary asset. You would not find that here.”

Attitudes toward women also are different, noted Messemer, of JPMorgan Chase. “In Europe, it’s still more difficult being a woman in the upper business echelon.
than it is in the Anglo-Saxon countries. In the U.S. or in England it’s not a topic if you work or are in a high position in the company. On the continent, particularly in Germany, it still is a big exception.”

To increase the likelihood that employees will be culturally sensitive, companies are seeking people who have worked in more than one country. Alphandery, of CNP Assurances, expects that his company will hire more people “who speak many languages fluently and have experience from abroad—who have worked in firms outside of France. This will probably be the first quality which will be required for top executives for companies like CNP.” France’s top personal life insurer, CNP Assurances also has operations in Argentina, Brazil, China, Italy and Portugal.

“We are looking for smart people who understand what some of the dynamics are and what some of the strategic and tactical challenges based in the industry are,” Tucker added. In the past 10 years, Brown Brothers Harriman has hired a combination of internal and outside people. “In the old days, it was a little more of a closed shop. I think that if you look back at the history of the bank, you could see where perhaps it wasn’t rejuvenating itself enough and as a result wasn’t dynamic enough.”

Zonis, of the University of Chicago, argued that countries with an entrepreneurial culture have an easier time recruiting foreigners. For example, he said, “I think [young people] are going to the UK because they see it as a more entrepreneurial culture which provides more opportunities than the bureaucracy of French industry.”

Several panelists perceived taxes as a make-or-break issue for potential employees. “The problem we have in France is the tax system is rather expensive. People who have been living in London or Germany … it’s difficult to get them to come [to Paris] because they pay more income tax,” said Pinatton. Messemer, who said she pays more than 50 percent in taxes in Germany, noted, “It’s very difficult to get really good international people if you don’t get them on an ‘ex-pat’ package,” which subsidizes living expenses. She also mentioned that JPMorgan Chase sometimes has problems “finding people who are really prepared to work hard. A lot of people are no longer willing to do that. Don’t ask me why.”
Faced with recruitment and retention challenges, the high cost of doing business, increased competition from globalization, the difficulty balancing long- and short-term goals and more, one might assume that European business leaders are pessimistic about their prospects. However, the virtual panelists are aware that the world has changed in confusing ways before. "Our predecessors and ancestors were grappling with the same kinds of things, often even bigger, believe it or not, than we have now. It just doesn’t seem that way because all those problems are solved and the ones that we’re dealing with today are not yet fully resolved," said John P. Gould, professor of economics at the University of Chicago Graduate School of Business.

Despite the many challenges, most of the panelists are upbeat about their companies and the future. Referring to his role at Shell UK, Mather observed, "I don’t think anybody pretends that it’s easy. I don’t think anybody feels comfortable. But, I do think people feel that what they’re doing matters. At the end of the day, whatever the challenges are—they are worth it. I don’t wake up in the morning and think, ‘How are we going to get through this day?’ I wake up and think, ‘What a privilege to have this opportunity.’"