View metadata, citation and similar papers at core.ac.uk

brought to you by CORE

provided by SAS-SPACE



# The USA

## Competition strategies must adapt to the euro

by Richard Cordero

The devaluation of the Thai currency in 1997 was the triggering event for the Asian financial crisis. For the countries in that region it is now too expensive to buy in dollars, and American producers are hard-pressed to compete with imports priced in their cheap currencies. Consequently, last August saw one of the worst US trade deficits ever – almost $17 billion. Now another earth-shaking currency event is about to hit companies in the US. It can be traced back to what US Secretary of Commerce William M Daley believes could prove the most significant development since the European Community was formed, namely, the introduction of the euro.

Indeed, the euro was ushered in on 1 January 1999 in 11 of the 15 member states of the European Union (EU). It is now their official common single currency, available for buyer-seller agreed payment by cheque, credit card, or bank transfer. By contrast, the 10 national currencies of these euro-participating member states (Luxembourg does not have its own currency) are only sub-units of the euro. They are linked to it by permanently-fixed official conversion rates and, as a result, are also linked to each other by derived non-fluctuating rates. Consequently, those currencies are no longer quoted on currency exchanges, only the euro is, which has replaced the ECU on a one-to-one basis. On 1 January 2002, the euro will become legal tender and euro banknotes and coins will be issued, while those of the national currencies will begin to be withdrawn from circulation, a process to be concluded by 30 June 2002, at the latest. Among the currencies that will no longer be legal tender are those as important for international trade and financial transactions as the German mark, the French franc, and the Dutch guilder.

Thus, since January 1999, some 300 million people among those with the highest purchasing power on earth have the euro as their official currency. They are expected to save over $30 billion annually on matters such as foreign exchange commissions, hedging cost, and the management of complex multi-currency treasuries, accounting systems and price lists. For the same reasons of savings and convenience, many more million business people will decide privately to use this new currency in their business dealings. They are citizens of countries whose dominant business partners are the participating member states, i.e. the other four member states, the 11 candidates for accession to the EU, the African, Caribbean, and Pacific countries associated with the EU by the Lomé Convention, and the countries in the Mediterranean basin tied to the EU by economic and commercial treaties.

All these core and peripheral countries will form the *euro zone* and give rise to the significantly most important trading block in the world. This is no exaggeration: the EU alone already accounts for 21% of world trade, followed by the US with 20% and Japan with 10%. With such a large economic basis ensuring its stability and acceptability, the euro is well poised to become the alternative currency for pricing international commodities such as oil, metals, and grains. Thus, this European single common currency is bound to become a major international trading, securities denomination and reserve currency. It simply cannot be ignored.

Yet the overwhelming majority of companies in the US are unprepared for the euro. The US Commerce Department estimates that 20% of companies do not want anything to do with the euro, another 20% do not understand all its potential effects and the other 60% are still trying to get ready; only the very large companies have made considerable progress. Such unpreparedness could deal a fatal blow to companies already weakened by the economic and financial crisis not only in Asia, but also in Latin America and Russia. Worse still, the effects of euro-unpreparedness will be far more insidious.

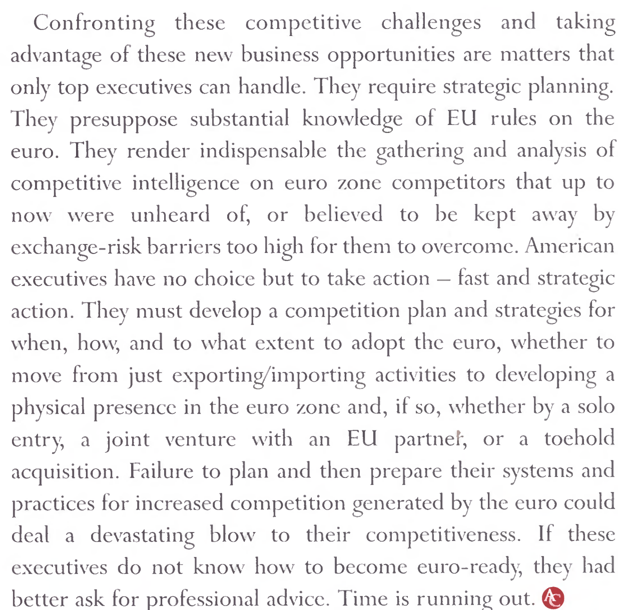
This is so because the euro will undermine the competitiveness of companies in the US doing business with EU countries, whose economies are not only healthy, but some of which are also expanding. For these companies to strengthen their competitive position, much more than just lowering prices is necessary. Significant changes in key business areas are required. One of the most visible areas is information technology. IT systems must be adapted to deal with a single currency rather than 10, in functions as vast and important as pricing, ordering, invoicing, and payments. Such adaptation entails rewriting existing or installing new software, and even upgrading or replacing hardware, in order to redesign or create new spreadsheets, identify all records with currency data and translate their currency values using a no-converse rate set and triangulation, etc. Even the installation of the euro symbol so that software applications and printers can use it may mean the difference between identifying figures as amounts in euros and making an accounting mess. IBM has estimated that just the IT adaptation to the euro will cost over $175 billion and be exceedingly more complex than fixing the Year 2000 problem! Adaptation also requires preparing euro price lists and catalogues and, of course, training all personnel to think in terms of the euro and to use any new euro IT systems.

None of these euro adaptation tasks can be handled by just hiring a couple – or even an army – of computer technicians. The latter cannot decide at what time during the three-year transition period the use of the euro will begin; nor for what transactions it will be used, nor by which customers from what date; whether dual pricing in dollars and euros will be adopted; whether bank accounts will be opened and, if so, where, or whether the company will rely on the obligation of banks in euro member states to convert free of charge between their national currency and the euro; whether securities will be redenominated or issued in euros, etc., etc., etc. The fact is that the euro raises a host of questions that can only be answered at a company's top echelons. Herein lies the crux of the matter: preparing for the euro is above all a matter of strategic planning because this new currency fundamentally changes the terms of competition.

To realise the full scope of this competitive challenge, one must understand that the euro is only the most noticeable manifestation of the Economic and Monetary Union (EMU). This union, built on top of the EU by the 11 participating member states, is based on rules aimed at fostering their macro-economic convergence in the areas of inflation, budget deficits, national debt and interest rates. With economic fundamentals within the same order of magnitude, the EMU members can more readily level the field of competition for their sellers and buyers. For their part, the 11 candidates to EU accession – as opposed to just their business people – strive after convergence because harmonising their economies with that of EMU enhances their chances of EU membership and of official participation in the euro system, while also shortening their transition period. The other peripheral countries naturally take into account the monetary and economic policies of their dominant economic partners, particularly since many of them have already pegged their currencies to either the pivotal German mark, the ECU (now replaced by the euro) or the French franc.

Hence, the introduction of the euro contributes to completing the integration of separate EU national markets into a single composite domestic market. It eliminates the cost of exchange transactions and hedging, which on average represents 7% of a commercial transaction in the EU. That percentage is large enough to make the difference between being competitive and being priced out of the market. Moreover, the elimination of currency fluctuation risk constitutes a most powerful incentive for companies in one euro member state to sell or buy in the other euro member states or even open branches and subsidiaries there. A single currency resting on a very broad economic base fosters monetary stability and, by reducing the cost of doing business, stimulates competition in all the countries that officially or unofficially use the euro. That can set off a commercial turmoil.

So one day in the near future companies in the US will wake up only to realise that the nice little niche that they have carved out for themselves, let's say, in France, is now surrounded by a pack of hungry competitors from Finland, Austria, and Ireland! Are these companies going to call in computer 'techies' to rescue them? Of course not! Or it may dawn on them that entering into previously-avoided contractual relations with firms in Italy, Portugal, or Spain is decidedly safer and, in principle, as safe as doing business in Germany, the Netherlands, or Belgium. Then they will come under fire from all their current and potential business partners in the euro zone, who will ask them to do business in euros, and for good reason: the time has come for those partners to amortise the equivalent of billions of dollars that they have spent on becoming euro-ready by adapting their own business practices and systems to the new currency. Their sheer numbers could force companies in the US either to oblige them ... or resign themselves to being placed at a competitive disadvantage vis-à-vis more accommodating companies.



Confronting these competitive challenges and taking advantage of these new business opportunities are matters that only top executives can handle. They require strategic planning. They presuppose substantial knowledge of EU rules on the euro. They render indispensable the gathering and analysis of competitive intelligence on euro zone competitors that up to now were unheard of, or believed to be kept away by exchange-risk barriers too high for them to overcome. American executives have no choice but to take action – fast and strategic action. They must develop a competition plan and strategies for when, how, and to what extent to adopt the euro, whether to move from just exporting/importing activities to developing a physical presence in the euro zone and, if so, whether by a solo entry, a joint venture with an EU partner, or a toehold acquisition. Failure to plan and then prepare their systems and practices for increased competition generated by the euro could deal a devastating blow to their competitiveness. If these executives do not know how to become euro-ready, they had better ask for professional advice. Time is running out.

**Dr Richard Cordero**

*PhD in law, University of Cambridge, England; MBA, University of Michigan, USA*

Dr Cordero is a researcher and writer specialising in the adaptation of business practices and systems to the euro, and other EU monetary and financial matters, as well as legal and business aspects of the telecommunications and entertainment industries in the US.
E-mail: RicCordero@aol.com

*Amicus Curiae*

**Submission of articles**

Readers of *Amicus Curiae* are welcome to submit contributions (not exceeding 3000 words) for publication. Information, including author style notes, is available on the Internet at: http://ials.sas.ac.uk/amicus.htm

*Please contact Julian Harris or Peter Gray for further information at:*

*Institute of Advanced Legal Studies*
*17 Russell Square*
*London*
*WC1B 5DR*
*E-mail: julian.harris@sas.ac.uk and peter.gray@sas.ac.uk*