'DO I LOOK LIKE A CEO?'

Bram Cohen has Asperger's, which makes it hard to deal with everyday life. Even so, he started his own company, BitTorrent

By Susan Berfield
Photograph by Eric Millette

Bram Cohen's brain works differently from most people's. He has Asperger's syndrome, a condition that keeps him rooted in the world of objects and patterns, puzzles and computers, but leaves him floating, disoriented, in the everyday swirl of human interactions. ¶ When Cohen was in his late twenties he sat on a wooden chair with a Dell keyboard on his lap for the better part of nine months writing a software program. In 2001 he introduced BitTorrent, an ingenious, disruptive, and controversial piece of technology that is available for free and lets people easily exchange huge amounts of digital information, from software upgrades to videos. Pirated movies have always been the most popular files shared. They, along with more legitimate files, now generate about half of all traffic on the Internet.

BitTorrent brought Cohen fame and notoriety. It turned him into a folk hero and a Hollywood villain. Later, to reclaim the program for himself and possibly for some greater good, Cohen was obliged to become something else he had never considered: a boss. Four years ago, at age 29, he co-founded a company, BitTorrent, to build a business around his software. He got good money from venture capitalists but is still trying to find a convincing strategy.

For Cohen, this has been a fraught journey into the sometimes bewildering world of the office. The social conventions that ease everyday interactions can still elude him. He doesn't like to shake hands or wear shoes or make small talk. He often plays with a Rubik's Cube. Sometimes when he is outraged, or more often when he is fatigued, he bursts forth with unwelcome candor. He can be oblivious, lecturing on solar cells or economic theory or euphemisms until someone stops him.

Cohen's predicament is not so unusual. Asperger's, only formally recognized in the mid-1990s, is being diagnosed with increasing frequency. Many psychologists view it as a mild form of autism, though that definition is controversial; some advocates believe it is simply a different way of being. In the coming years more people like Cohen will arrive in the workplace, and their presence will have significant consequences, perhaps most obviously in the way we communicate.

Cohen's childhood in Manhattan was one of isolation. He lived comfortably enough with his mother and father and younger brother, Ross, and they shared a vigorous intellectual life. But he had no friends. At 16, he could program in three languages. Yet he could not comprehend the social hierarchies of adolescence. "I was picked on a lot," he says. "There was something obviously wrong with me. But it wasn't acknowledged until I was much older that something had always been off-kilter. Were I to have to redo high school, I would just drop out immediately." He attended the State University of New York at Buffalo for one miserable year and then left.

"THIS IS STUPID"

Back in Manhattan, staying with his parents, he struggled in the working world as a computer programmer. "At first he would be enthusiastic, and then pretty soon he would tell the people who were running the startup they were doing things wrong," says his father, Barry, a writer who had returned to school to study computer science. "If they didn't listen to him—and they

Cohen in San Francisco, where his quirks aren't seen as a big deal

never did—he would say 'this is stupid' and he would quit."

By 1997 the code rush was on, and Cohen went west. In San Francisco he felt at ease, and even a bit elated, surrounded by other computer geeks. Here his trouble deciphering human complexities, his seeming indifference to social imperatives, and all his quirks of character were mostly viewed as beside the point. The point was what he could accomplish. In this, Silicon Valley is not as distinct a place as it might seem. Psychologists have noticed clusters of people with Asperger's wherever there is a concentration of high-tech companies.

It took Cohen a few years and several more startups before he discovered what he wanted to do: find an efficient way to share huge amounts of digital data. Napster and other peer-to-peer programs already allowed people to pass smaller music files from one computer to another. But big files would clog the system. The elegance of Cohen's solution is that as more people join a network, data move faster rather than slower. His software breaks files into pieces and scatters them on users' hard drives. When someone requests a movie, the software gathers the pieces from the nearest computers on the network and assembles them only once they reach their destination. This allows a file to download much more quickly.

Cohen was surprised that BitTorrent ushered in the golden era of movie piracy. "I was some dude working on some project," he says. "I couldn't anticipate the piracy. But I was very careful from the beginning to distance myself from it. There's only so much planning you can do for the effect on the Internet at large when you're just trying to get people to use your software."

LEARNING EMPATHY

Cohen mostly enjoyed his newfound status. And it was amid this success that he was able to put a name to his lingering complaint. One afternoon in the summer of 2003 he was eating at a Mexican restaurant in Berkeley with his girlfriend, Jenna, and her young daughter. They were talking about empathy, a notion that baffled Cohen. "Then a baby cried, and my daughter turned and made a sad face," Jenna recalls. "He said, 'You mean like that?' I said, 'Yes, it's automatic.' " Not for Cohen, though, who told her that emotions seemed mysterious. Jenna, who had worked with autistic kids, suggested he might have Asperger's.

Cohen never sought a formal diagnosis but turned his considerable attention to the matter. He learned how to detect and mimic human expressions, follow social cues, maintain eye contact, flirt. He began pretending to be normal. "Then I realized how out of it I had been my entire life," he says. Jenna likens Bram to the android Data on *Star Trek*: "He'd add information to his social algorithm and practice until it became natural. He's graduated to being an eccentric nerd."

During the next year, Jenna and Bram had a son and were married. Cohen's father began pestering him to create a company around his hugely popular software. "And I kind of felt like I should do something," says Cohen, who was moving among various projects. A friend introduced him to Ashwin Navin, who had worked at Goldman Sachs and Yahoo!, and along with Cohen's brother, they formed BitTorrent. Then they set out to make peace with the movie studios and bring in investors. In May 2005 pirated versions of the much-anticipated third *Star Wars* movie, *Revenge of the Sith*, were being swapped before the official release. Shortly after, Dean Garfield, the head of legal affairs at the Motion Picture Association of America, approached Cohen and Navin to see if they were serious about going legitimate. They began talking. In November of that year, BitTorrent and the MPAA announced a deal that was largely symbolic but did improve the company's reputation in Hollywood: BitTorrent agreed to remove links

BitTorrent President Navin (left) worked with Cohen to make peace with Hollywood

that directed users to pirated movies. Cohen doesn't like to travel, but he went down to Los Angeles for the day.

Cohen and Navin also were meeting with venture capitalists. David Chao, a co-founder of DCM, a $1.6 billion fund, had been using the software to share family videos and was intrigued by it. Cohen arrived at Chao's office for an initial presentation, took off his shoes, and announced that he had Asperger's. "It's one of the first things he tells most people," says Chao. "He wants to make sure there are no misunderstandings." Cohen said he wanted to run the company, mostly because he didn't trust anybody else to, but promised he'd one day bring in a more experienced leader. Navin would be

MARKHAM JOHNSON

president. Chao agreed to invest $8.75 million. At the first board meeting, Cohen worked on a Rubik's Cube while he was talking, recalls Chao. "He wasn't distracted, though. His hand was solving it." With someone else, Chao says, he might have said, "Please don't play games while we're having a board meeting," but he didn't.

As Cohen and Navin began hiring employees, issues emerged. Ross, who was in charge of the engineers, didn't seem suited to the more structured environment being created. Bram fired him. "He just didn't work out," says Bram. The brothers haven't spoken much since, and Ross didn't return phone calls and e-mails.

Then there was Bram himself. He could be disruptive. He likes to talk and play with his puzzles. "We have to keep him contained so others can work," says Navin. "New employees didn't know they could tell him they had to get back to work." And his overly blunt but rarely ill-intentioned comments didn't always go over well. Ivy Hsu, the office manager, was the first person Cohen and Navin hired. One day Cohen said to her: "I don't understand the point of being detail-oriented. Only the dumb people in this world focus on small details." Hsu has since learned how to deal with him. "You have to communicate according to the rules he understands," she says. "You can cut him off, you can walk away. There is no point in sugarcoating things, because if you do, he may miss the whole point. You just tell him: 'Bram, you're wrong. Bram, don't say things like that.' Usually you would never do that to your boss."

COHEN LIKES TO TALK AND PLAY WITH HIS PUZZLES. "WE HAVE TO KEEP HIM CONTAINED SO OTHERS CAN WORK," SAYS NAVIN

By the end of 2006 it was clear that Cohen's days as CEO were coming to an end. Some founders unprofitably delay this rite of passage. For Cohen, it couldn't come soon enough: "Do I look like a CEO to you? Just saying." BitTorrent was ready to sell a commercial version of the software to media, gaming, and tech companies and to launch a consumer site with licensed content. Navin and Cohen had also interested another investor, Ping Li, a partner at venture capital firm Accel, an early backer of Facebook. Li agreed to put in nearly $20 million to help BitTorrent expand. There would be accounts to supervise, strategies to devise, performance reviews to conduct, meetings to attend. Cohen was bored just thinking about it all.

Giving up the post of chief executive to become chief scientific officer wasn't hard for Cohen, but the nine-month search for his replacement, led by the recruiting firm Heidrick & Struggles, was full of frustration. After BitTorrent found a new chief executive, Cohen dissed the process and some of the other candidates in his blog: "Just because you were approached about being BitTorrent's CEO doesn't necessarily mean that I'd ever heard of you. If I had ever heard of you, it doesn't necessarily mean that I thought you had the necessary experience .... Even if I did think you had the necessary experience, it doesn't mean I wouldn't have gotten fuming mad at your name being suggested for any of a number of other reasons, including in some cases widely known lack of competence and morals." Heidrick doesn't talk about its clients and declined to comment about its work for BitTorrent.

The executive BitTorrent hired is Doug Walker, who had led graphics software company Alias Technology in Toronto. He is circumspect when it comes to Cohen but does say: "You're always going to have an honest conversation with Bram. To me that's fair, even if you may not always like it."

So does Bram Cohen's creation have a future? Some wonder if BitTorrent has missed its moment. Gaming companies are using the software to more swiftly and cheaply distribute their wares. Hollywood studios? Not so much. The company's reputation for piracy may be part of the problem. But media companies also are finding ways to deliver entertainment themselves. All of which has left Cohen & Co. retrenching—in mid-August they laid off 20% of 60 employees—and struggling to find a way forward.

Still, Cohen's original brainstorm has carried him far. And even if his company falters, or his attention is diverted to solving a different problem, his software will be used by millions of people around the world. | BW |

BUSINESSWEEK.COM | To learn more about how BitTorrent's Bram Cohen manages with Asperger's, watch a video interview at www.businessweek.com/go/tv/autism

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In Defense of Piracy

In an essay in *The Wall Street Journal,* Stanford Law School professor Lawrence Lessig argues that our copyright laws are confusing, inefficient, and sometimes nonsensical. Lessig, who is on the board of Creative Commons and author of the forthcoming book *Remix,* believes that the war on peer-to-peer file sharing is a failure. "After a decade of fighting, the law has neither slowed file sharing nor compensated artists," he writes. "We should sue not kids, but for peace."

To read Lessig's essay, go to: **http://bx.businessweek.com/online-video/reference**

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Japan's biotechnology industry—the world's second largest behind the U.S.—is in a period of transformative growth. Targeting biotechnology as a key industry for development, the Japanese government has launched policy initiatives to encourage growth and investment in bio-industry clusters around the country. These clusters are home to a growing number of world-class business ventures whose innovation has made Japan the world leader in several bio-industries. For example, Kringle Pharma, Inc., a clinical stage biopharmaceutical company launched in 2001 in the Kansai Biocluster Project, developed recombinant human Hepatocyte Growth Factor (rhHGF), which functions to accelerate the regeneration and restoration of human tissue and organs. With rhHGF, Kringle is developing regeneration pharmaceuticals that may provide cures to resistant diseases and using its innovative technology to meet the high demand of pharmaceutical companies worldwide. Breakthrough technologies such as this make Japan's biotech industry a fertile environment for foreign investment.

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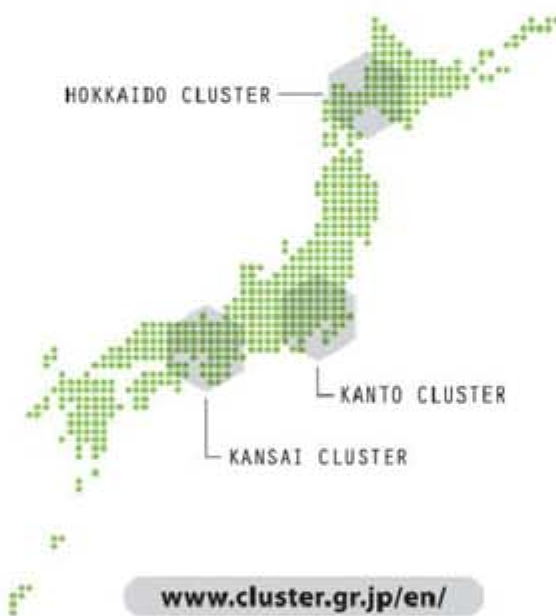

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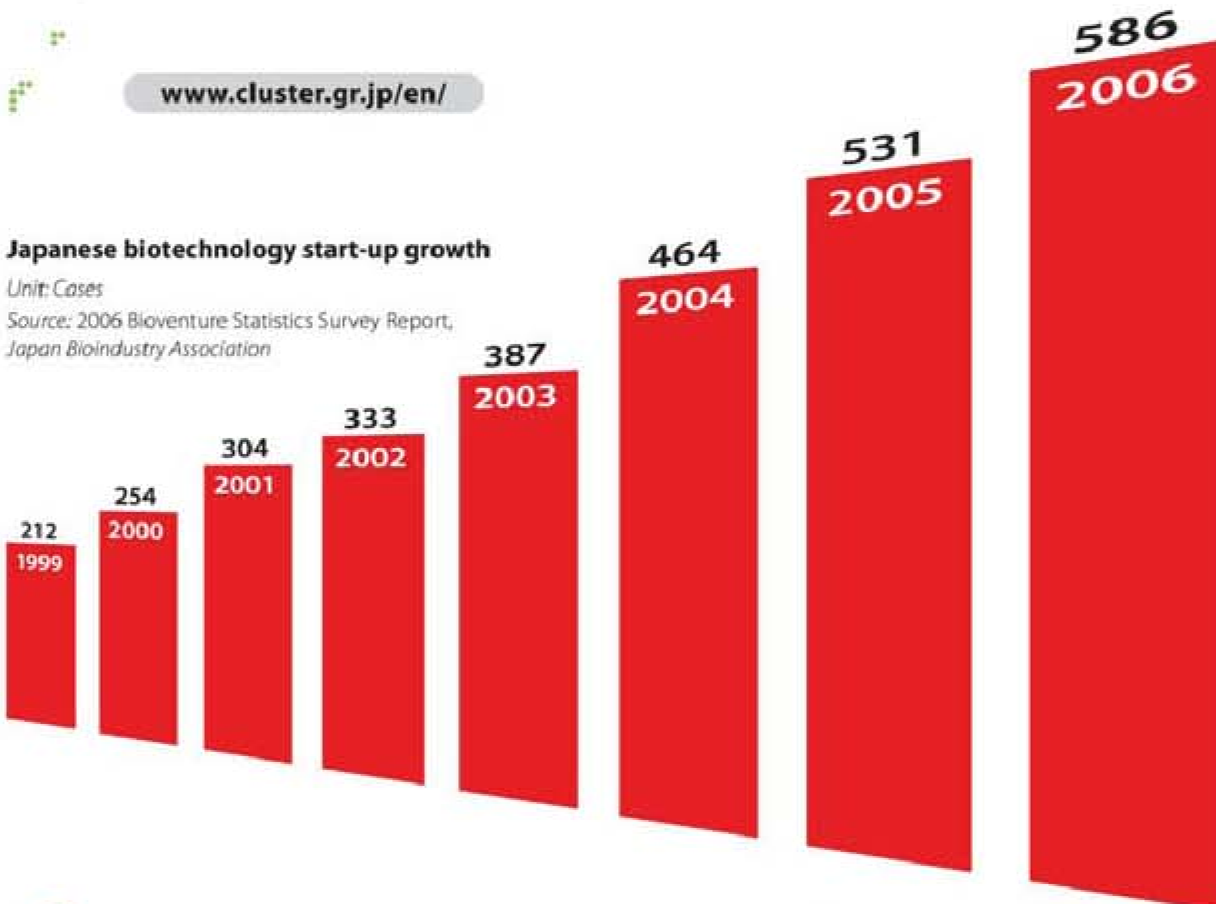
Japanese biotechnology start-up growth

Unit: Cases

Source: 2006 Bioventure Statistics Survey Report, *Japan Bioindustry Association*



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WHAT'S NEXT

REAL ESTATE

It's Low, Low Tide In Miami

Vulture investors are swooping in to feast on the leavings of the housing crash

Miami Ice: Broker Zalewski says it will be years before the market thaws

JEFFERY SALTER/REDUX

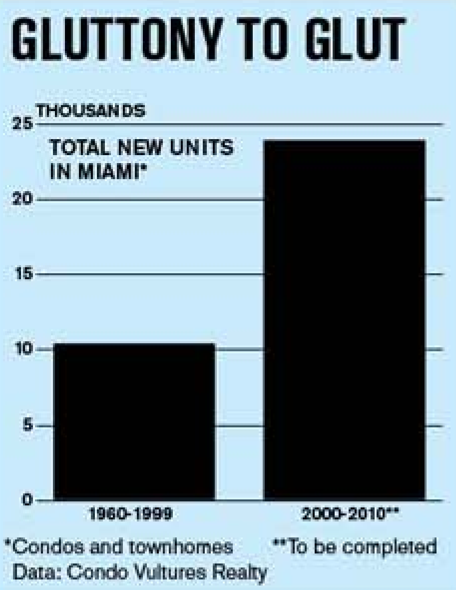
By Roben Farzad

On the 79th Street Causeway that connects inner Miami to the city's beaches, a colony of giant turkey vultures sits ominously on a radio tower, staring at the downtown skyline. Migratory scavengers, they're drawn to tall buildings.

Across the bay, vulture investors, that other breed of migratory scavenger, are feasting. South Florida is in the throes of a truly hellish real estate bust. Home prices are down 24% in the past year, with many places changing hands for less than half their height-of-bubble values. The region has seen foreclosures on more than $14.2 billion worth of property this year—a record. Developers can't sell enough units to pay construction loans. Condo boards are trying to keep the stairwells of their half-empty buildings clear of vagrants. Landlords are renting out units at daily rates to makers of porn films.

The bleak tableau is exactly what

vulture investors have been waiting for. Having sat out the bubble, they're flocking to the Magic City to make lowball, often all-cash offers for numerous properties at once. Some members of this motley assortment of foreign professionals, U.S. money managers, and retired corporate executives learned how to prey by picking through the detritus of the U.S. savings and loan bust. Others earned their stripes in emerging-market financial crises. They differ in their tactics; what unites them is their absolute insistence on paying bottom dollar.



*Condos and townhomes **To be completed
Data: Condo Vultures Realty

Consider the hard bargains being driven by Beverly Hills banker Joel Heffron. On a humid October morning he ventures into Miami's Brickell Avenue financial district to meet with Peter Zalewski, principal at Condo Vultures Realty, a Miami real estate brokerage and consulting firm catering to distressed-property investors. The two are looking for real estate for Heffron's personal portfolio. They size up the luxe lobby of a waterfront high-rise that was the first building on mainland Miami to break $500 a square foot. Now it anchors what Zalewski has christened the Foreclosure District.

EASY PICKINGS

And yet the building is still too rich for Heffron's cold blood. "Look," he says, taking off his sunglasses. "The deal that I want to do—where my heart is at—is to steal apartments that I can rent for a few years and then sell. I have the cash. What I need is a nice building—not too nice, but not popcorn ceilings, either—with ownership problems or people not paying their maintenance."

The two move on to the neighboring tower. Zalewski notes that the seven-year-old waterfront building has banned realtors from using lockboxes, which hold keys for other agents to show properties and are usually placed on front doors, so as not to advertise that entire floors of condos are for sale. And yet, a flyer in the elevator reads: "Come to the board meeting in the Clubroom to see the status of our collections, foreclosures, and delinquencies."

On the 14th floor, a foreclosed two-bedroom with an expansive view of the bay is listed at $299,000, down from $700,000 just months ago. Heffron, 65, thinks the property could go for less than $250,000. The bank, after all, isn't pleased about paying a $680 monthly maintenance fee, which from the looks of the building's unkempt pool deck is sure to rise. In this financial crisis, says Heffron, sellers have no choice but to cut their asking price every 10 days or so until the property moves.

Not since a hurricane devastated Miami in 1926 has the city offered so much property at such steep discounts. "You're not going to see a new condo go up in this town for seven years, minimum," says Zalewski. "The common Joe can't get a mortgage, and a 40% downpayment is becoming the rule for anyone who can. But if you have the cash, you can feast like a king."

Especially foreign cash. Esteban, a doctor from Colombia who requested that his last name be withheld, has seen his buying power boosted by the strong Colombian peso, which he swapped for U.S. dollars this summer when it hit a decade high. On a recent Tuesday he inspects a new two-bedroom condo with a wraparound balcony overlooking the port of Miami, one of several purchases he wants to make. The unit's absentee owner paid $650,000 pre-construction, tried to sell it for $515,000, and is now asking $489,000. Esteban is confident he can close on a deal near $425,000 before Christmas, having just spied a foreclosure notice on a neighbor's door. "I don't care if they tell me to f--- off," says the Colombian. "They have to face the bank, not me."

A mile south, Frank Marrero, a snowbird from Hoboken, N.J., is three luxury bayfront condos into a campaign to buy 15 by 2010. "If you have cash down here and say you'll close in two weeks, you're golden," says the 31-year-old mortgage broker. Marrero is targeting the nonrefundable 20% cash deposits that buyers have put down on properties still in development. He offers to repay the buyers some portion of their deposit to entice them to back out. Then he plays hardball with the developers. So far he has pulled off this maneuver twice, he says. His goal is to buy places so cheaply that he can rent them out for enough to cover the entire monthly nut and still produce 8% cash flow on the investment—with the option of selling the units at a profit if the market comes back.

"Hey, other people—not me—got in at crazy prices," says Marrero. "Now the weak are trickling off, and I swoop down for the kill." |BW|

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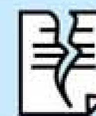
Buyers' Remorse



When rueful condo buyers want out, the billable hours soar. *The Miami Herald* has been covering the surge in South Florida attorneys marketing the new legal niche of "contract cancellation." In a prescient Mar. 22, 2007, article, the *Herald* reported that "buyers seeking to get out of contracts are pouncing on changes in developers' plans" to wiggle out of contracts. What started as a novel legal ploy is now commonplace.

To read the *Herald* story, go to **http://bx.businessweek.com/real-estate-speculators/reference/**

CHART BY LAUREL DAUNIS-ALLEN/BW

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Most Harley buyers at this El Paso (Tex.) store use financing from HDFS

Risky Loans: Harley Hits the Slick

Its finance arm pumped up sales with hog wild lending. That could harm its pristine credit rating

By Matthew Boyle

Not long ago, a national marketing campaign from motorcycle maker Harley-Davidson addressed the sputtering economy with a heavy dollop of devil-may-care attitude. The tag line: "Screw It. Let's Ride.

Harley seems to have applied the same logic to its loan portfolio. In a pattern eerily similar to the housing bust, the $5.7 billion Milwaukee company used its in-house finance unit to chase after subprime borrowers, making it easy for them to buy $20,000 hogs with no money down. The risky lending—which forced Harley to take a $6.3 million write-down amid rising default rates and decreasing interest among buyers for its securitized loans—could foreshadow problems in other industries. Companies from retailers to blue-chip manufacturers such as Caterpillar, Deere, and Boeing (page 56) used finance arms to pump up sales and maintain an additional profit stream.

Harley-Davidson Financial Services (HDFS) has for years aggressively pitched retail bike loans to subprime borrowers, who now hold nearly a third of them. Now there's concern that the problems at HDFS could jeopardize the parent company's pristine credit rating. (*BusinessWeek* went to press before the company reported third-quarter results on Oct. 16, in which analysts expected earnings per share to decline 26%.) While acknowledging the "difficult environment," Harley spokesman Bob Klein says the subprime portion of the HDFS loan portfolio has remained between 25% and 30% since 2004. "Overall, the portfolio is very high quality," he says.

HDFS offers loans both to retail customers and Harley dealers, who finance the bikes that sit in their showrooms. Dealers can also earn incentives in the form of lower interest rates if they push a certain percentage of customers' loans and motorcycle insurance to HDFS. "We'd be crazy not to use [HDFS]," says Mark Barnett, a high-volume Harley dealer in El Paso, Tex., who says 83% of the new bikes he sells are financed through the unit. While HDFS made 38% of all retail loans for Harleys five years ago, that proportion now exceeds half.

29%

Percentage of motorcycle loans from Harley-Davidson Financial Services held by subprime borrowers*

*end of 2007
Data: Company reports

ROARING GROWTH FOR HDFS

With credit markets frozen, Chief Executive James Ziemer faces some tough decisions. RBC Capital Markets analyst Edward Aaron argues that investors "need to know how [Harley] will raise capital to fund this business." BMO Capital Markets analyst Edward Williams says Harley is more vulnerable to a downturn because it "aggressively went after a lower-quality borrower" to gain market share against other lenders.

Indeed, between 2003 and 2006, the percentage of HDFS borrowers paying 15% or more in interest—an indicator of credit risk—increased from 8% to 19%, according to company reports. HDFS' share of Harley's operating income also grew to more than $200 million, about 15% of the company total, up from 7% in 2000.

The first sign of danger came early last year, when RBC's Aaron warned investors that loan delinquency rates were rising faster than normal, to more than 4%. While Harley trimmed production in response to slowing sales, it continued to go after marginal borrowers with promotions like 2007's

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"Stick it to the Man" campaign, which offered zero money down and teaser interest rates as low as 2.9%.

As long as HDFS could package loans and sell them as securities to investors, the strategy worked. In the first quarter of 2008, though, HDFS was forced to retain $54 million in loans no investor would touch. Even fewer buyers stepped forward in the second quarter as loan delinquencies kept rising.

SALES DOWN, JOBS CUT

Harley's finance arm has taken some steps to tighten lending to subprime customers. And its beefed-up loan collection staff is making more calls on weekends and evenings to chase down deadbeats. Klein says credit "may be less accessible" to customers with low credit scores and that HDFS has reduced its no-money-down financing offers, reserving them for the most creditworthy customers.

Softening demand for discretionary items such as motorcycles has exacerbated the woes at Harley's credit arm. Harley's U.S. retail sales were down 8.7% in the second quarter, and the company axed 730 workers earlier this year, its deepest workforce cut since the 1980s. Robust international growth rates are expected to weaken as the economic crisis spreads abroad.

Harley told investors last quarter that it remains committed to lending "across a broad credit spectrum," but analysts wonder how much longer the commitment to risky borrowers will last. "On one hand, you don't want to lose too much market share," says a buy side analyst. "But on the other hand, quite simply, you don't want to keep up your sales by extending credit to people who might default on payments."

A bright spot for HDFS is the particularly strong resale market for used Harleys just now, according to recent data from the National Automobile Dealers Assn. That reduces the severity of loan losses if HDFS is forced to repossess motorcycles. "The good thing about Harleys is they don't decline wildly in value," says Barnett, the Texas dealer.

Unfortunately, that can't be said of Harley-Davidson stock. The shares have lost half their value over the past two years. |BW|

FINANCE

Not All Lenders Are Losers

The credit arms of such companies as Caterpillar and Boeing appear largely unscathed by the crisis

By Matthew Boyle

GE Capital, once the golden child in its parent's portfolio, has been a drag in recent weeks as investors battered General Electric stock on fears the financing arm was vulnerable. But what about similar units of other companies? Whether a finance division is a plus or a peril depends largely on how the company uses it.

Cat's credit arm finances purchases of its own heavy equipment

Take Caterpillar's financing operation, which makes loans to buyers of its heavy machinery. Cat Financial accounted for just 15% of the company's total pretax profit of nearly $5 billion in 2007. By contrast, GE Capital's contribution to its parent is about three times that. While Cat's bad-debt write-offs increased to $39 million in the first six months of 2008, up from $27 million in the same period last year, experts say Cat is well positioned to weather the crisis. "These guys are [financing] stuff they make and could sell" in the used-equipment market, points out Morningstar senior analyst John Kearney. "And they're not just financing to your average guy in the street." As Caterpillar CEO James W. Owens likes to tell investors: "We know the customers, and we know the product."

Then there's cheap-chic retailer Target and its credit-card unit. Earnings from the company's $8.7 billion credit-card portfolio more than doubled from 2005 to 2007. But that income stream is turning sour as many cardholders neglect to pay their bills. The unit's charge-off rate—those debts deemed unrecoverable—has soared to almost 10% of the total portfolio, up from 5.66% about a year ago. One problem, notes Christopher Garman, publisher of *Leverage World*, which follows the debt markets, is that as "companies chased this profitability, they took on too much risk."

Those who didn't—or couldn't—pursue easy profits might find opportunities amid the credit freeze. Boeing Capital hasn't made a loan in more than two years because airlines could get cheaper rates at European banks. With banks hoarding cash, Goldman Sachs estimates that Boeing could lend as much as $3 billion next year to hard-pressed buyers. While Kostya Zolotusky, Boeing Capital's managing director, says the unit hasn't made any loans yet, he notes "it is possible that customers could turn to us now." |BW|

JACK SMITH/BLOOMBERG NEWS

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Sweating Through An IPO Drought

With capital scarce, even the most promising venture-backed companies are running low on cash

By Spencer E. Ante

Gajus V. Worthington has seen the effect of the financial meltdown on U.S. startups, and it's not pretty.

The chief executive of Silicon Valley's Fluidigm set out to take his chipmaker public just over a month ago. On the first day of the road show, Sept. 5, Worthington gave a standing-room-only presentation to blue-chip investors interested in buying Fluidigm stock. Three weeks later, after panic seized investors, he pulled the plug on the initial public offering. Worthington realized he couldn't proceed after money managers he met with in San Francisco told him they didn't know how long they'd have jobs. "You could smell the fear," he says.

HIGH-STAKES GAMBLE

Now Fluidigm is in an awkward position shared by many of the most promising startups in the country. It has built up substantial operations in hopes of capitalizing on future opportunities yet it's burning through cash at a time when it's nearly impossible to get more from public investors. The company had $32 million in cash as of the end of June, and it's using about $6 million to $7 million a quarter. Worthington could run out of money at the current burn rate by the end of 2009, but he says he won't cut back, at least for now. "Our primary focus is growing the business," he says.

It's a high-stakes gamble that's being played out at thousands of startups across the country. Innovative companies that venture investors helped build in recent years now find they can't go public and it's much harder to sell out in an acquisition. Only one venture-backed company went public in the last two quarters, and the value of mergers and acquisitions fell 55%, to $10.6 billion, according to Dow Jones VentureSource.

1

The number of VC-backed companies that have gone public in the last two quarters

In recent weeks, venture firms have begun advising their portfolio companies to cut expenses and lay off staff. Sequoia Capital, the Silicon Valley firm that funded Apple and Google, gave its current crop of startups a bracing presentation. One slide showed the words "Death Spiral" and a skull-and-crossbones to signal the fate that awaited companies that didn't take quick action. "In the next six months you'll see a lot of companies go down," says Ted Wang, a lawyer at Silicon Valley's Fenwick & West.

Worthington doesn't think he can afford to slow down. Fluidigm's chips can manipulate fluids with thousands of tiny valves, making biological and genetic experiments faster and easier than in the past. Revenues nearly doubled in the first half, to $5.5 million, though Fluidigm lost $15.3 million.

Worthington had hoped for an IPO to give Fluidigm a cash cushion

ROBYN TWOMEY

Worthington had hoped to raise $80 million in the IPO to give him a cushion of cash. Fluidigm had priced the deal at 14 to 16 a share, but offers from investors quickly fell to single digits. At one point during the road show, Worthington checked into a hotel room and saw a newspaper lying at his feet. The headline read: "Worst financial crisis since the Depression with no end in sight."

The CEO laughs about the timing now. Despite the risks of running low on cash, he is determined to outrace his rivals. He's hiring marketing staff to help land more customers in biotech and academia.

Worthington draws strength from previous near-death experiences. After September 11, Fluidigm was running out of money, and it managed to scare up more capital. This time, Worthington figures that even if he can't go public, he could raise cash from Wall Street money managers or his company executives. "This is not the first time we've been through this kind of thing," he says. |BW|

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TJX: Dressed To Kill For the Downturn

Why T.J. Maxx may hold an advantage over other retailers as the recession deepens

By Jena McGregor

BW 50

T.J. Maxx has distinguished itself in past downturns as a place for high-fashion brands to unload extra inventory that other retailers can't sell. Recently brands ranging from Valentino to Calvin Klein have shown up in its stores.

But in the current credit-strained environment, there's another reason the off-price retailer and its parent TJX could stand to benefit: liquidity. TJX pays its vendors promptly and doesn't try to negotiate for additional deals if items don't sell, as department stores often do. Industry observers say that while those retailers can take 60 to 90 days or more to settle up, TJX typically pays within 30. These days, that's a critical selling point both to vendors, who are more concerned about finding funds to buy raw materials and pay expenses, and to the financers who act as middlemen in many of the deals. It could give TJX—which also owns discounters Marshalls and HomeGoods—an added advantage in getting a wider selection of items. As lending terms tighten up, says Burt P. Flickinger III, a retail consultant with Strategic Resource Group, TJX is like "a cash machine for the big fashion brands."

While TJX is reluctant to provide details about the terms it strikes with the 10,000-plus vendors on its roster, spokesperson Sherry Lang does say "we are religious" about paying promptly. The retailer can afford it. The Framingham (Mass.) company is seeing relatively healthy demand, having reported a mere 1% drop in September sales at stores open at least a year. That performance was poorer than expected, but still far ahead of such retailers as Gap, Chico's FAS, and Abercrombie & Fitch, which all turned in double-digit September sales declines.

Apparel makers, particularly smaller and midsize brands, are being hit on two sides. They frequently rely on a form of financing known as "factoring," in which brands sell their receivables to a third party, or "factor," for immediate cash in exchange for a fee. The factor then collects the payment from the retailer. With stores struggling, intermediaries are starting to demand better terms on those payments. New York-based Rosenthal & Rosenthal, which offers factoring to the apparel industry, says it's taking a closer look at retailers' creditworthiness, and says TJX's prompt payments make it an excellent company with which to work. Says veteran retail consultant Howard Davidowitz: "The factors are tougher than ever before."

PAYING UP
TJX Settles Accounts Fast

Payment time	
30 Days or less	TJX
60-90 Days or more	Department stores

Data: *BusinessWeek*, analysts' estimates

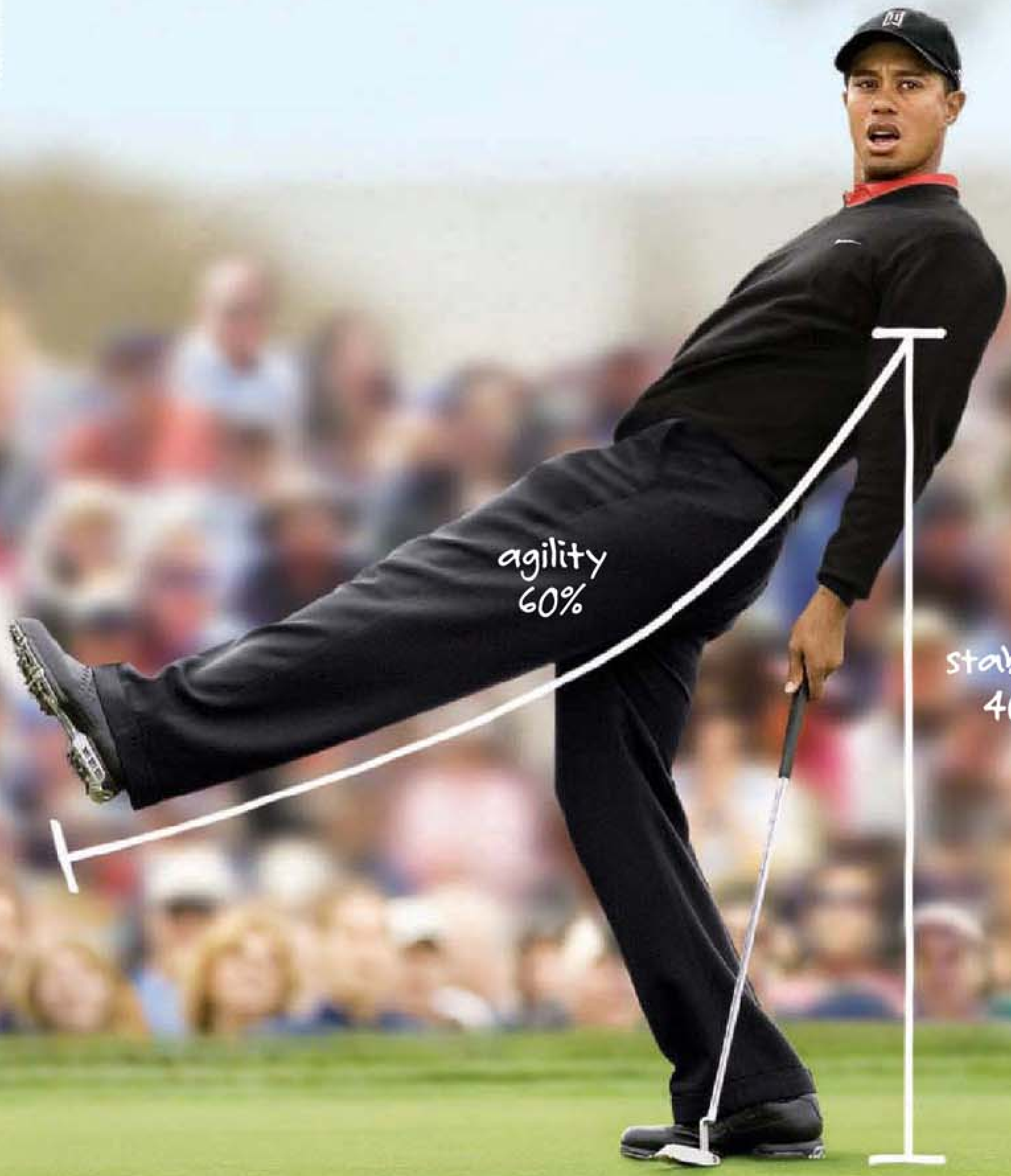
TIMOTHY FADEK/POLARIS

Meanwhile, department stores are cutting back on how much they buy. Orders placed much earlier this year for the holiday season are suddenly being slashed, leaving fashion brands with excess inventory that's harder to unload in this environment. Because TJX buys later in the season, it's able to step in and stock up now.

The results are evident in the broader range of goods streaming into T.J. Maxx. A recent visit to the Oak Creek Village Shopping Center in Durham, N.C., revealed a T.J. Maxx outlet stuffed with everything from $99 True Religion jeans (regularly $160) to $149 Bottega Veneta sweaters (ordinarily $750). "The merchandise availability right now is just tremendous," says Patrick McKeever, an analyst who covers TJX for MKM Partners, an equity trading and research firm. Despite the inventory glut, TJX's Lang says the company has to be careful to choose the right garments, as department stores are cutting their prices right now, too.

TJX, says one consultant, is like a "cash machine for the big fashion brands."

Carol M. Meyrowitz, TJX's chief executive officer, is feeling confident. "Customer transactions were up across virtually all divisions," she told investors in the Oct. 9 sales announcement, calling the company's position going into the holidays "excellent." While others are eyeing what may be the worst holiday season in decades, Meyrowitz' cash-friendly formula might just make for a happy holiday. | BW |



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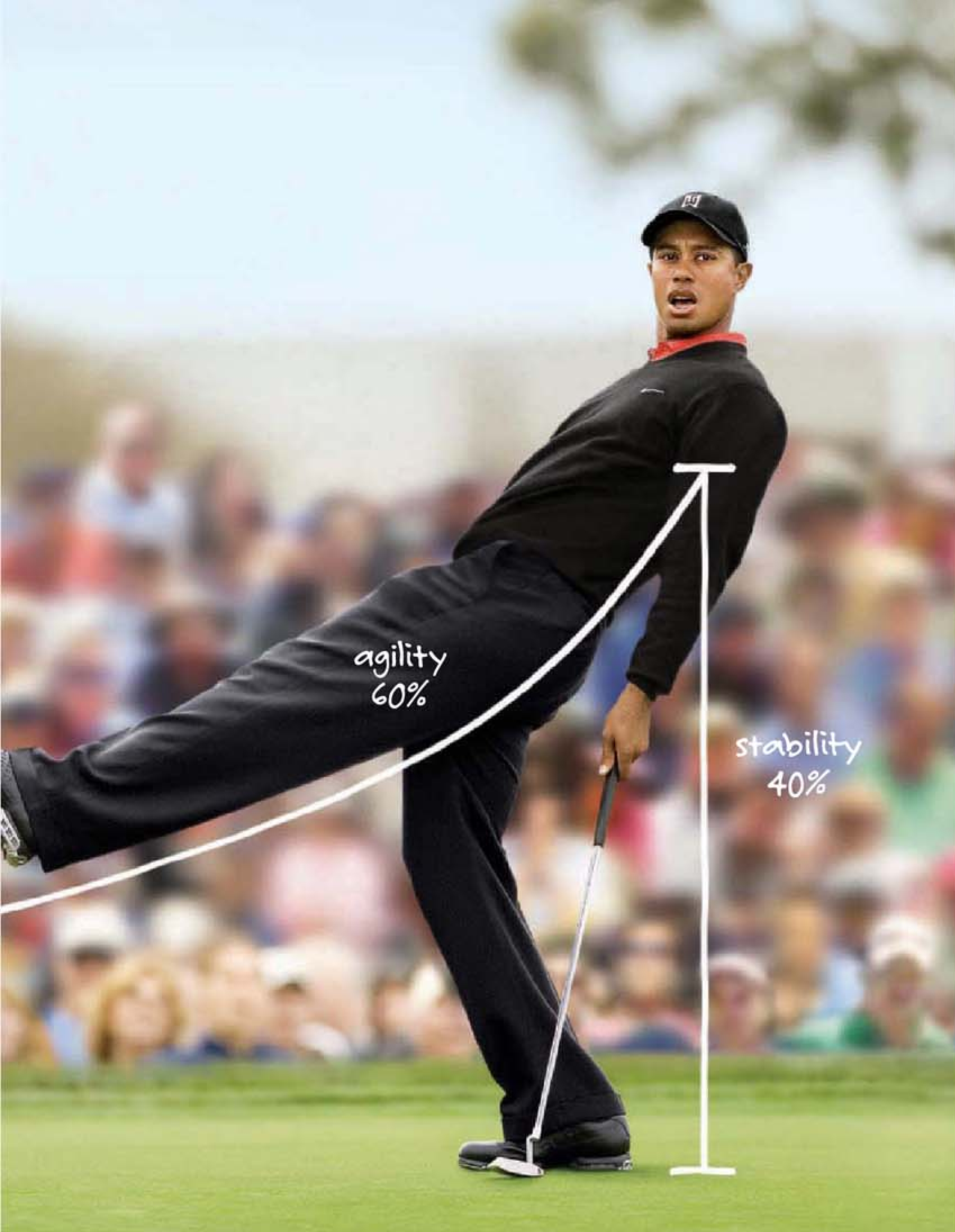

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How Companies Abuse Work Visas

A new report confirms critics' charges against the H-1B program. Tighter oversight may be on its way

By Moira Herbst

For years critics have charged that the U.S. visa program for highly skilled workers is susceptible to abuse. Now the federal agency that issues the visas has confirmed some of those concerns.

The program for what are known as H-1B visas is designed to help U.S. companies bring workers with rare or specialized skills into the country. A Microsoft or IBM can use the visas to hire someone from abroad if they can't find an American citizen with equivalent skills. But in a recent study, U.S. Citizenship & Immigration Services (USCIS) found that 13% of the requests for H-1B visas were fraudulent and 7% contained technical violations. In one case, when a company requested a visa for a "business development analyst," USCIS found the person would be working in a laundromat, doing laundry and maintaining washing machines.

The study marks the first time the agency has documented systematic problems in the program. It's based on a sample of 246 H-1B petitions and does not name the companies involved.

Critics say the report underscores the problems with H-1B visas. They charge that companies use the visas so they can hire cheap workers from abroad instead of hiring Americans, pushing down pay and benefits in the U.S. "The report makes it clear that the H-1B program is rife with abuse and misuse," says Ron Hira, assistant professor of public policy at the Rochester Institute of Technology.

Hundreds of U.S. companies use the program to bring overseas workers into the country, and participants such as Microsoft and Google have long argued that the current limit of 65,000 visas a year should be increased. But the USCIS study makes it more likely that critics, such as Senators Dick Durbin (D-Ill.) and Charles Grassley (R-Iowa), will be able to win tighter oversight of the program before it is expanded. Presidential candidates Barack Obama and John McCain have both voiced support for expanding the program, with reforms.

The study found that 13% of H-1B visa requests were fraudulent and 7% contained technical violations

CLOSING LOOPHOLES

Bill Wright, a spokesman for USCIS, says the agency is already weighing adjustments based on the report's findings. It's developing a new risk-assessment program that, among other things, would closely examine requests from companies with 25 or fewer employees, since that category was found to have a higher rate of violations.

Technology companies also called for stepped-up oversight. "U.S. employers who play by the rules of the H-1B visa program are hurt when visas go to employers who don't," says Robert Hoffman, a vice-president at Oracle and co-chair of Compete America, a tech lobbying group.

The report identified a variety of violations by companies requesting work visas. Some H-1B workers didn't have the academic credentials or experience detailed on the applications. Others never worked at the location specified on their forms. Still other H-1B employees were paid less than the prevailing wage for their position and geographic location, another violation of the rules.

Durbin and Grassley say the USCIS report shows the visa program needs more oversight. Along with other reforms, they want the government to investigate program participants regularly, something it doesn't currently do. "Until we make a conscious effort to close the loopholes, we're going to see continued abuse where people coming to this country on H-1B visas are working at laundromats," Grassley said in a statement. |BW|

KOREN SHADMI

'This Would Be Bigger Than NAFTA'

Quebec is easing commerce and labor barriers with France, which may lead to a broader Canada-EU deal

By Pete Engardio

MONTREAL

It's easy to see how the penthouse offices of Fraser Milner Casgrain, one of Montreal's top law firms, can inspire envy. The view is superb: Blazing red foliage is starting to cover Mont-Royal, and the St. Lawrence River snakes through the city for miles into the distance. Inside, modern art lines rosewood-paneled walls.

Yet to Michel A. Brunet, the firm's CEO, his posh offices at times feel like a gilded cage. "I live in a world of restricted mobility," Brunet sighs. Quebec is the only Canadian province with a legal system based on old French civil codes. That means Brunet may not practice elsewhere in Canada, which like the U.S. uses a common-law system. And Quebec's onerous work rules mean even French corporate lawyers recruited by Brunet's firm have to go back to school before taking the Quebec bar exam. This can take five years.

On Oct. 17, French President Nicolas Sarkozy and Quebec Premier Jean Charest are set to sign an accord that could liberate Brunet as well as workers in hundreds of other professions who are hindered by the need for special credentials. The deal will allow for free labor mobility between Quebec and France for engineers, plumbers, pharmacists, nurses, and other professionals. Once they get visas, such workers from France will be quickly certified to work in Quebec, and vice versa.

What could be even more important, Canadian and European officials will begin preliminary talks in Montreal on a potentially much broader trade alliance between Canada and the EU. Besides freer labor movement, such an agreement could lower remaining barriers on trade in goods and include common health and safety standards. "This would be bigger than NAFTA," says Charest, referring to the North American Free Trade Agreement among Canada, the U.S., and Mexico.

The trade push is part of Charest's drive to make Quebec, long one of Canada's most closed labor markets, a magnet for global talent. He already has signed a similar labor agreement with neighboring Ontario and other provinces. A broader Canadian-EU pact could also speed a movement to simplify commerce in Canada's balkanized provinces, which have clashing rules on everything from margarine coloring (white in Quebec, yellow elsewhere) to the size of truck tires.

Union boss Vaudreuil says Quebec's labor market must open up

SPYROS BOURBOULIS

WORKER SHORTAGE

Why is free-trade sentiment gaining ground in Canada when it has become politically toxic in the U.S.? For one, Canadians crave new markets. Some 85% of exports go to the U.S., and a 40% leap in the value of the Canadian dollar against the greenback over five years has eroded competitiveness.

But the biggest driver behind a possible Canada-EU pact is the fear of labor shortages. Canada's labor pool is growing by just 123,000 a year, half the rate of 25 years ago. That number could drop to 42,000 by 2010, says business professor Linda Duxbury of Ottawa's Carleton University. Plunging birthrates have hit especially hard in Quebec, where aircraft maker Bombardier says it will need 3,500 more skilled workers by 2017.

Quebec's construction industry is also feeling the pinch. Masons, roofers, and carpenters are all in short supply. Until recently, Quebec's construction union, Centrale des Syndicats Démocratiques, kept tight control of jobs. And workers from most other provinces still must go back to school and pass a written exam, in French, if they want to work beyond six months. Now, with shortages intensifying, the union endorses freer labor mobility. "Twenty years ago, I don't think this would have been possible," says union president François Vaudreuil. "Now we have to open ourselves to the rest of the world." |BW|

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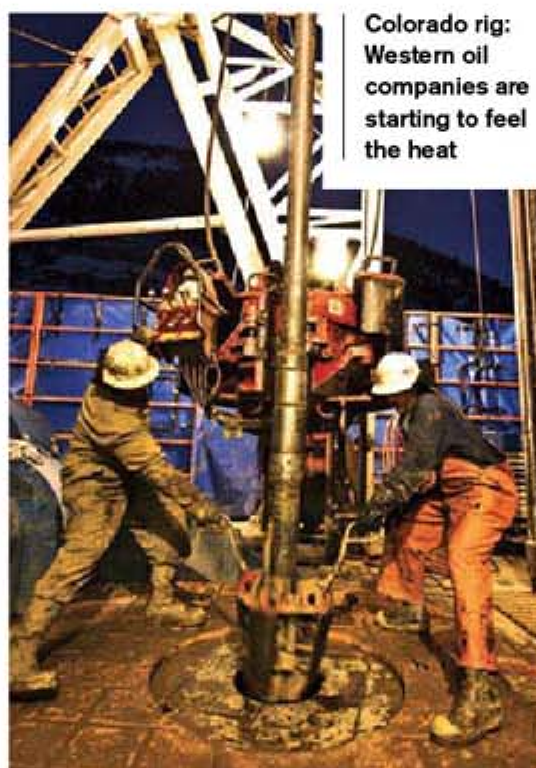
A Power Shift In the World of Oil

New data from Platts show producers from Russia and elsewhere are gaining on the top multinationals

By Steve LeVine

Big Oil is still king, but its dominance is under siege. Around the world, oil multinationals, such as ExxonMobil, Royal Dutch Shell, and BP, have never been so challenged. Even amid record profits from high oil prices, they're battling increased drilling costs, a serious shortage of skilled labor, and threats of higher taxes. And eclipsing all of these headaches is the muscle-flexing of such oil-rich countries as Russia, Venezuela, and Middle Eastern petro-states, which are increasingly shutting their doors to Big Oil to cultivate their own homegrown companies.

The multinationals remain industry leaders, but this year's rankings in Platts Top 250 Global Energy Companies, scheduled to be released on Oct. 20, highlight the declining power of U.S. and European heavyweights. (Platts, like *BusinessWeek*, is a unit of The McGraw-Hill Companies.) While Western oil companies occupy the top five spots, players from other regions are rapidly moving up the list.



Colorado rig: Western oil companies are starting to feel the heat

Russia, not represented among the top 10 companies on last year's list, now holds two slots. State-controlled Rosneft has moved up to No. 6, from No. 16 last year; while natural gas behemoth Gazprom is No. 10, up from No. 17. (Private Lukoil has advanced to No. 11.) The Russian companies have benefited from a combination of high oil prices and Russian Prime Minister Vladimir Putin's consolidation of the country's oil assets into a handful of players.

U.S. UTILITIES

Platts annually ranks the companies by assets, revenue, profit, and return on invested capital. Asian countries have added five more players to the top 100 over the past four years, while Eastern European countries have added the same number since 2005.

The steady shift of power is occurring beyond the realm of oil. The top half of the list also contains more U.S. electric utilities, which, after several tough years, are benefiting from higher prices, deregulation, and cost controls. Europe is also seeing a new generation of super-utilities, spurred by privatizations of state-run businesses and new rules that encourage cross-border mergers.

The latest list also reflects a trend to public listings in previously opaque parts of the world, such as the Middle East. Abu Dhabi National Electric (234) and Saudi Electric (170) are the first gulf outfits to be ranked. With more players seeking to augment state support with investor capital, the list is sure to grow. | BW |

PLATTS' 2008 TOP 10

COMPANY	ASSETS*	REVENUES*	PROFITS*	RETURN ON INVESTED CAPITAL	3-YEAR GROWTH RATE**
1. ExxonMobil (U.S.)	$242,082	$358,600	$40,610	30.5%	10.7%
2. Royal Dutch Shell (Britain)	269,470	355,782	31,331	22.6	10.3
3. Total (France)	176,463	198,872	19,158	21.8	3.7
4. Chevron (U.S.)	148,786	214,091	18,688	22.4	14.4
5. BP (Britain)	236,076	284,365	20,845	18.9	-0.1
6. Rosneft (Russia)	74,805	48,355	12,862	31.7	120.4
7. ENI (Italy)	157,843	126,825	14,551	18.5	14.3
8. StatoilHydro (Norway)	94,743	95,607	8,082	19.7	19.8
9. Petrochina (China)	152,685	113,901	19,864	17.8	29.0
10. Gazprom (Russia)	224,037	87,073	24,815	15.2	38.0

*Millions **Cumulative Data: S&P Compustat/Platts

BUSINESSWEEK.COM |
For the complete Platts ranking of the Top 250 Global Energy Companies, go to businessweek.com/interactive_reports/platts_2008

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Medicare and the Credit Crisis Collide

For many seniors, autumn is when drug benefits run out. This year, that may mean months without meds

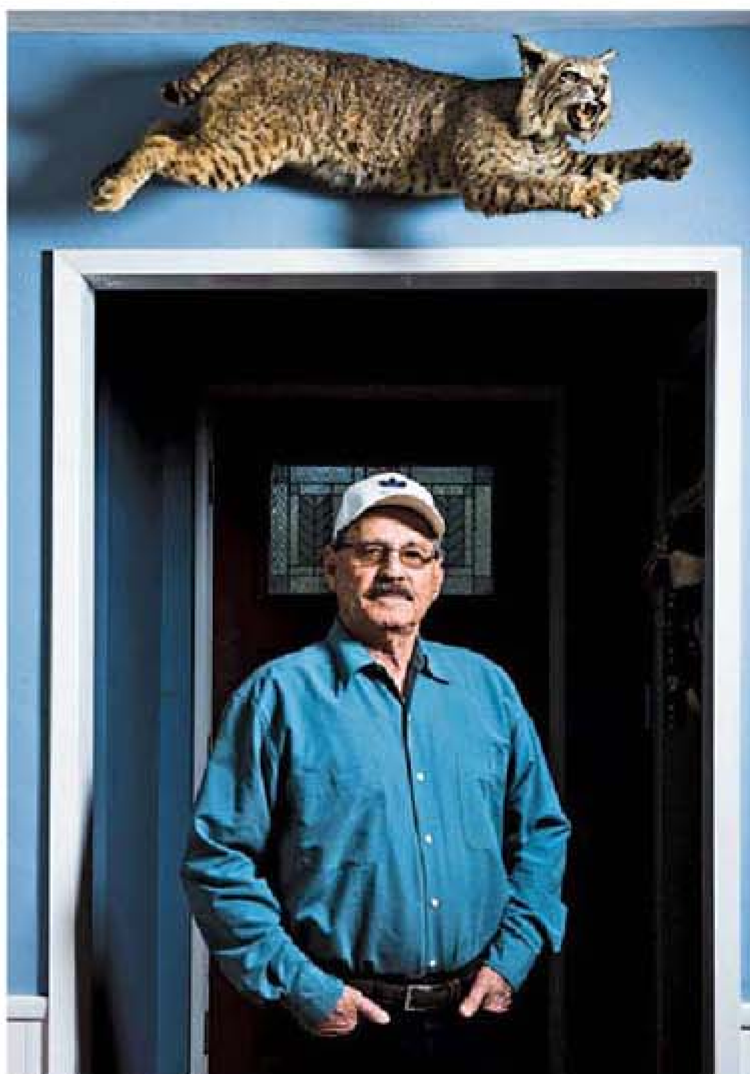
By Arlene Weintraub

For many older Americans, fall is a bitter time of year associated with a deceptively sweet name: the "doughnut hole." Far from a sugary treat, it's a coverage gap in the Medicare Part D drug program.

When Part D was first implemented in 2004 to help elderly patients pay for their prescription drugs, the government imposed a yearly limit on how much it was willing to shell out. Seniors are covered right up until they hit the threshold, which is $2,510 in 2008. From that point until the end of the year, they pay fully out of pocket—unless their costs soar to the point where the senior qualifies for catastrophic coverage, which kicks in at $5,726.

The doughnut hole has always been a source of dread for the elderly. But now, with the financial crisis decimating 401(k)s and other retirement plans, many cash-strapped seniors are simply doing without some of their meds. In August a survey from the Henry J. Kaiser Family Foundation showed that in 2007, 26% of Part D beneficiaries—3.4 million people—landed in the doughnut hole. On average, their monthly out-of-pocket costs doubled, to $196. As a result, 15% of people with chronic illnesses stopped taking their drugs while they were in the coverage gap. "This raises concerns," says Tricia Neuman, vice-president at Kaiser Family Foundation in Menlo Park, Calif.

Larry Kay of Yucaipa, Calif., is having so much trouble fighting his way out of the doughnut hole that he's thinking about coming out of retirement. A hunter and former quality-control inspector for a company that makes fences, the 69-year-old Kay hit the hole in May and is now paying $650 a month for drugs to treat his high cholesterol and a lung condition called chronic obstructive pulmonary disease, or COPD. He has stopped using his COPD inhaler in the morning, even though he's not supposed to skip doses. "If my doctor knew, he'd be very upset," he says.



Kay is rationing his use of the inhaler prescribed for a chronic lung condition

Health policy experts believe the next Administration will be under pressure to address the doughnut hole, and both candidates have expressed some support for reforming the program. Senator Barack Obama backs the idea of letting the government negotiate drug prices for Part D. (It doesn't have the right to do so now.) Senator John McCain has said that higher-income beneficiaries should pay higher premiums for their Part D plans.

Right now, Wall Street's crisis and the $700 billion bailout plan are drawing attention away from health-care reform. But there is little doubt the next President will place drug benefits for seniors high on his agenda. "There is a growing recognition that the doughnut hole is impairing people's access to medications," says Dr. Carolyn Clancy, director of the Agency for Healthcare Research & Quality in Rockville, Md., a public service agency of the U.S. Health & Human Services Dept.

Meanwhile, the doughnut hole continues to exacerbate financial burdens on seniors. On Sept. 26, health-care advisory firm Avalere Health released a report predicting Part D beneficiaries who joined the 10 most popular Medicare plans would see their premiums rise by 30%. At places like California Health Advocates in Sacramento, which helps Medicare beneficiaries navigate the system, frustration is mounting, says spokeswoman Karen Fletcher. "Seniors go through the deductible, then they fall into the gap, then a new year comes around, and they have to start all over again," she says. | BW |

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When the Punishment Fits the Stock Loss

Defendants in an AIG scandal face life behind bars, and the result may foreshadow subprime cases ahead

By Michael Orey

In coming weeks, five former insurance executives, including General Reinsurance ex-CEO Ronald Ferguson, are due to appear in federal court in Hartford. There, U.S. District Judge Christopher F. Droney will sentence them for their role in a sham transaction to boost the loss reserves of American International Group. When the deal was disclosed in 2005, prosecutors contend, it caused AIG's share price to drop 6% to 15%. Because of that, the defendants, who were convicted of fraud in February, could go to prison for life.

While the case involves events that seem far removed from the present financial crisis, it highlights an issue that's sure to be front and center if prosecutors seek retribution for the market losses of recent weeks. Under federal guidelines, the base-level sentence for someone convicted of securities fraud is zero to six months. But a variety of factors can increase time behind bars—including the size of shareholder losses, the number of victims, and whether a defendant is an officer or director at a public company. In reaction to the implosion of Enron, WorldCom, and other scandals that cost investors billions, lawmakers sharply raised the potential penalties in 2003. Now, instead of a few years in prison, fraud that results in stock losses exceeding $400 million could earn a defendant a life term.

Former Gen Re CEO Ferguson in February at federal court in Hartford

Given the size of losses related to the subprime meltdown, prosecutors may be able to threaten alleged culprits with lifetime incarceration. Reid H. Weingarten, a Washington attorney representing Elizabeth Monrad, the convicted former Gen Re CFO, argues that "this puts unhealthy leverage in prosecutors' hands to extract unfair plea deals." Going for the maximum sentence "may be popular in these chaotic times," he says, "but it usually has absolutely no relationship to the severity of the wrongdoing." Indeed judges in some recent securities-fraud cases have found guideline sentences draconian and have meted out far less time, especially when the crime did not imperil a giant company.

The size of current market losses "puts unhealthy leverage in prosecutors' hands to extract unfair plea deals"

In the case of AIG, the insurer's stock fell to 61.92 from 71.49 in the month following its disclosure of the Gen Re transaction and a subsequent probe by then New York Attorney General Eliot Spitzer. (Since then, AIG shares have dropped below 3 because of unrelated subprime losses that forced a massive government bailout.) Attorneys for the five defendants argue that a host of factors caused AIG's stock to swoon three years ago, including the forced departure of AIG chief Maurice "Hank" Greenberg. The defendants—including AIG's former head of reinsurance, Christian Milton—plan to appeal their convictions.

For sentencing, a lot rides on the complex and controversial discipline of determining market loss. Both sides retained financial experts to determine how much shareholder harm could be directly tied to the fraudulent inflation of AIG's loss reserves. The defendants say that amount was zero, which means under the guidelines they would face a year or two at most in prison. Prosecutors, seeking life, contend losses were as high as $1.4 billion. Such disparate conclusions are not uncommon, defense lawyers say. This points to the exercise as more art than science. "In the end, you're making a lot of sort of crude assumptions," says David Topol, a Washington attorney who monitors shareholder lawsuits for insurers. "When you get an enormous disparity, somebody's clearly wrong." | BW |

DOUGLAS HEALEY/BLOOMBERG NEWS

078 Getting ready for higher taxes
081 Gene Marcial: Inside Wall Street

Finance guru Bodie (left), swaps ideas with Vanguard founder Bogle

PROTECTING YOUR NEST EGG IN VOLATILE TIMES

By Christopher Farrell

The savings American workers have diligently set aside for retirement is vaporizing. As of Oct. 7 retirement plans had lost as much as $2 trillion over 15 months, or some 20% of their value, according to the Congressional Budget Office. That has many workers wondering how they'll be able to retire and whether everything they thought they knew about investing has been turned on its head. Diversification across sectors and countries, for example, was supposed to protect investments, but few areas of the market have been spared. And what future returns can be expected from stocks and bonds? Have all of our rules of thumb gone out the window? We asked Jack Bogle, founder of fund giant Vanguard Group and a pioneer in the investment indexing business; and Zvi Bodie, a finance professor at Boston University School of Management, co-author of the leading finance textbook

ILLUSTRATION BY SEAN MCCABE; (BODIE) ROBERT SPENCER; (BOGLE) BILL CRAMER/WONDERFUL MACHINE

Investments and an expert on retirement security, to discuss issues facing savers and investors today. Christopher Farrell launched a discussion between the market veterans by asking if diversification remains a bedrock strategy. The conversation has been edited and condensed.

Jack Bogle: I am a believer in diversification. You buy index funds for stocks, and your bond portion should equal your age. This is how I invest, so I know how little it's hurt me to have a substantial position in U.S. bonds. I'm in half Treasuries, half corporates.

The most common diversification talked about is international. What's wrong is that as soon as people start really talking about it and believing in it, international stocks are overpriced. About 80% of money going into equity funds last year was going into international. If that isn't a warning sign! Here we are: The U.S. is one of the better-performing world markets. From the market peak in 2007, the S&P 500 is off 42.5%, international [measured by the MSCI EAFE Index of developed countries] is down 49.4%, and emerging markets [measured by the MSCI Emerging Markets Index] by 55.8%.

> "Just two mutual funds—the risky assets and the safe asset—[will] generate the entire set of risk-and-reward trade-offs" ZVI BODIE

In recent years, international investing has had a higher correlation with the U.S. market than was traditional. If you invest internationally, you have to invest in foreign companies not as diversifiers but wealth producers. If you like international, get in gradually, maybe with 20% of your portfolio, half in developing markets and half in emerging markets. Europe looks a lot like us, so it's at least possible you might get a better return out of emerging markets. I don't invest internationally myself.

Zvi Bodie: I want to add something that strengthens your case. In markets like China, retail investors can invest only in the tiny fraction of equity investments traded on a stock exchange. So compared with the equity investments there that aren't traded on the exchange, those investments are way overpriced. A much better way to invest is to buy U.S. companies doing direct foreign investment in China.

I distinguish between diversification and hedging or insuring. When I use the term diversification, I use it in the sense that you have a bunch of risky assets, and instead of putting your money in one of them, you spread it across them by paying attention to whether those assets move in lockstep. Because if two risky assets are perfectly correlated, you're kidding yourself if you think you're diversifying.

And then there is insuring or hedging. That's when you've got a safe asset and to my mind that is Treasury Inflation-Protected Securities, or TIPS. One way to protect yourself is to combine a diversified portfolio of risky assets with the safe asset. We teach students that you only need two mutual funds—the risky assets and the safe asset—to generate the entire set of risk-and-reward trade-offs.

Bogle: Amen.

Bodie: And that could be provided at minimal cost. But then a lot of smart people working on Wall Street would be deprived of their high income. So they put all sorts of bells and whistles on these things, none of which has to do with improving the welfare of clients.

Bogle: If people would look at not just a percentage point in costs, but what 1% to 2% in lower returns costs you over a lifetime. Compound 8% and 6% over 50 years. Or use returns adjusted for possible inflation, so call it 5% and 3%. Take a dollar, and at 5% over 50 years it grows to $11.50. But at 3% it grows to just $4.40. Most people would not want to give that $7 difference to Wall Street, and they're right. Investors earned it, why give it all away? I've been working on this idea of low-cost indexing for a long time, and my record of failure in persuading active managers of its self-evident validity is just about 100%.

Bodie: But that's not true, Jack. Passive indexing is huge today.

Bogle: Vanguard's total assets are $1.2 trillion, and clearly indexing has been the driving force in our growth. But there are two things that are sad about that. One is that many index funds are just ripping off customers. They have 50 to 100 basis points of expenses, and it's ethically outrageous that people can sell these things.

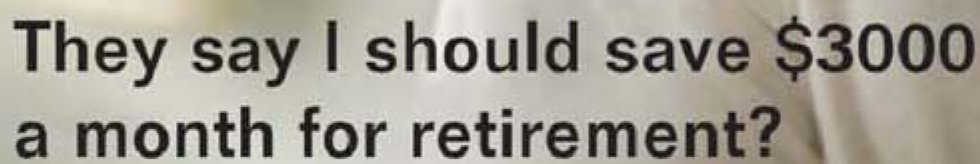
Indexing is now about 14% of equity fund assets, and that's O.K. as far as it goes. I'd have thought it would get to 20% to 25%. It's proven to work and only works in low-cost mode. But the underlying tragedy is that indexing leveled off at around 9% of fund assets in 1999 or

Diversifying overseas hasn't paid off

-42.5%	S&P 500*
-49.4%	International markets**
-55.8%	Emerging markets†

Data: Bloomberg Financial Markets, 2007 peak to Oct. 10, 2008; *from Oct. 17, 2007; **MSCI EAFE from Oct. 29; †MSCI Emerging Markets from Oct. 3

They say I should save $3000 a month for retirement?



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2000, and the growth to 14% is in exchange-traded funds [ETFs]. And those are index funds you can buy and sell in real time all day long. What kind of a nut would want to do that?

The other thing that really troubles me is commodities. People need to understand this infinitely important principle of investing, which is that stocks and bonds have an internal rate of return. For a bond, it's the interest rate compounded over the years. For stocks, it's today's dividend yield of 2.5% or so and implied 6% earnings growth. With commodities, you're betting solely on the expectation that you'll sell at a higher price than you bought. It will give you diversification, but I can't believe the rate of return on gold is going to be 7% to 8% a year, like the long-term return on stocks.

> ETFs "are index funds you can buy and sell in real time all day long. What kind of nut would want to do that?" JACK BOGLE

Christopher Farrell: On Wall Street the talk is about return, but both of you emphasize risk.

Bogle: You can control risk. You can't control return. That's up to the beneficence that stock and bond markets are generous enough to bestow on us. That's why we talk about diversification.

We can, however, look ahead and make reasonable predictions. In the bond market, we know with 90% probability that return in the next 10 years will be 4.5% to 5%. That's the historical number. If we have huge inflation and a Great Depression, and lots of bonds default—this is why I like Treasuries—then that's something else again. In stocks, we know the sources of stock returns. Dividend yield is almost 2.5%, and earnings growth from these levels ought to be 6% over the next decade. That's an 8.5% return.

Market volatility is to be ignored, up to a point. I said in my last book [*The Little Book of Common Sense Investing;* his new book is *Enough: True Measures of Money, Business and Life*] that it turns out the stock market is a giant distraction to the business of investing. Think about now, in this orgy of speculation. In 1929 there was 140% turnover in the U.S. market [meaning the entire market of stocks was bought and sold almost one and a half times]. When I came into the business in 1951 it was 25% to 30%

a year. Last year it was 280%. It will probably be 300% to 320% this year.

The volatility of the market doesn't really hurt the average retired investor because dividends keep coming in. But some of these dividends are gone. Companies that were paying them have gone out of business, almost entirely, actually, in the financial sector. So dividends are somewhat jeopardized, which I find broadly speaking one of the more challenging things. On the other hand, a lot is behind us.

Bodie: I'd supplement what we've been talking about by saying that everyone should think of his total capital as composed of a financial part and a human-capital part. If your human capital is safe, your nonhuman capital can be very tilted toward equities at a young age and tilted toward bonds at an older age. Let's take my son-in-law who works on Wall Street. His human capital is effectively a risky stock, since his industry is volatile. So I say to him over and over: "You want to be all in fixed income."

Bogle: Did you persuade him?

Bodie: Yes.

Bogle: I'm amazed, because if you're in that business you think trees grow to the sky.

Bodie: I was very forceful because he is in charge of my three-year-old granddaughter, who is the most precious thing in my life right now. |BW|

Business Exchange

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Reassessing Risks

In the March/April *Financial Analysts Journal*, Vanguard founder Bogle predicted that "changes in the nature and structure of equity markets... are making shocking and unexpected market aberrations ever more probable." Such "black swan" events, he wrote, using a term popularized in Nassim Nicholas Taleb's book *The Black Swan: The Impact of the Highly Improbable*, are due in part to the financial economy swamping our productive economy.

To read the paper, go to **http://bx.businessweek.com/retirement-strategies/reference**

ILLUSTRATION BY SEAN MCCABE

FOUR WAYS TO SOFTEN THE TAX BLOW

By Amy Feldman

It's not something that makes good campaign politics. But given the crumbling economy and the federal government's budgetary needs, some Americans are likely to be hit with a tax increase regardless of who wins the Presidential election.

To be sure, there are vast differences in the tax plans of Barack Obama and John McCain. Obama's proposal calls for a bunch of middle-income tax cuts paired with an increase in the top marginal tax rates to 36% and 39.6% from the current top rate of 35%, to be paid by families with incomes over $250,000 and singles over $200,000. It would also increase the rate on those earners for long-term capital gains and qualified dividends to 20%, from 15%. McCain vows to extend George Bush's 2003 tax cuts on income and investments. (McCain recently said he would halve the cap-gains rate, to 7.5%, in 2009 and 2010.) Without new tax legislation, those rates are set to expire at the end of 2010. With a financial bailout to pay for and a potentially Democratic Congress, tax experts figure that rates on both income and capital gains will be in play over the next two years.

"The difference between the two [candidates] is not that Obama wants to collect more tax, but that he wants to collect it from different people," says Clint Stretch, director of tax policy at Deloitte in Washington. "One of the challenges is that both plans would collect less income tax [than is collected] today. In the Obama world, maybe fiscal discipline means some tax benefits he would give people don't come to pass. In the McCain world, maybe the extension of Bush tax cuts he proposes would not come into effect. It's really a question of how this gets bargained out with a Democratic Congress—if there is one—because if nothing happens then taxes go up."

It's unlikely that any tax plan will be pushed through quickly, so you have time to consider your options. Here are four ways you might be affected by higher taxes and some suggestions for thinking about the consequences.

With a bailout to pay for and a likely Democratic Congress, tax experts figure that rates on both income and capital gains will be in play

CAPITAL GAINS

Common wisdom says to sell your winners if you believe rates will go up. Yes, it's obvious. It's also not always the best strategy. That's because you're paying taxes early, and you'll need to recoup that outlay as well as transaction costs through higher gains on your investment. "Those two things can outweigh the tax savings," Stretch says. "If you have an investment with a low cost basis and low transaction costs, then it may make sense to sell. If you have a high basis or your gain is in the 10%-to-20% range, it probably does not make sense. For most people you are talking about a reasonably small amount of money, and there are cases in which taking the gain is detrimental."

Let's say you own shares of Stock A that is now valued at $10,000, and your cost basis is $7,000. If you sell now, at the 15% rate, you'll pay $450 in tax. If you wait, and the cap-gains rate goes

JACOB THOMAS

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[1]Source: Pensions & Investments, May 28, 2008, based on AUM

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to 20%, you'd pay $600. Is that worth the potential $150 savings, especially after fees?

"The big question is, 'What are you going to put the money into? And will you earn enough more to recoup the taxes paid?'" says Robert Barbetti, an executive compensation specialist with J.P. Morgan Private Bank in New York. According to his figures, it would take two years invested in something that offered an additional two percentage points in return annually to recoup the tax paid in the example above. To make the right decision, you need to think about what you're going to buy once you sell, and whether it offers enough extra return to be worthwhile.

Think twice before you sell your winners to avoid a higher capital gains tax. Will gains from your new investment offset the hit?

COMPANY STOCK

With most 401(k) plans, if you've been laid off or are over 59½ and eligible for distributions, there's a little-known opportunity to take company stock out of the plan and pay tax just on its cost basis. Here's how it works. Say you have 100 shares of stock in Company X that trades at $50, and your basis is $10. You would take the stock out and pay $350 in tax, assuming you're in the 35% tax bracket.

The difference between the $50 value and the $10 basis, or $40, for tax purposes is called net unrealized appreciation, or NUA, and is taxed at long-term capital gains rates regardless of when you sell. Even without an increase in rates, that's a nice savings. At a 15% capital gains rate, you'd pay a total of $950, instead of $1,750 if you had to pay income taxes on the entire distribution. If the marginal income tax rate goes up, that benefit becomes more valuable. Barbetti says that with more people being laid off, especially on Wall Street, he's been seeing increased interest in this tax move.

DEFERRED COMPENSATION

If you're lucky enough to have a deferred compensation plan, you know that the big benefit is tax deferral, which allows money to compound tax-free until it's withdrawn. That's valuable if tax rates remain constant or decline. Even if tax rates went up as high as 50%, much higher than anything under consideration, deferring compensation would still make sense over the long haul. You might want to reconsider deferring compensation if you expect rates to rise at the time you want to take your money out.

You'll need to think about this in advance. If you want to defer base salary and nonperformance-based bonuses earned in 2009, you will need to elect to do so by this Dec. 31. Once you choose to defer, you can't change your mind and take the money out of the plan sooner.

RESTRICTED STOCK

If you've been offered restricted stock, you should think about taking the 83(b) election. That election, which must be made within 30 days, allows you to pay the income tax up front and pay tax on future gains at the lower cap-gains rate. If you don't make the election, you pay tax when the stock vests, regardless of whether you sell it. If the stock goes up dramatically before it vests, you'll save yourself a hefty amount of cash by choosing the 83(b).

But if the stock remains flat (or worse, declines), you may have paid tax (or, worse, too much tax) years in advance for no reason. "You are triggering tax but not putting cash in your hand, so you need to look at the opportunity cost," says Deloitte's Stretch.

Say you're given $10,000 worth of restricted stock. If you're in the 35% bracket and make the 83(b) election, you'd pay $3,500 now. If the stock rises to $15,000 and you sell when you vest, you'd pay an additional $750 at today's 15% cap-gains rate, for a total of $4,250. (If the cap-gains rate goes to 20%, you'd pay $250 more.) If you didn't make the 83(b) election and paid income tax on the full $15,000, you'd owe $5,250. If you're in the highest marginal rate and it goes to 39.6% by the time your restricted stock vests, you'd owe $5,940. That potentially higher tax hit, plus the likelihood that stock you'd receive has been pummeled in the market rout, is why Barbetti recommends considering the 83(b) election now. "If you think your restricted stock will vest in a higher tax year," he says, "then maybe you bite the bullet and pay the tax this year." |BW|

JACOB THOMAS

A HOT TICKET IN LOTTERIES

In recessionary times, lotteries are catching the fancy not only of people wanting to become instant millionaires but also of state governments eager to close their budget gaps. Scientific Games (SGMS) is reaping a bonanza from the mushrooming of lotteries—from Florida, Georgia, and Texas to China, Finland, Germany, and Italy. No wonder mogul Ron Perelman has accumulated a 28% stake in Scientific Games.

SCIENTIFIC GAMES TAKES A TUMBLE

Data: Bloomberg Financial Markets

The company, which provides instant ticket and online lottery products and services "continues to win substantial [multiyear] contracts from both U.S. and international lottery authorities," says Steven Ralston of Zacks Investment Research, who rates the stock a buy. SG also provides computerized systems to the horse-racing industry and operates off-track betting facilities. Ralston forecasts SG will earn $1.14 a share in 2008 on revenues of $1.2 billion, and $1.58 in 2009 on $1.33 billion.

Like other stocks, SG, which hit 40 on Oct. 15, 2007, has tumbled: It's now at 16, near its 52-week low of 15. "We view that as a unique opportunity in view of several catalysts coming in the next three to six months," says Celeste Mellet Brown of Morgan Stanley, who rates SG, a client, overweight, with a target of 42. Among the catalysts: the launch of a new ticket-printing facility in China and approval of additional lottery games expected there before yearend.

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MARVEL A BIT LESS MARVELOUS

Data: Bloomberg Financial Markets

Marvel's Full Metal Jacket

With the box-office success of Marvel Entertainment's (MVL) *Iron Man* last summer, investors expect the stock of the company, which owns a library of 5,000 comic-book characters, will also show superhuman performance. Marvel (once controlled by Perelman) is licensing its characters to producers, toy makers, and comic publishers.

"Marvel's business is well insulated from the impact of a slowdown, and we think the stock [now at 28.40] can outperform the market by at least 15% over the next 12 months," says Doug Cruetz of investment firm Cowen. Marvel's second-quarter results, driven by strong licensing sales resulting from the popularity of its movies, beat Street estimates.

A new distribution deal with Paramount Pictures will boost Marvel, says Cruetz. He sees it earning $1.93 a share in 2008, $2.14 in 2009, and $2.25 in 2010, up from 2007's $1.70.

QUESTCOR IS GAINING GROUND

Data: Bloomberg Financial Markets

A Sales Boost For Questcor

Tiny, little-known Questcor Pharmaceuticals (QCOR) is taking aim at two ailments: infantile spasms and multiple sclerosis (MS). Its recent sales spike comes from rising off-label use of its lead drug, Acthar, for baby spasms, a severe form of childhood epilepsy. Acthar, a purified peptide hormone, is approved by the Food & Drug Administration for over 50 indications. Some 3,000 U.S. babies suffer from spasms, and Questcor has a 40% share of that market, says Han Li of investment firm Stanford Group, who rates the stock a buy. He first recommended Questcor on Sept. 10, at 5.49 a share. By Oct. 15 it had risen to 6.71, so he hiked his target to 9 from 7.

Questcor has beefed up its sales force to boost its MS market share from 0.5% (115 patients) to 5.8% (1,492) by 2013. Han sees profits of 41¢ a share on sales of $90 million in 2008, and 50¢ on $100 million in 2009. |BW|

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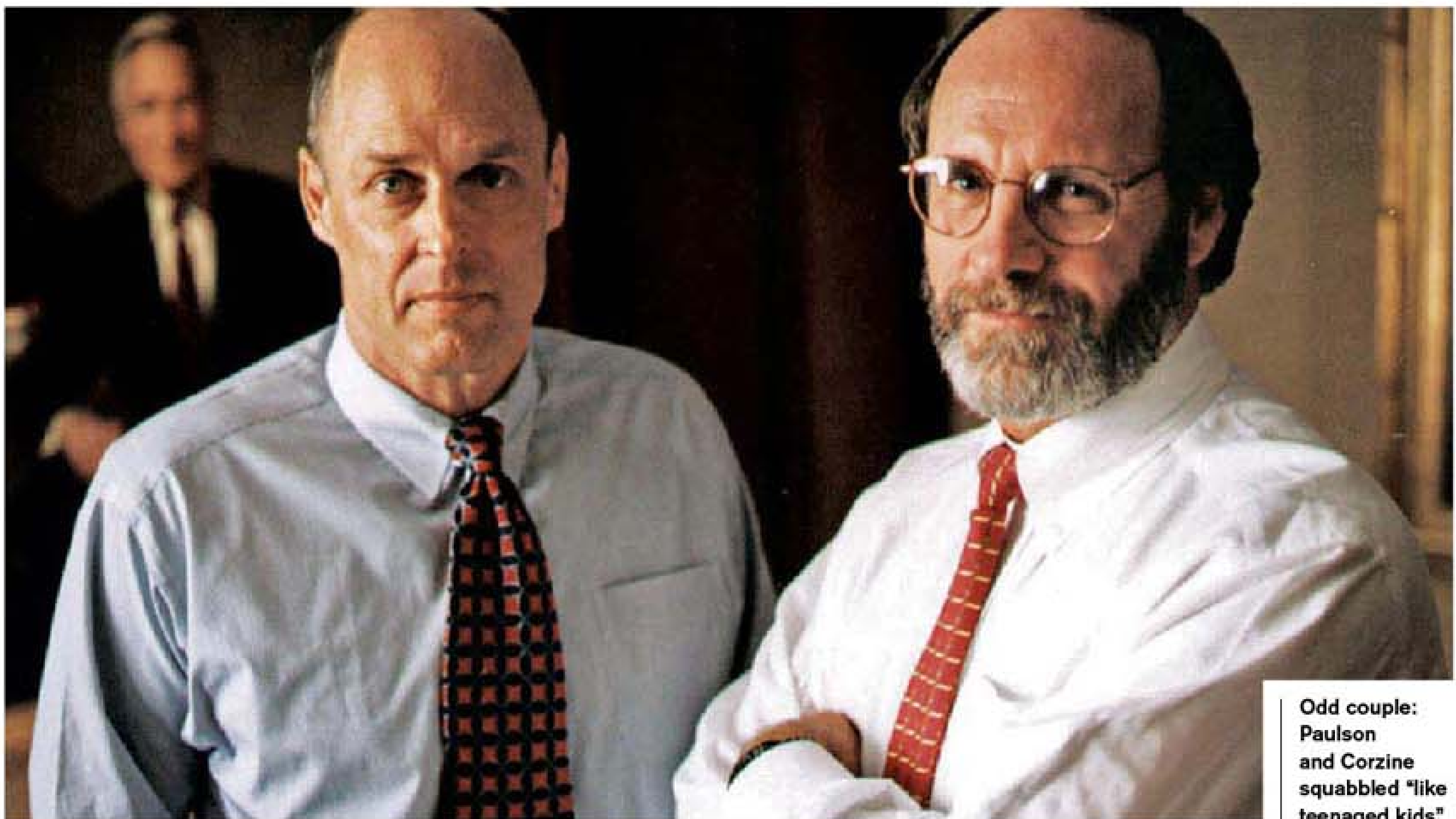
Goldman Sachs' Long Climb to the Top

This history of the firm is rife with conflict and intrigue. It's also a vivid chronicle of Wall Street



Odd couple: Paulson and Corzine squabbled "like teenaged kids"

AP PHOTO

Time will tell whether Henry Paulson, architect of the Wall Street bailout, proves to be the savior of the U.S. financial system or just the redeemer of a lot of fellow fat cats. But the Treasury Secretary and former CEO of Goldman Sachs surely knows how to wield power. Take his role in ousting Jon Corzine, his onetime co-CEO at Goldman, after the odd couple—the methodical Paulson and the impulsive Corzine—squabbled "like teenaged kids," in the words of one colleague.

It seems the headstrong Corzine, now governor of New Jersey, acted too independently in 1998 to suit Paulson, an executive committee member at the then-privately held partnership. Corzine tied up too much capital in one risky deal and, flying solo, approached commercial banks such as Chase Manhattan about a merger. So, while Corzine, all unsuspecting, swooshed down the slopes in Telluride, Colo., on a family Christmas vacation, Paulson and three others hatched a scheme that forced Corzine out the door in a few months. The alleged plotters included John Thain, now chief of Merrill Lynch and the former head of the New York Stock Exchange, who was so close to Corzine that he was trustee-designate for his kids. Recalls a Goldman partner: "It was like living the history of imperial Rome."

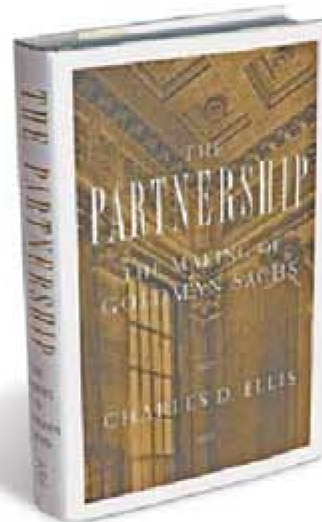
That juicy tale is one of many in *The Partnership: The Making of Gold-*

man Sachs, Charles D. Ellis' 729-page paean to the famed firm. Ellis traces Goldman's evolution from a sole-proprietorship in 1869 to today, when it stands bloodied but still on its feet at the center of Wall Street.

Along the way the author provides a remarkable window into the growth of the Street. We move from genteel days, when poaching a rival's clients was something investment banks just didn't do, to more recent times, when insider-traders, dubious research analysts, and various fraudsters (there were surprisingly few at Goldman) became the subject of tawdry headlines. We watch firms move from basic stock-peddling to sophisticated derivatives-playing. And we see Goldman haltingly take its business global, although, amazingly, not in any big way until the mid-1980s. Lately, more than half of its profits in some years have come from outside of the Americas, and it is a major underwriting force in such frontiers as China.

The account is full of colorful detail. Sidney Weinberg, for instance, a seventh-grade dropout who chanced on a job as a janitor's aide at the firm in 1907, rose to steer Goldman through the Depression and lesser disasters until his death in 1969. "He ate, drove, wore, and used the products produced by [client] companies—cheese had to be Kraft, coffee had to be Maxwell House, cars were Fords, etc...." And like Paulson and a long string of Goldman honchos, Weinberg became a counselor to a President, in this case Franklin Roosevelt, for whom the Goldman executive worked during World War II. Weinberg had a son, John, who served in the U.S. Marine Corps in that war and later ran the firm until 1990.

At points, Ellis slips into inside baseball. His detailed accounts of financial dealings may interest only the most fervent market wonk. And he quotes too many executives at very great length, perhaps a result of the access he was afforded to more than 100 partners. At three-quarters the number of pages, the book might have been twice as good, especially if Ellis had dropped gushy superlatives that at times make the work read like an official history. How often must we hear how extraordinary Goldman staffers are? Can it be true that Goldman leaders "knew more about and cared more about their people" than those at any other firm, especially when market reversals pushed Goldman into hefty layoffs?



The Partnership: The Making of Goldman Sachs **by Charles D. Ellis; The Penguin Press; 729 pp.; $37.95**

But those are quibbles. Ellis captures Goldman's mixed legacy: Its staffers have at times stood among the smartest on the Street, as when they largely sidestepped the subprime mortgage debacle. Earlier the firm narrowly missed hiring Michael Milken, the junk-bond felon, and Jack Grubman, the tainted dot-com securities analyst.

But Goldman also stumbled: As the "principal financial enabler" to freebooting British publisher Robert Maxwell in 1991, Goldman was hit for $500 million in costs, most to settle with defrauded pension funds, Ellis says. And the collapse of Long-Term Capital Management, a Goldman banking client slammed by market reversals in 1998, cost the firm a bundle.

Pressed by the current financial crisis, Goldman is becoming a commercial bank, and so it may pull back on trading risks, jeopardizing its outsize returns. Clearly, times change: Paulson in 1999 vetoed an acquisition of J.P. Morgan that would have effected the same transformation, fearing that Goldman would lose its identity. Even with all the new regulators it will face, however, Goldman will continue to run its own show, probably providing material for still more books in the future. |BW|

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Family Feud

In *Goldman Sachs: The Culture of Success* (Touchstone, 1999) ex-Goldman trader Lisa Endlich covers a lot in 326 pages. One section, echoed by Ellis, alludes to ill will between the intermarried Goldman and Sachs families after partner Henry Goldman backed the Kaiser during World War I. The bad blood lasted until at least 1967, says one source, when hardly any Goldmans were on speaking terms with any Sachses.

To read *BusinessWeek's* review of Endlich's book, go to: **http://bx.businessweek.com/goldman-sachs/reference/**

BUSINESSWEEK.COM | For more on Goldman Sachs, watch a video interview with author Charles Ellis at www.businessweek.com/go/tv/ellis.

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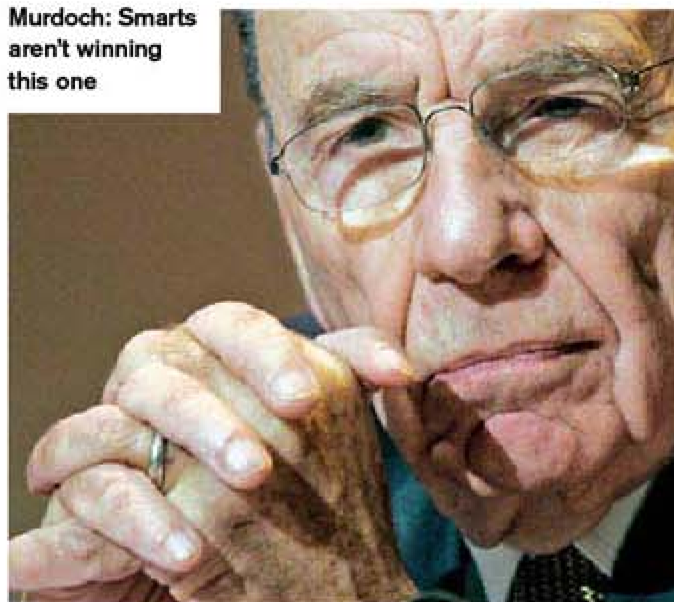
Is It Better to Be a Fox or a Mouse?

Disney is less dependent on ad revenues than News Corp., and today that's a saving grace

It hasn't been fashionable to be a big, groaning media conglomerate for a long time. So the remaining giants ardently woo investors, trying all manner of story and seduction to win a little bit of love, to be seen as not just like all the other guys. ¶ But in this era, it's no easy task for media megaliths to find a pretty come-on to convince Wall Street of their brilliance. Sumner Redstone finally gave up and in 2005 decided to slice his Viacom in half. Time Warner execs boast about a portfolio composed more or less entirely of top brands, but that pitch will go unheeded as long as it owns AOL, still the corporate equivalent of cement shoes.

The two best claims for company exceptionalism are those presented by News Corp. and Walt Disney. If I may grossly oversimplify, the stories go something like this: News Corp.'s Rupert Murdoch has employed his strategic brilliance to painstakingly assemble a machine that will outsmart all players on the global media chessboard. Disney deserves a premium stock valuation from its powerful brands and its unparalleled variety of ways to make money from them. (It's been selling this notion to investors lately, under the alliterative tag "the Disney Difference.") Both have been knocked around by the stock market in the past year. Disney's 27% drop over the twelve months ending Oct. 14 sounds grim, but such a showing outperforms its peers and market indexes. Just compare it with News Corp.'s 57% decline. Apparently, not all exceptions are created equal.

To mangle a metaphor, Murdoch's problem is that his papers have come home to roost. His newspaper division accounted for around 19% of News Corp.'s revenue in its last fiscal year, which ended June 30, making it the company's second-largest unit. Though there's more to Dow Jones than *The Wall Street Journal*, investors perceived that deal as a very expensive way to buy more newspaper assets, and time has not improved the aftertaste. (A company spokesman says the company is pleased with the *Journal*'s and Dow Jones' overall performance.) And, analysts say, its TV station holdings leave News Corp. further exposed to local ad trends, which have not been encouraging. And the digital pixie dust that the 2005 MySpace purchase sprinkled over the company lost some of its power in April, when the company admitted that the Fox Interactive Media unit (which houses MySpace) would miss its $1 billion revenue target. News Corp. hasn't provided one for fiscal 2009.



Murdoch: Smarts aren't winning this one

Murdoch is "still the smartest guy in the room," says one analyst. "But so what? People are still selling the [expletive] out of his stock." (Murdoch, who's sitting on $4.7 billion in cash, recently said he will only buy properties with two revenue sources—that is, nothing supported only by ads.)

The explanation of Disney's performance begins with one simple fact: Among its peers, the entertainment giant derives the smallest percentage of revenues from advertising. This is a good data point to have on your side when ad spending is tanking. Disney's stated selling point—that only it can take, say, *High School Musical* and extrapolate a gazillion revenue streams by leveraging everything from merchandising to movies to theme parks—has won traction with at least some investors. The mercurial reign of Michael Eisner is now in the rearview, and CEO Bob Iger wins plaudits for steadiness. The big question is what a recession—and a presumed travel slowdown—will do to Disney's theme parks business, which accounted for around a third of its revenue last quarter. (Company reps, citing a quiet period before reporting earnings, declined to make executives available for comment.)

While this slow media environment is likely mere rehearsal for what looms, Disney appears to be a better bet for stability. Ultimately, its trump cards are pretty prosaic: The company is less dependent on advertising, and it sold off a newspaper division in 1997. The media moguls perched in massive offices brooding over bold moves may not want to hear it, but in times like these, strategic brilliance doesn't drive their stocks. Avoiding anything radioactive does. |BW|

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For Jon Fine's blog on media and advertising, go to businessweek.com/innovate/FineOnMedia.

(FROM TOP) BRAD TRENT; MARK LENNIHAN/AP PHOTO

Google's Shaky Smartphone Debut

Its Android software on T-Mobile's new G1 is intriguing, but everything needs work

In the software world, a "developers' release" is a preliminary, unfinished version of a program that lets engineers kick the tires and gauge its potential. Think of T-Mobile's new G1 phone as a kind of developers' release, a chance for ordinary customers to test Google's much trumpeted Android software for smartphones.

This iPhone wannabe is an intriguing but flawed effort—worth a look for early adopters but probably not what you want to carry as your everyday phone. The G1 will be available on Oct. 22 for $180 with a two-year contract; data plans start at $25 a month.

The design of the Wi-Fi-ready G1 handset from HTC makes assessing Android harder than it should be. With its awkward slide-out keyboard, the phone is difficult to type on. It also lacks features we are coming to regard as standard on contemporary smartphones. Unlike other big-display, touchscreen phones, the screen orientation does not change when you rotate the handset, and the display can only be used horizontally when the keyboard has been slid out. You can use a BlackBerry-like trackball instead of touch to navigate the screen, but I found this hard to use with precision. There's no stereo Bluetooth, and using a wired headset requires an adapter.

Then there's the network. As befits its Google heritage, Android is centered on Web browsing and needs a fast connection. T-Mobile's speedy new 3G network is available in only 21 cities and—based on my experience in Baltimore—3G coverage in those areas is spotty. I ended up doing nearly all of my testing of everything but voice on Wi-Fi.

Of course, there will be other and better Android phones next year, and 3G networks are improving. What about the software? The most promising thing about Android is the way Web services and search are integrated across applications. In many programs, anything you type into an open window is interpreted as a search request, tailored to whatever you are doing at that moment. For example, if you are in phone mode—the default state if no program is running—then typing initiates a search of contacts. A list of matches comes up as soon as you start to type and is refined as you add letters. Typing in the browser window opens a Google Web search; in Google Maps, it starts a location search; and in the Amazon.com MP3 store, you get a music search. If Android sees what looks like an address in a Web page or mail message, tapping it will bring up a Google map. All of this is clever and often useful. But typical of Android's many inconsistencies, when you start typing in any Gmail folder, nothing at all happens. If you want to search messages, you must hit the Menu button and choose search.

The G1 has a slide-out keyboard, but it's clunky

Android can be clever and often useful. Tap an address in a Web page, for example, and a Google Maps window appears

There's also a lot missing. You can sync contacts and appointments only through Gmail and Google Calendar. If you want to sync with Outlook or iCal on a computer, you first must get the data into the Google applications. There's no built-in video player other than a YouTube application, and the music player is miles short of iTunes.

Android's ultimate success will depend on third-party software efforts. Unlike the tightly controlled iPhone store, there are no limits on what Android programmers can do, which means we are likely to see lots of applications of decidedly mixed quality. For the moment, the Android Market offers only free programs. Since developers want to make money, the market lacks the polished applications, especially games, that make the iPhone so appealing—though I did have some retro fun with Namco's Pac-Man.

The iPhone has flaws, too, but Apple had all the important pieces in place from Day One. Android is a work in progress. I suspect it could be a formidable competitor in six months or a year, but it has a long way to go. |BW|

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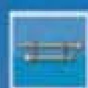
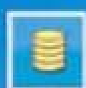
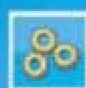
 **Control Workflow**

 **Control Costs**

 **Control Operations**

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FAKE CHIPS THAT PUT THE MILITARY AT RISK

"Dangerous Fakes" (In Depth, Oct. 13) offered readers concerned about the financial crisis something else to worry about: counterfeit parts in America's weapon systems. The article traced the path of fake military-grade microchips that make their way from China to unregulated U.S. brokers, who, in turn, supply the Pentagon and defense contractors. "These brokers should be charged with treason," wrote one reader, as a debate raged on our Web site about where to assign blame. Others argued that critical military components should be made exclusively in the U.S. *–Brian Grow*

The idea of securing materials from the lowest bidder to put in military equipment is just laughable. It's wrong to blame the Chinese. If U.S. military officials want to behave like dumb tourists buying sapphires in Bangkok, it's up to them!

Screen name: Tony157

Our lawmakers have to mandate that certain critical products be made in the U.S. But I guess they're too busy helping their Wall Street buddies.

Screen name: alskdjf

I say these brokers should be charged with treason. But this will be passed over by the public—busy worrying about what new, made-in-China thing to buy.

Screen name: Torino

There is no such thing as a "fake" or "counterfeit" chip. A more precise word would be "secondhand" or "refurbished."

Screen name: Fez

What do we have to do for our government to protect us from this rogue nation? First it was counterfeit luxury goods, then counterfeit foods and counterfeit drugs, and now counterfeit military parts.

Linda Galasso
HOLMDEL, N.J.

We see this all the time in the electronics industry: buying parts from China, then spending a ridiculous amount to have them tested. It brings the price up to what it would have been to buy from a reliable supplier.

Screen name: Crystal

In a free market, which the U.S. so fervently champions, we can't fault Chinese entrepreneurs who see the moneymaking opportunity in recovering reusable chips from junked equipment.

Albert Chu
RANDOLPH, N.J.

The price of being a leader in this important area is the potential for being identified with the problem rather than the solution.

Our decision, as a defense contractor highlighted in the article, to attack the problem of counterfeit parts in the aerospace and defense industry comes from our commitment to our servicemen and women. We have no tolerance for inferior parts or technologies. We will continue to be candid and aggressive in our efforts to help the industry ensure the integrity of its products.

Michael Heffron
President, Electronics & Intelligence, BAE Systems
NASHUA, N.H.

THE POWER 100

GIVE SOCCER'S BIGGEST MOGUL HIS DUE

Placing Manchester United owner Malcolm Glazer at No. 33 on "The Power 100" sports industry list (Special Report, Oct. 13) is a gross miscalculation on your voters' part. This British soccer franchise is the most visible sports club on the planet. That alone should confer a higher rating for Glazer. You can throw in his Tampa Bay Bucs ownership as an afterthought.

Jon Feldman
BEL AIR, MD.

THE MORTGAGE CRISIS

PAUL O'NEILL FINDS THE ROOT OF THE PROBLEM

Former Treasury Secretary Paul O'Neill's point was right on: You can't put people who have insufficient income, no wealth, and no consistent job history into mortgages ("Paul O'Neill: Blunt Talk About the Crisis," Facetime, Oct. 13). The tragedy is that he and the Bush Administration did not see eye to eye. We'll need straight shooters like him in the new Administration.

Bob Schieck
ANTIOCH, ILL

CORRECTIONS & CLARIFICATIONS
The illustrations for "Pink-Slip Special" and "Profiles in Pilfering" (BTW, Oct. 13) should have been credited to James Gulliver Hancock.

MATT MAHURIN

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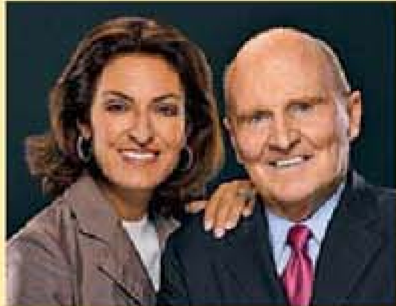
Trust in a Time of Turmoil

Why Washington is having to go to extremes to restore America's confidence



Is there any way to stabilize the current financial situation?

Roberta Lenhart
NORTH HOLLYWOOD, CALIF.

The government may have answered your question for us with its shock-and-awe $250 billion plan to deploy funding into large and small banks and loan guarantees to get interbank transactions moving again. It's too soon to tell if this program will unfreeze credit and reboot the financial system, but it's hard to imagine it won't go a long way toward putting things right again.

As we wait and watch, let's not forget why such a radical move was necessary. Washington was at the center of a perfect storm in terms of trust. President Bush, a lame duck in any regard, has an approval rating near 25%, and some of his recent speeches have made an art form of "mailing it in." Meanwhile, congressional leaders, with their even lower approval ratings, can't make a move without being suspected of ulterior motives, and some are, in fact, acting in a reckless, partisan manner. Two trust-damaging examples: House Speaker Nancy Pelosi's rant before the unsuccessful first vote on the $700 billion restructuring bill (now known as TARP) was essentially a stump speech, and Senate Majority Leader Harry Reid ruminating about an unnamed insurance company being close to failure sent that sector into a stock market tailspin. The only people generating any measure of confidence in the Capital are two appointees, Hank Paulson and Ben Bernanke. Yet even with their tireless efforts, their communication skills do little to dispel skepticism.

But we're not suggesting leaders can't build trust in mid-crisis. They can—by taking strong action, provided that action is taken quickly, openly, and straightforwardly. Together, speed, transparency, and simplicity form a "trust screen"—the closer any leadership move comes to meeting all three, the more trust it will create.

Trust can be rebuilt, even in the middle of a crisis, by leaders who make straightforward moves in a quick and transparent way

Indeed, several measures that were already being implemented in Washington—before Tuesday's announcement—passed this trust test. Take the increase in FDIC guaranteed funds from $100,000 to $250,000. It happened overnight, and people clearly understood its impact. The move was the essence of transparency and clarity.

But other parts of TARP weren't meeting the mark, in particular the plan to reduce foreclosure rates by buying up mortgages and the auctioning off of banks' toxic securities. Both programs practically shouted "Slow Rollout!" and appeared rife with complexity and potential for conflict. It was easy, for instance, to imagine homeowners demanding to know why the government was retooling their neighbors' mortgages and not their own.

Pelosi: Did her pre-bailout speech erode Americans' trust?

And so, with Washington's piecemeal approach not working, the credit markets remained paralyzed. And a howitzer response became necessary.

In all this, there's a vital lesson for businesspeople. When crisis strikes, it's awfully late to start thinking about how much trust you've stockpiled over the years. Trust is the very foundation of effective leadership; it's the grease of change. Leaders need to be building trust every single day. In every communication, they must rabidly avoid complexity and gobbledygook. There can be no pabulum and no mindless cheerleading. Just the plain, old truth, delivered the same way to every audience.

Business leaders can also build trust by connecting with their people. We're not talking about walking the hallways saying "hi." We're talking about forging relationships by hanging out where the work gets done, talking and listening, eye-to-eye. They should run frequent no-holds-barred town meetings. They should talk about who they are and what they feel, their motives and dreams. The more authentic a leader shows himself to be, the stronger the connections. Authenticity feeds trust.

We're hopeful that TARP and a new President and Congress will bring trust back to Washington. But for businesspeople, the reality that such an extreme response was needed should sound like bells tolling. Build trust while you can; build trust today. | BW |

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Jack and Suzy look forward to your questions. You can e-mail them and view their new Web site at welchway.com. For their PODCAST, go to businessweek.com/search/podcasting.htm.

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