

Business and  
the eurozone

# Calamity contingencies

From his base in the Königsallee, the canal-side boulevard that is Düsseldorf's premier shopping street and one of the smartest German office addresses, Andreas Schmitz is well placed to monitor European economic progress – or lack thereof.

Not only does he head HSBC Trinkaus, a German subsidiary of the UK financial group that helps look after the wealth of the surrounding Rhine-Ruhr industrial heartland and beyond. As president of the BdB, the country's main banking association, he is also a frequent visitor to Frankfurt, the commercial capital and home to the European Central Bank.

As the ECB and Europe's national leaders grapple with a sovereign bond crisis that threatens the continent's nearly 13-year-old monetary union, Mr Schmitz's corporate clients are among those questioning its durability. "There is no blueprint for anything," he says. "You do discuss certain scenarios with customers, but it is like poking around in the fog."

For months it has been the best-kept secret of European business. In spite of the most solemn declarations from the continent's political leaders that they will move heaven and earth to save the euro, are more and more companies quietly trying to protect themselves against the possible disintegration of the 17-nation currency? The general opinion of dozens of business executives interviewed by the Financial Times this month is that although a eurozone break-up would be both undesirable and fiendishly difficult to plan for, to cross one's fingers and hope for the best is emphatically no longer an option.

As politicians prepare for another make-or-break European Union summit in Brussels on December 9, the persistent inability of governments to find a comprehensive solution to the eurozone's troubles is forcing companies, especially big multinationals, to think the unthinkable.

Apocalyptic visions considered in boardrooms across Europe range from bank failures and the collapse of credit to the destruction of the EU's single market, mass social unrest and a recession or worse. Even the most benign of that range of outcomes would have repercussions well beyond the eurozone – making the issue one of consequence to businesses and government officials worldwide.

Although the UK, for instance, is not part of the single currency, the euro area accounts for 47 per cent of the value of its exports, making it inconceivable that British companies and banks could escape the consequences if it were to unravel. "Good risk management means planning for unlikely but severe scenarios, and this means that we must not ignore the prospect of a disorderly departure of some countries from the eurozone,"

Andrew Bailey, a senior regulator at the UK's Financial Services Authority, said last week. "I offer no view on whether it will happen, but it must be within the realm of contingency planning."

One cat was let out of the bag this month when Tui, the German travel company, confirmed it had asked Greek hotel owners to sign new contracts based on the possibility that Greece might abandon or be kicked out of the monetary union. Under the amended contracts, Tui would protect itself against currency risk by paying the hoteliers in "new drachmas", or whatever unit Athens chose as a replacement for the euro.

Andreas Andreadis, the president of Sete, an association of hoteliers, says he advised his members to "disregard the request because it's a hypothetical issue". Mr Andreadis, who is also chief executive of Sani, a hotel operator, adds: "We don't have a contingency plan for a break-up."

Precise plans are almost impossible to draw up because there is neither a precedent nor an established procedure under EU law for a country to exit the eurozone. But the taboo on public discussion of a break-up was broken at the French resort of Cannes this month by none other than Angela Merkel, Germany's chancellor, and Nicolas Sarkozy, France's president. Furious at George Papandreou, the Greek prime minister, for announcing that he intended to hold a referendum on the latest international rescue plan for his country, or perhaps on its entire European future, they raised for the first time the possibility that Greece might one day not remain part of the eurozone. Mr Papandreou

quickly ditched his proposal – and was obliged to resign the premiership.

Within days of these events Nomura, the big Japanese bank, took matters further by publishing a research paper for its clients entitled "Currency risk in a eurozone break-up: legal aspects". Lawyers with financial markets expertise are examining how such a collapse would affect euro-denominated debt issued under different national legal regimes.

In the eurozone's southern cone, where governments are either locked out of bond markets or paying ever higher interest rates to issue debt, the Merkel-Sarkozy *démarche* concentrated minds.

"We are aware of very few companies making contingency plans for the case of a euro break-up. Having said so, we have made a first rough analysis about the consequences of the discontinuation of the euro as the Portuguese currency," says Jürgen Dieter Hoffmann, finance director at Volkswagen Autoeuropa, one of Portugal's biggest exporters. "The conclusion is that overall the impact would not be

so negative to our company, as we are mainly an exporter and belong to a worldwide group."

Not everyone is as forthright. In Spain, Baldomero Falcones, executive chairman of FCC, a construction and infrastructure group, says his company has put together a "Plan B" for a possible financial storm sweeping across southern Europe. But he adds: "In this Plan B we didn't introduce the possibility of the break-up of the euro. The probability, I think, is very low, because the cost for all Europe would be incredible."

A similarly two-edged message

comes from some of Italy's most distinguished businessmen: yes, we are preparing for financial and economic shocks that could be extremely serious, but no, not for a eurozone break-up. Rodolfo De Benedetti, chief executive of CIR, the big industrial holding companies, says: "Our group is constantly studying ways to reduce potential risks from unexpected events and to be ready to counter any scenarios, even the most improbable. Nonetheless, I am confident that European leaders will succeed in preventing the break-up of the eurozone."

Marco Milani, chief executive of Indesit, the Italian company that is one of Europe's leading manufacturers of domestic appliances, says Indesit's focus is on investments that will safeguard it in hard times.

Very few studies exist in the public domain of the extent to which European business is actively arming itself against a nightmare that no one wishes to unfold. But IT2 Treasury Solutions, a London-based supplier of corporate software, conducted an anonymous survey this month of 75 corporate treasurers from countries including the UK, the Netherlands, Finland, Switzerland, Norway, Sweden, Canada and the United Arab Emirates. According to the survey, just over 53 per cent of respondents expected the eurozone to split up in the next 12 months. More revealing, perhaps, 78.5 per cent of the treasurers believed their companies could handle a eurozone break-up, in financial and operational terms, with less than three months' notice.

Corporate treasurers are on the front line of the crisis, responsible for protecting assets and managing exposure to foreign exchange, interest

rates and other risks. Kevin Grant, IT2 chief executive, says many not only appreciate the eurozone dangers but have also taken defensive action.

"As a result of the financial crisis, many have already taken steps to manage indirect exposures arising from commercial obligations or exposure to vulnerable financial institutions," he says. "There do not appear to be too many big companies that believe they have all their eggs in one

basket... Treasurers in multinationals remain generally positive about their ability to weather the systemic fallout from any European exit."

**M**any boards have learnt the lessons of 2008, when the collapse of Lehman Brothers in the US froze credit markets and tipped the west into recession. Three years on, big businesses boast stronger balance sheets and healthier liquidity levels. In terms of financing, currency hedging, cost controls and long-term investment strategy, they have enormously improved risk management.

Yet there are limits to how effectively businesses can prepare for the unknown. Max Warburton, an automotive industry specialist at Bernstein Research, observes that companies represented in Germany's blue-chip Dax-30 index have undoubtedly contemplated the risk of a eurozone break-up. "But the consensus seems to be that there is little that can be done at the corporate level to plan for

what [one] executive described as 'a black swan scenario,'" he says.

What seems likely, however, is that German carmakers - traditionally prolific users of currency hedging products - have cut back in recent months because rising yields and intensifying uncertainty have made hedging more and more expensive. "It sounds like the German [manufacturers] are holding low-yielding German Bunds and are keeping cash at German and international banks that they trust," concludes Mr Warburton.

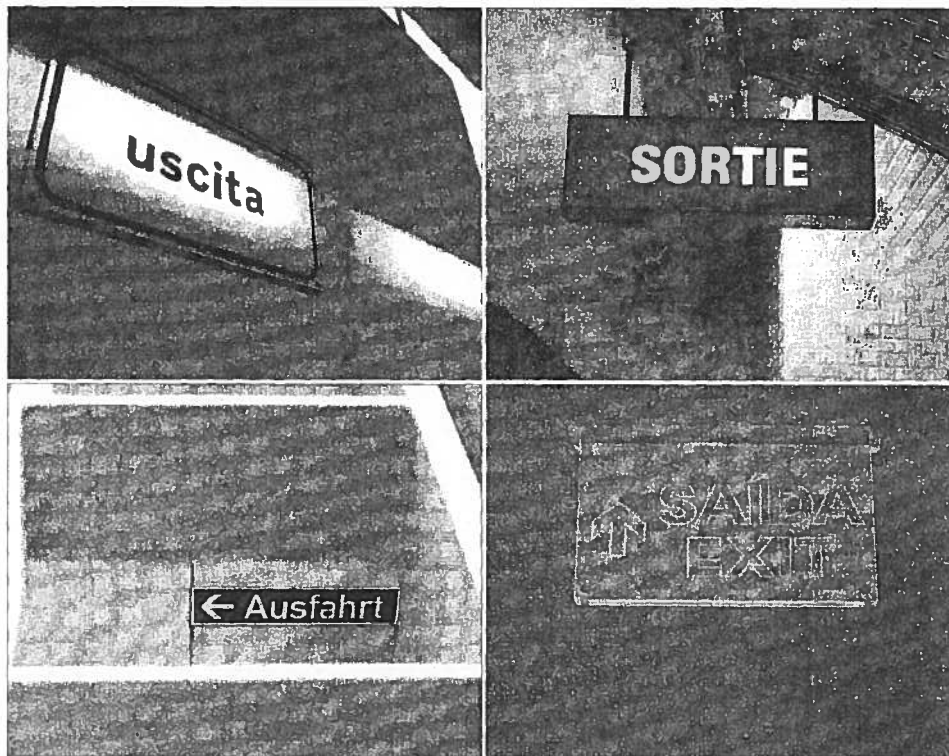
For industrial giants such as Volkswagen, it is easier to spread risk in an effort to strengthen the corporate fortress against a calamity than it is for the small and medium-sized companies that make up the bulk of European business activity. The Irish Exporters Association, which represents hundreds of SMEs as well as some multinationals, revealed survey results last week that showed 94 per cent had made no preparations for a euro implosion. "There is an urgent

need for exporters to incorporate scenarios in which the euro collapses into their strategic planning process, given the potential balance sheet implications," says Philip Halpin, economic adviser to the association.

However, several European executives say it is impossible to calculate accurately the dimensions of a break-up. "Just like after Lehman collapsed, we have created different scenarios and done some exercises. But it's difficult to assess what an event of that size would imply," says Hans Wijers, a Dutch former economic affairs minister and now chief executive of AkzoNobel, the coatings group.

While it can seem tempting simply to refuse to imagine the worst and hope that political leaders finally come up trumps on December 9, the comments of one senior French manufacturing executive may be instructive. "I wouldn't plan for a euro break-up any more than you would make plans for the fall of the monarchy. They would chop your head off"

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**'Exporters urgently need to incorporate scenarios in which the euro collapses into their strategic planning process'**

**Way-out scenario?**  
One survey of corporate treasurers this month found 53 per cent expected the eurozone to split up in the next 12 months

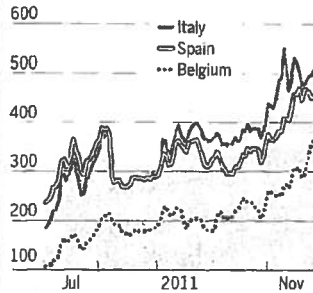
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## Escalating expenses

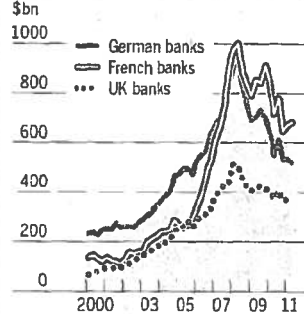
Borrowing costs (yields on Iboxx indices, %)



10-year government bond yield spreads over Germany's (basis points)



Banks' exposure to selected eurozone debt\* \$bn



Reporting by James Boxell, Jan Cienski, Daniel Dombey, Kerin Hope, Neil MacDonald, Victor Mallet, Giulia Segreti, Jamie Smyth, Matt Steinglass, Gerrit Wiesmann, James Wilson, Peter Wise

Sources: Eurostat, Consensus Economics, Thomson Reuters Datastream, BIS

\* Claims on Ireland, Italy, Greece, Portugal and Spain on an immediate borrower basis

## US and Asia

# Beyond Europe, executives make plans for the unthinkable

Around the world, companies have been following the European crisis with helpless fascination, trying to assess the potential impact on their businesses, write Ed Crooks and Jeremy Lerner.

Many executives expect a recession in Europe, and are revising market projections accordingly. More immediately, they are examining how a break-up of the euro might affect their financial health. Holdings in money market funds that might be invested in European banks, and the sovereign debt of eurozone countries – once seen as low-risk assets – are the focus of the greatest scrutiny.

Craig Martin of the US Association for Financial Professionals, says there has been "concern and angst" among American companies about the safety of their assets, and some have been

cutting their exposure to eurozone financial risk. "Most of the companies I know have been very diligent about looking at their money market funds that might be invested in European funds," he says. "They are trying to be as safe as possible."

Rick Fearon, chief financial officer of Eaton, a US industrial group with global operations, says moving company money out of the euro and into the Swiss franc is one way to address fears about political risk in the eurozone.

"I think it is possible you might have a loss of confidence in the euro and you might have an abrupt fall," he says. "Could I tell you the precise probability? No, but it is certainly not insignificant. And, given that, why take the risk? You are not earning a big return anyway."

Asian companies, too, have been taking action. Japanese financial institutions such as Nomura have curbed their exposure to European risk,

cutting their holdings of eurozone government debt, including that of Greece, Italy and Spain.

In India, meanwhile, there is concern about a euro collapse triggering a global liquidity crunch. Rajiv Kumar, director-general of the Federation of Indian Chambers of Commerce and Industry,

says the country must prepare for a "messy" breakdown, adding that he was alarmed by the sense of helplessness across Europe.

Others, however, believe Europe could still somehow step back from the brink. Murilo Ferreira, chief executive of Vale, the Brazilian mining group, says deleveraging in Europe will be painful but there are reasons to stick with the single currency. "Germany, for instance, was doing well with the euro. Going back with the Deutsche-Mark, which would then appreciate, it would not be easy for them to export any more."

Additional reporting by James Lamont

## Speed read

● **Uncharted territory** Precise plans are almost impossible to draw up as there is neither a precedent nor an established procedure under European Union law for a country to exit the eurozone

● **Lessons learnt** Today, many big European businesses boast stronger balance sheets, healthier liquidity levels and better risk management than when the global crisis hit in 2008

● **Stymied by size** It is harder for the small and medium-sized companies that make up the bulk of European business activity to spread risk

## On the web

News and analysis on the eurozone's debt problems, the threat of default and contagion in the currency bloc [www.ft.com/eurozone](http://www.ft.com/eurozone)

Companies that operate in the troubled 17-nation single currency area want it to survive but are starting to concede that simply hoping for the best is no longer an option.

By Tony Barber

