The EU and the Entrepreneur: An Attitude Adjustment in Europe

Europe's unification has created opportunities for investors

Herve van Caloen

Herve van Caloen is an international portfolio manager at Simms Capital Management, an RIA in Greenwich, Conn.

Europe's economic unification has triggered structural changes that are carrying the continent toward American-style capitalism. The transformation has also created a unique climate for investors seeking growth opportunities.

Inflation is low, as are interest rates, which converged to a lower-than-expected level after the euro's debut. European governments have ceded economic policy-making to the conservative Germans, creating an integrated union and allowing weaker governments to put their fiscal houses in order. The result bodes well for businesses. Lower interest rates are benefiting companies headquartered in areas that previously suffered from chronic inflation, such as Spain and Italy. And a coherent monetary policy, enabled by the euro, has helped level the playing field.

A NEW COMPETITIVE ENVIRONMENT HAS LED TO COST REDUCTIONS AND LEANER COMPANIES

Meanwhile, the elimination of tariffs has opened industries to competition. Corporations, no longer protected by national boundaries, are now subject to American-style hostile takeovers from their European competitors. Legal challenges have become available in the remaining pockets of protectionism. One by one, old defense mechanisms are crumbling.

Although impressive, those changes signal just the beginning of the economic unification of Europe. Newly opened borders have initiated tax cuts as countries compete for investment dollars. Privatization will deregulate the labor markets, a trend that appears strong and irreversible.

The new competitive environment has also led to cost reductions and leaner companies, while open borders and reduced currency risks have increased companies' bargaining power. European countries with cheaper labor and lower corporate taxes can attract manufacturing facilities ready to relocate.

Corporate-location flexibility has, in turn, stimulated further tax reductions. Germany, for example, with the highest corporate tax level in the EU and the highest labor costs in the world, has lost capital to neighboring countries' production facilities. Thus, Germany is eliminating capital gains taxes and lowering corporate and income taxes in an effort to keep capital within its borders. Other countries will be forced to do likewise.

In the past, corporate management was often deemed prudent for sitting on huge piles of cash, justifying poor stock performance. Shareholder value was not an issue, so managers were rarely fired for inaction, and unsatisfactory returns were blamed on economic or political environments. Today, cash-rich European companies are takeover targets and, like their American counterparts in the 1980s, European managers feel the heat. Poorly managed companies with undervalued stocks are attractive targets for raiders, who promptly unseat weak executives.

Shareholders now focus on stock performance. Enhanced stock returns attract more capital to the market, which promotes more entrepreneurship—a radical change in attitude for the European market. In recent years, Germany established the Neuer Markt, a stock market for small, new companies. In Brussels, the Easdaq was set up for the same purpose. The U.S. Nasdaq will soon launch its own European small-cap stock market.

The European economic revival marks a singular opportunity for investors seeking continued growth in their equity portfolios.