

# Bloomberg Businessweek

March 19, 2018

## Old Wall Street

Lloyd Blankfein, Goldman Sachs CEO



## New Wall Street

David Solomon, Heir Apparent



**Big changes  
at the top** 31

“We believe technology will lead us to a 100% accessible world.”

*Manel Alcaide, Co-Founder of Visualfy, Spain*

Understanding that deafness creates isolation, Manel wanted to break down barriers between the deaf and the hearing world through the use of technology. He created Visualfy, which translates sounds into visual and sensory alerts on a smartphone and other devices. Enabled by Android's open-source operating system, users can completely customise alerts in the app to their needs. Through Visualfy, Manel brings dignity to disability and aspires to create a world that is inclusive and accessible to all.

**Watch the mini-documentary about the app that visualises what can't be heard: [g.co/androidstories](https://g.co/androidstories)**

**android**





# How Disruptive Tech Can Enhance Financial Advisory

**Edward Jones**

It was once the stuff of science fiction, but artificial intelligence (AI) technologies are increasingly becoming a reality for financial advisors. With the growth in internet use and the ubiquity of smartphones, the industry has undergone a digital transformation. AI is at the cutting edge of that shift, presenting advisors with greater opportunities to serve their clients better.

AI, which uses data to make predictions and solve problems, is already a part of everyday life for many individuals. Virtual assistants, such as Siri and Alexa, help millions with personal tasks, while internet giants from Facebook to Uber are using machine learning to attract customers with individually tailored offerings. And that's just the beginning. In the financial space, AI can automate simple tasks or manage complex thinking, as well as customize product design and develop predictive analytics.

It's an opportunity that financial advisors are starting to embrace, especially given AI's potential to increase understanding of client needs and automate some aspects of client interaction.<sup>1</sup>

Part of that push is a reaction to the data explosion currently underway. The flood of information available creates challenges for industries, such as financial advisory, to efficiently manage the data. AI allows advisors to do just that while also preserving the personal relationships at the heart of financial advisory.

## THE PERSONAL TOUCH

Successful integration of AI solutions can bolster those human relationships while helping to streamline efficiencies. Jennifer Keegan, director of information systems, data and analytics at Edward Jones, said people often fear that AI will replace humans, but the technology actually augments what an advisor can do. AI shortens the time advisors spend on mundane, manual tasks such as data entry, and provides support for back-end processes, giving advisors more time to interact directly with clients. AI also mines through mountains of data rapidly, giving advisors more insight into their clients' individual needs.

**Successful integration of AI solutions can bolster those human relationships while helping to streamline efficiencies.**

"If you listen to the data...it allows you to personalize choices like the portfolios [clients] want to be in, the risks they want to take," Keegan said. "You're going to know things preemptively...and be able to proactively act on that information, to put ideas in front of them that they didn't know might be a good choice for them or didn't know existed."

<sup>1</sup> Financial Stability Board, "Artificial Intelligence and Machine Learning in Financial Services: Market Developments and Financial Stability Implications," November 1, 2017, <http://www.fsb.org/wp-content/uploads/P011117.pdf>

**“If you listen to the data... it allows you to personalize choices like the portfolios [clients] want to be in, the risks they want to take”**

That type of proactive advisory can strengthen client relationships and engagement. A report by PricewaterhouseCoopers expects AI, machine learning, and customer analytics to drive client engagement over the next decade. The idea is that automation and data will provide intelligence on consumer behavior, choices, and preferences.<sup>2</sup>

## WEIGHING THE RISKS

Any burgeoning technology is going to come with risks that must be considered. Machine learning makes predictions and suggestions based on patterns of data. But algorithmic bias can be present in the data sampling that is used to reach a conclusion, which may not be truly representative of the data set as a whole. Humans can also inadvertently skew algorithms during the testing phase, interpreting results through the lens of their own personal biases.<sup>3</sup>

That could create some ethical concerns, said Lex Sokolin, global director of fintech strategy at Autonomous Research. “Machine learning works on large sets of human-created data,” he said. “If there are biases reflected in that data, the AI will replicate such biases at scale. This may have some social effects beyond business efficiency.”

A November 2017 study by the Financial Services Board found “substantial promise” in AI technologies but warned of additional risks, including concerns over data transparency and privacy. It also warned that the rush to embrace AI may result in an overdependence on third-party technology companies that may not adhere to or properly understand applicable laws and financial regulations, leading to potential liabilities down the road.<sup>4</sup>

On the flip side, the FSB noted that the public and private sector can use AI and machine learning to comply with those regulations, as well as assess data quality, detect fraud, and streamline information sharing.

For now, AI falls under the purview of financial regulators, who will continue to monitor its evolution as it applies to the industry. But there is no doubt that AI will remain a significant part of the financial landscape, and savvy advisors are taking note. ●



## Benefits of AI and Machine Learning

- Robotic and intelligent process automation
- Augmented intelligence and predictive analytics
- Automate processes free up time for human interaction
- Anti-crime surveillance tools
- Increased data sharing and regulation

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<sup>2</sup> PricewaterhouseCoopers, “Financial Services Technology 2020 and Beyond: Embracing Disruption,” <https://www.pwc.com/gx/en/financial-services/assets/pdf/technology2020-and-beyond.pdf> <sup>3</sup> Kevin Petrasic, et al., “Three Big Questions About AI in Financial Services,” White & Case, July 18, 2018, <https://www.whitecase.com/publications/insight/ai-financial-services> <sup>4</sup> Financial Stability Board, “Artificial Intelligence and Machine Learning in Financial Services”

# Clean Heating

China's first commercial nuclear heating solution aims to help the country heat more and emit less **By Li Nan**

The release of Yanlong, a heating solution that harnesses heat generated by a small nuclear reactor, has made headlines. The pool-type low-temperature heating reactor, unveiled by the China National Nuclear Corp. (CNNC), operated safely for over 168 hours in November 2017, heralding a new era for heating in China.

"A 400-megawatt Yanlong, also known as the DHR-400, is expected to be the source of indoor heating for a maximum area of 20 million square meters. According to these calculations, it can supply heating for nearly 500,000 residents, roughly the average population of a Chinese county," Ke Guotu, Chief Designer of the reactor, told *Beijing Review*.

## A milestone

The launch of Yanlong is the first step of CNNC's ambitious plan to boost nuclear heating in north China over the next few years. The company expects to gain approval for the construction of a pilot nuclear-fired heating project by the end of 2018, and to put it into commercial operation after 2020.

The use of nuclear energy for heating is nothing new. In the 1960s, nuclear power plants in some European countries, such as Sweden, supplied both heat and electricity. But since nuclear plants were usually located far from densely populated areas, the heat generated by these reactors could not be effectively transmitted to people's households. By contrast Yanlong's reactor is used exclusively for heating and is much smaller than those used in nuclear power plants, and Yanlong is intended to be installed in close proximity to cities. "Yanlong is small and easy to integrate with existing city heating systems," Ke said.

To tackle the problems of air pollution and global warming, China has vowed to increase the proportion of non-fossil fuels in its primary energy consumption to 20 percent by 2030, while ensuring that carbon emissions peak around the same time. Curbing coal consumption and increasing

the use of non-fossil sources of energy are seen as two critical measures necessary for China to build a clean and low-carbon energy system in the coming years.

China is committed to developing nuclear energy, provided safety requirements are met. A number of nuclear power generation projects are scheduled to be launched in coastal areas, according to the 13th Five-Year Plan for Energy Development (2016–20) released by the National Energy Administration in December 2016. In addition, innovative small-scale smart reactor and commercial fast reactor projects will be pursued.

"Yanlong is a milestone in the history of China's household heating, nuclear power and energy development," said Liu Baohua, Deputy Chief of the administration, at the launch ceremony of Yanlong in Beijing on Nov. 28, 2017.

Yanlong is a new substitute for fossil

fuel-fired boilers. According to Ke, a 400-megawatt nuclear heating reactor can generate as much heat per year as the burning of 320,000 tons of coal, or 160 million cubic meters of natural gas, and the reactor releases no carbon dioxide or dust into the atmosphere. Yanlong, if used as an alternative to coal-fired or gas-fired boilers of the same supply capacity, will reduce emissions of carbon dioxide by 640,000 tons or 204,600 tons, respectively, per year.

## Multiple advantages

Coal-fired boilers have long been one of the primary causes of north China's atmospheric haze, especially in the Beijing-Tianjin-Hebei region. "More than 20 percent of end-use energy consumption in China is generated by coal, 10 percentage points higher than the global average," reads the 13th Five-Year Plan



Yanlong, a pool-type low-temperature heating reactor, is unveiled by the China National Nuclear Corp. in Beijing on Nov. 28, 2017.

for Energy Development.

Nuclear-fueled heating systems do not generate PM2.5, and that is significant for curbing smog in China, Wang Yuanfeng, a civil engineering professor with Beijing Jiaotong University, told *Beijing Review*.

China has slashed its coal consumption in recent years, but there is a long way to go before the country realizes its energy and environmental goals for 2030.

"Yanlong offers a new heating option north China, and since nuclear power is a key part of the energy system, it is expected to help the government deliver on its promises regarding climate change," said Wan Gang, Head of the China Institute of Atomic Energy (CIAE).

Low cost is another of Yanlong's selling points. Producing a gigajoule of heat with a DHR-400 costs just 30–40 yuan (\$4.58–\$6.10), on par with traditional coal-fired boilers and around 40 percent of the cost of producing heat using a gas-fired boiler. "I think Yanlong as cheap as coal and cleaner than gas will be popular in the future residential heating market," He Bingqing, Deputy Director of the Consultation and Research Center of the Ministry of Land and Resources (MLR), said.

The Beijing-Tianjin-Hebei region has launched a clean heating campaign to introduce gas-fired boilers and electric heaters, ditching the old, polluting systems that relied on coal. However, the campaign was thwarted in parts of Hebei Province, as 2017 witnessed a natural gas shortage that drove up gas prices, making both gas and electricity expensive heating options for local residents.

Yanlong makes it possible to turn coal-fired boilers into nuclear energy-fired ones at an affordable price, said He.

According to Ke, building a pool-type low-temperature heating reactor costs 1.5 billion yuan (\$228.8 million). "If a reactor with an investment of 1.5 billion yuan can serve 500,000 people for 60 years, then to me it seems that its long-term benefit is impressive and it's inexpensive," said He of the MLR.

## Hurdles ahead

Yet despite the economic and environmental benefits, Yanlong's journey toward widespread marketability does not look set for easy sailing. "Resistance to nuclear power is the biggest hurdle for Yanlong to be commercialized," said Ke. Many Chinese feel apprehensive about the use of nuclear energy, especially



Cyclists ride along an avenue lined with ginkgo trees in Beijing in November 2017.

after the Fukushima nuclear disaster in 2011.

"Yanlong is the outcome of a mature technology," said Ke. The idea of designing a low-temperature heating reactor was first raised in China in 1981, and after decades of study, Chinese scientists have now built more than 10 pool-type reactors for research purposes, maintaining a record of safe operation for over 300 reactor years.

The Yanlong reactor is submerged in a well-sealed underground pool containing more than 1,800 tons of water. This abundant water supply prevents the core from being exposed.

The system through which heat generated by the reactor is transmitted to household heating radiators relies on three isolated pipe circuits; water in the reactor pool does not flow into the heating system, and neither does any radioactive substance.

Statistics from CIAE show that the radiation levels in nuclear-heated buildings are equivalent to the natural background radiation dose, which is considered safe for humans.

In the case of a severe accident, such as an earthquake, the reactor is designed to shut down automatically to avert the possibility of a meltdown. "The technology of a pool-type low-temperature heating reactor is proven to be reliable. A disaster of the kind that occurred in Chernobyl and

Fukushima cannot happen here," said Ke.

The management of nuclear waste poses a major challenge. Reprocessing uranium and plutonium is one way to deal with used fuels. China has already mastered certain technologies associated with the treatment and recycling of nuclear waste, while new complexes for the processing of nuclear waste have been set up and the necessary funds earmarked.

But public unease extends to all matters nuclear, as seen in August 2016 when the site selection for a planned Sino-French nuclear fuel reprocessing project was halted following protests in Lianyungang, in east China's Jiangsu Province.

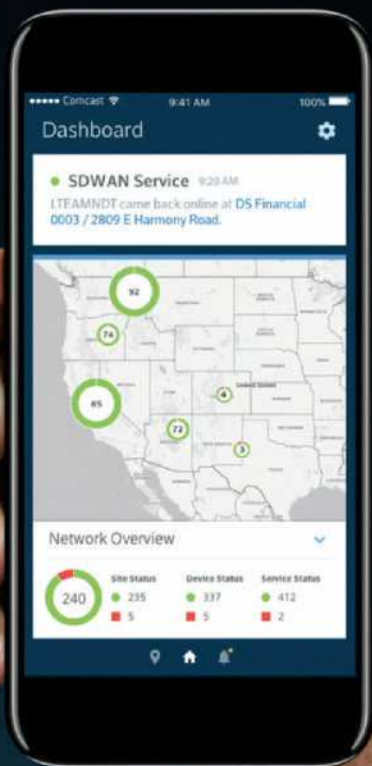
Lu Fengding, former Chinese Ambassador to Sweden, believes that a multi-pronged promotional campaign is necessary for the public to know more about nuclear power, and that the media, including social networks, should communicate more information about nuclear energy, and also that education pertaining to nuclear power should be strengthened on campuses. "Of course, more scientific breakthroughs in this regard are expected.

After all, the facts speak for themselves," Lu told *Beijing Review*. ■



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# Bloomberg Businessweek



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# IN BRIEF

## Asia

● China has created a new environmental agency, the Ministry of Ecology and Environment.



● A favoritism scandal threatens to derail Japanese Prime Minister Shinzo Abe's agenda. After a government probe found that officials deleted references to Abe's wife in a land deal critics called too good to be fair, Abe addressed parliament to deny ordering the alterations.

Beijing enjoyed its cleanest winter air in years as China worked to reduce its carbon dioxide intensity by 18 percent before 2020.

● The Philippines said it would withdraw from the International Criminal Court a few weeks after the judicial body began an inquiry into the country's war on drugs. Earlier this month, President Rodrigo Duterte ordered police not to cooperate with United Nations officials investigating human rights violations.



● Blackstone Group raised a record **\$7b** for a fund to invest in Asian real estate. The amount is close to the combined \$7.5 billion raised by 28 other Asia-focused funds through all of 2017. ▷ 34

● Coincheck, a Japanese platform for trading cryptocurrency, paid out **\$435m** to customers whose assets were stolen in a Jan. 26 cyberattack. The sum values the currency that was taken at more than its current level but less than it was worth when the company was hacked.

● Homelessness in Australia surged 14 percent from 2011 to 2016, according to new census figures. The data come as the country debates a cap on immigration, which has also been soaring.

## Europe

● "If we send someone off to jump into a black hole, neither he nor his constituent atoms will come back, but his mass energy will come back. Maybe that applies to the whole universe."



Physicist Stephen Hawking died on March 14 at age 76, more than half a century after being diagnosed with the degenerative muscular disease amyotrophic lateral sclerosis. He was expected to live only a few years. Instead, he made groundbreaking discoveries applying quantum mechanics to black holes.

● The U.K.'s budget watchdog finally put a price on the Brexit divorce:

**\$52b**

That's about equal to the GDP of Croatia.

● Turkey approved sweeping changes to electoral laws. Notably, the reforms relax a requirement that political parties secure at least 10 percent of the national vote before entering parliament, potentially allowing in members of extremist groups that support President Recep Tayyip Erdogan.

● Volkswagen said it's secured **\$25 billion** in electric-car batteries, ramping up pressure on Tesla.

The German automaker pledged to have 16 factories cranking out electric vehicles by 2022.

# Americas

● U.S. students staged a walkout to protest gun violence on March 14, exactly one month after the Parkland, Fla., shooting.



● Just a day after saying that CNBC contributor Lawrence Kudlow had a "very good chance" of replacing Gary Cohn as director of the White House National Economic Council, President Donald Trump officially offered him the job. ▷ 45

● Theranos and its founder, Elizabeth Holmes, settled with the SEC over allegations that they fraudulently solicited more than \$700 million in investments. Holmes neither admitted nor denied wrongdoing in the matter; her lawyer declined to comment.



founder, Elizabeth Holmes, settled with the SEC over allegations that they fraudulently solicited more than \$700 million in investments. Holmes neither admitted nor denied wrongdoing in the matter; her lawyer declined to comment.

● Small-business optimism is at its highest since the Reagan administration, according to a survey by the National Federation of Independent Business. Owners' biggest challenge: finding skilled labor.



● Walmart said it would deliver groceries in 100 cities by yearend.

● Democrat Conor Lamb declared victory in a tight special election for the U.S. House of Representatives in a Pennsylvania district that voted overwhelmingly for Trump in 2016. The seat opened up with the resignation of pro-life Republican Tim Murphy, who allegedly asked a woman he'd had an affair with to have an abortion. ▷ 49

# Africa

● Journalists and activists in Tanzania argued in court against a restrictive new law governing the media.

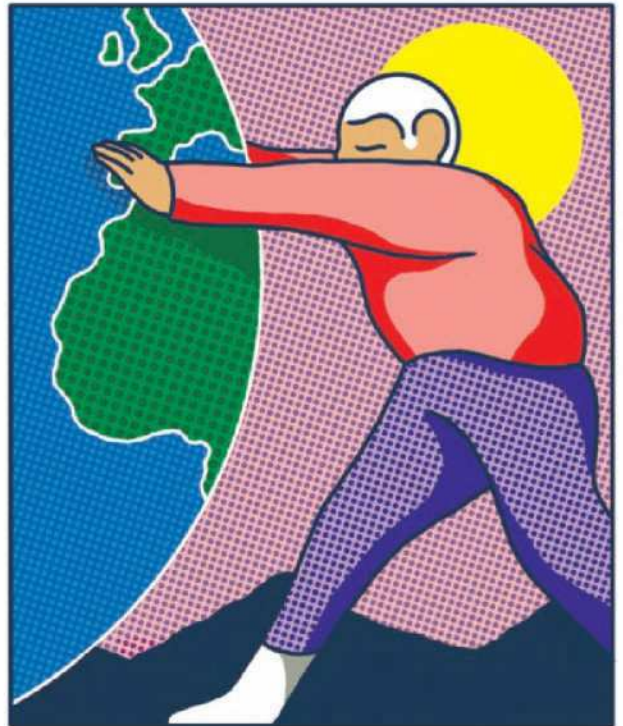
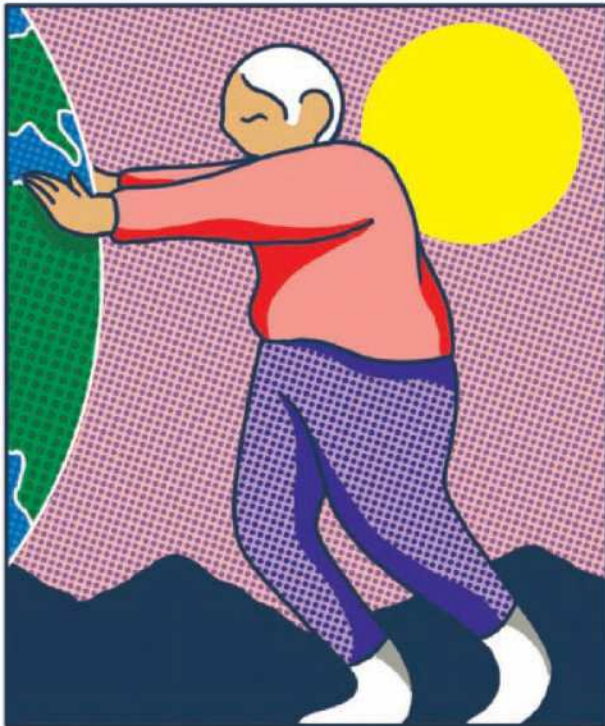
● A former coup leader won the first round of Sierra Leone's presidential election. Julius Maada Bio seized power in the country in 1996 but stepped down after three months to make way for a democratically elected candidate.

Among other things, the rules require all journalists to be accredited by the state.



The retailer will partner with Uber Technologies and other third parties to carry the goods.

## REMARKS



# Globalization Isn't Going Away

- Trump and other world leaders are going up against an unstoppable economic trend
- Michael Schuman

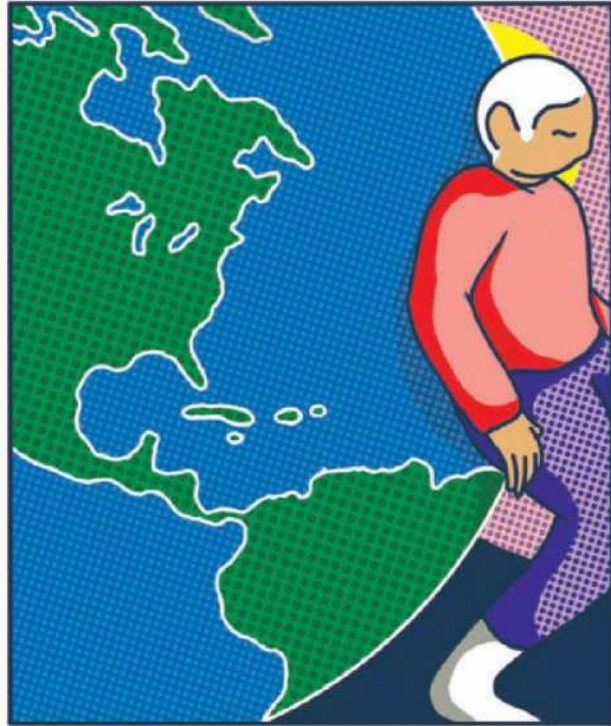
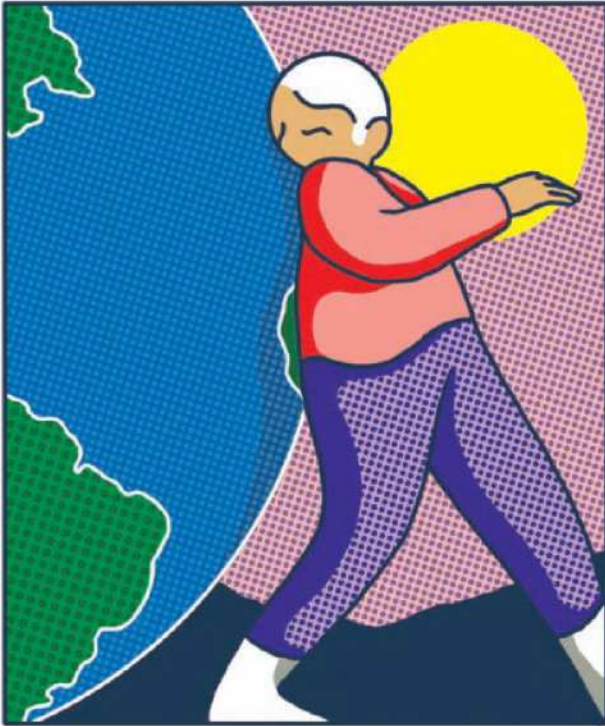
Globalization seemed to be on the ropes. Nationalist politicians had maligned it as the source of closed factories, stagnant wages, and unwanted migrants. Washington had pulled out of international pacts on climate change and trade. The British were abandoning Europe's grand experiment in peaceful integration.

Recent weeks brought more body blows. The White House turned darkly protectionist, threatening the global trading system. China's leadership—which sees itself as the patron of globalization—put it at risk by promoting the very industrial policies that fostered anti-trade sentiment in the U.S. and Europe. Italian voters flocked to political parties that rail against immigrants and the euro. Globalization, which helped to flatten the world's economic playing field, seemed about to be flattened itself.

But the dramatic events of the past several weeks don't show how weak the power pulling the world together has become, but rather how many punches it can absorb without collapsing. Enough of the world has benefited from globalization to know which side of the fight to be on. The message to the new nationalists is clear: Persist in your fight against globalization, and you may end up down for the count.

Just look at Donald Trump's tariff fiasco. Critics pummeled him after his off-the-cuff announcement on March 1 of across-the-board tariffs on imported steel and aluminum. A crowd of economists and business leaders warned of job losses, damaged industrial competitiveness, and higher costs for businesses and consumers.





Government officials from China to Canada were outraged. The European Union vowed to impose punitive duties on Levi's jeans and Kentucky bourbon. U.S. stock markets tanked. Trump's chief economic adviser resigned, and his Republican colleagues, who have all too often acquiesced to his divisive antics, this time stood up to him. More than a hundred members of Congress signed a letter demanding he back down.

Undeterred, Trump doubled down. Peter Navarro, his trade czar, insisted that no country would be exempted from the coming tariffs. Speaking of a trading system rigged against U.S. interests, Navarro said, "We're not going to take it anymore."

Apparently, they are. The final tariff plan, signed on March 8, didn't pack much punch. Trump excluded Canada and Mexico, two of the largest steel exporters to the U.S., and offered to leave out other close allies, too. The president's supporters praised the move—right-wing website Breitbart heralded it as a "triumph for economic nationalism." But that's just spin. Globalization won the round.

The situation isn't so different in Italy. In the March 4 national election, parties with anti-Europe sensibilities—the populist Five Star Movement and a coalition including the immigrant-hating League—won a majority of the votes. Fears rippled through the continent that Italy, like Britain, could withdraw from Europe.

But markets took the election results in stride—for good reason. The anti-Europe parties, facing the reality of actually having to govern, tried to appear not so anti-Europe. Matteo Salvini, the usually rabid chief of the League, said that

even though the euro "was, is, and remains a mistake," he had no intention of yanking Italy off the currency. Holding a Brexit-like referendum over Italy's participation in the monetary union was, he said, "unthinkable." Five Star leader Luigi Di Maio has also backed off his party's calls for a referendum, stating in February that "we want to remain part of the EU and the euro zone."

Perhaps Salvini and Di Maio are aware that, despite the success of their parties, most Italians still prefer to be engaged in Europe. Even the much criticized euro isn't all that unpopular. In a late 2017 poll, 59 percent of Italians supported the single currency. Or perhaps they realized the damage that would be inflicted on their country if they did withdraw. Investors would dump Italian stocks, bonds, and other assets en masse.

In China, the Communist Party is no less wary of a roll-back in globalization. In his address to the annual National People's Congress on March 5, Premier Li Keqiang pledged to hasten the government's efforts to upgrade the country's manufacturing prowess, even though officials in Washington consider the subsidy-rich program an assault on fair competition and a likely target of future import restrictions. But behind the swagger, China's leaders are not oblivious to how a disruption of global trade would inflict serious hurt onto a Chinese economy riddled with excess capacity and dependent on exports for millions of jobs. Clearly worried, Beijing recently dispatched Liu He, one of its most influential economic mandarins, to Washington to try to restart trade negotiations with the Trump administration—though to no ►

◀ avail. Concerns about a trade war could be why Beijing has blustered about retaliating for the U.S. metals tariffs, but so far has pulled its punches.

America's new economic nationalists may whine that free traders care too much about supposed economic efficiency and not nearly enough about a deteriorating middle class or threats to national security. Resistance to protecting vital industries and the workers employed within them, they say, damages national interests in a global economy where others don't play fair. Of course, globalization has its downsides. Foreign competition in an environment of open markets has forced factories to close, pressured many industries, and undercut the welfare of some American households. And it's true that not all U.S. trading partners play the trade game fairly. But one fact is almost impossible to refute: Reversing globalization helps the few and harms the many.

The voices opposed to the metals tariffs represented the many. The tariffs may be a boon to a handful of steelmakers and their employees, but the cost would be hoisted onto everyone else, in higher prices, lower sales, and fewer jobs. That's why so many Americans remain unconvinced by the anti-trade rantings of Trump and his allies. A Pew Research Center poll released in November reported that 56 percent of Americans believe the North American Free Trade Agreement is good

for the U.S., vs. only 33 percent who say it's bad. Navarro and his nationalist buddies might be willing to pay more for their cars or washing machines and to protect steelworkers at the expense of others. Most of their fellow Americans are not.

That's the lesson Trump, Salvini, and other anti-globalists should take away from recent events. Complaining about globalization is easy; fighting its transformative power is not. Championing a closed steel mill or attacking poor immigrants makes for good TV; closing doors to the world hurts those watching at home. Most people are wise enough to realize they gain too many benefits from being connected to the global economy—lower prices, better job opportunities, and fatter profits—to run the risk of sacrificing them.

Trump's tariffs are almost certainly not the final round of his boxing match with globalization. On March 12 he blocked a bid by Singapore-based Broadcom Ltd. to acquire U.S. chip giant Qualcomm Inc., citing national security (page 18). The case presents a classic contest between the advantages of open markets and the realities of maintaining a technological edge in a competitive world. His administration is also expected to slap duties on a wide range of Chinese products to counter the country's alleged intellectual-property violations. The Chinese would almost certainly retaliate. Next time Trump gets into the ring, he should be prepared for another bloody nose. **B**

## VIEW

To read Francis Wilkinson on the NRA's stumbles in Florida and Leonid Bershidsky on the high costs of Brexit, go to [Bloombergview.com](http://Bloombergview.com)

# A Stronger Stand for Peace

● Firmer diplomacy and a more robust democracy can raise the odds of a political settlement in Afghanistan

After almost 17 years of fighting, it's clear the war in Afghanistan has no military solution at a price either the country or its partners is willing to pay. So President Ashraf Ghani is right to have made a far-reaching peace offer to the Taliban.

That said, if this latest effort is to avoid the sorry fates of preceding agreements, Ghani has work to do. The main task for him and Abdullah Abdullah, the chief executive in Afghanistan's shaky unity government, is to bolster the legitimacy of the country's democracy by setting a

firm (and realistic) date for long-delayed parliamentary and local council elections. Afghanistan's partners can support this move by pushing (and helping to pay for) fixes to the country's voter registry, which is also essential for next year's presidential elections.

As for the Taliban, only the factions willing to renounce violence, join the political process, and honor the constitutional rights of all Afghans deserve a place at the table. This is nonnegotiable, as the president has said. And even if the Taliban spurns Ghani's offer, he has regained the initiative.

The U.S. needs to ramp up its diplomacy to achieve a settlement, both in foreign capitals and in Afghanistan. More broadly, persuading Pakistan to cut off its support for the Taliban will require a well-considered mix of sticks and carrots, as well as high-level engagement with neighbors China and India. And no solution is possible without the

cooperation of Russia and Iran, which have exploited Afghanistan's divisions to advance their own strategic goals.

That kind of diplomacy may call for some unsavory linkages and difficult trade-offs. Ghani acknowledged as much, at least implicitly, with his offer of a cease-fire and negotiations. He also said he'd be willing to accept the Taliban as a political organization, let it open an office in Kabul, release prisoners, and work to lift sanctions on individual Taliban members.

The Taliban continues to kill civilians, and experience shows it's wise to be skeptical about its intentions. The U.S. strategy of conducting airstrikes and maintaining a troop presence remains sound. But a U.S. troop surge did not end the Taliban insurgency half a decade ago, and more bombings and boots on the ground are unlikely to end it now. A political settlement is the only real path to lasting peace. **B**

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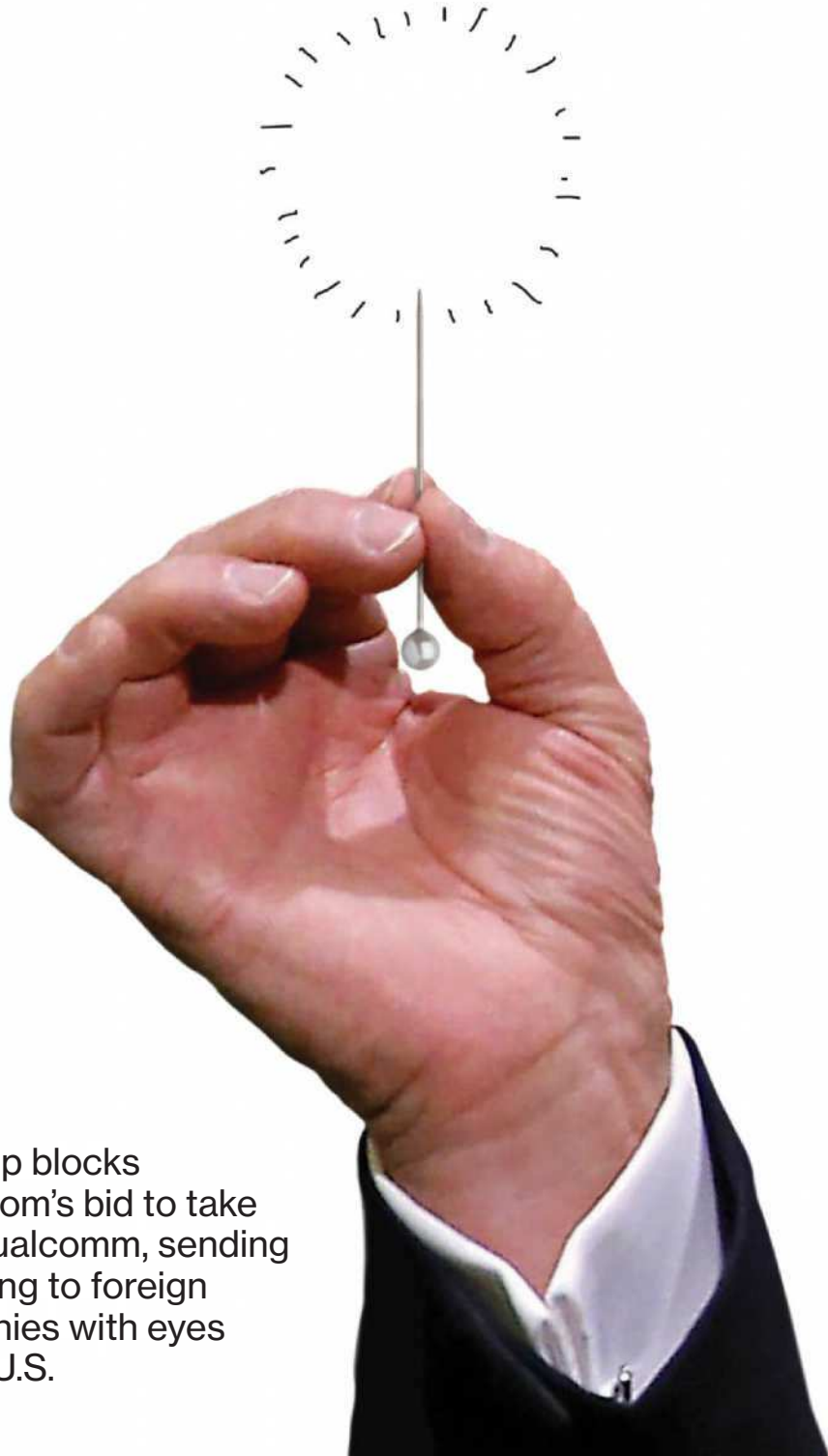
LOOK AHEAD

● The trial over the Justice Department's attempt to block the AT&T-Time Warner merger begins

● On March 21, Tesla shareholders vote on the company's proposed \$2.6 billion stock award for Elon Musk

● Financially ailing IHeartMedia reports fourth-quarter earnings on March 22

# No Deal



● Trump blocks Broadcom's bid to take over Qualcomm, sending a warning to foreign companies with eyes on the U.S.

March 19, 2018

Edited by  
Eric Gelman and  
Dimitra Kessenides

Businessweek.com

Broadcom Ltd. is “doing something great. I appreciate it,” said President Donald Trump in November when he announced the Singapore-based chipmaker’s planned relocation to the U.S. It was certainly great for Trump, bolstering the argument that his policies were making America more hospitable to business. Broadcom’s chief executive officer, Hock Tan, on the other hand, doesn’t seem to have gotten as much out of that White House photo op.

Trump on March 12 took the unprecedented step of swatting down a potential Broadcom takeover of U.S. chipmaker Qualcomm Inc. before the companies even agreed on a deal. He followed the recommendation of the Committee on Foreign Investment in the U.S.—the regulatory body led by the secretary of the Treasury charged with reviewing foreign takeovers—and cited “credible evidence” that Broadcom may take actions that could impair national security should it acquire Qualcomm. Broadcom disputed that finding but is complying with the order and withdrawing its offer for Qualcomm.

The odds of a merger happening were already low. CFIUS earlier this month ordered a 30-day stay of Broadcom’s attempt to unseat a majority of Qualcomm’s board and force the company into negotiations over its \$100 billion offer. What’s jarring is the swiftness and the scope of the U.S. government’s rejection. CFIUS often takes months to review a transaction, and usually there’s back-and-forth behind the scenes as regulators give acquirers the option of agreeing to concessions to win approval of their transaction. This investigation wrapped up mere hours after CFIUS officials met with Broadcom executives on March 12 to hear the company’s side.

Broadcom has repeatedly bungled the politics on the deal. It claimed—unsuccessfully—that because it’s relocating to the U.S. and a majority of its leaders are American, the deal shouldn’t fall under CFIUS’s jurisdiction. The committee rebuked Broadcom for failing to provide proper notice about efforts to speed up its relocation to the U.S. It’s possible the March 12 meeting went spectacularly badly and intensified CFIUS’s frustration with the company. But it’s also possible the Trump administration had already made up its mind.

The Broadcom review was something of a departure for CFIUS, which typically looks at only full-blown takeover bids, not proxy fights. One interesting possible justification for the scrutiny is to discourage copycats. Republican Senator John Cornyn of Texas raised that prospect in a letter to Treasury Secretary Steven Mnuchin urging a CFIUS review of the Broadcom proxy fight earlier this year. Cornyn suggested if CFIUS didn’t intervene,

other foreign suitors would be encouraged to wage proxy fights to gain effective control of U.S. targets while avoiding the panel’s scrutiny. It’s also not that hard for foreign companies to reincorporate in the U.S., says Bob Willens, a tax expert. If Broadcom had been successful, other companies could have followed its lead and used a U.S. domicile to launch takeovers that might otherwise have triggered an investigation from CFIUS.

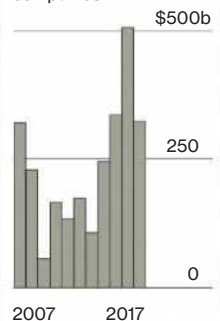
Trump’s order suggests that CFIUS took those concerns seriously. And Trump not only barred Broadcom from acquiring Qualcomm, but also effectively shut down its ability to wage a proxy fight. Broadcom’s slate of directors is “disqualified” from standing for election at Qualcomm’s annual meeting, according to the presidential order, even though most are American.

It’s a clear sign that momentum is building for legislation introduced in Congress last year that would formally expand CFIUS’s jurisdiction to include joint ventures, minority investments, and real estate transactions near military bases. The proposal stemmed from concerns about China’s push for foreign acquisitions to strengthen its technological prowess. But Broadcom is based for the moment in Singapore, and its business model, rather than its nationality, was the problem in the eyes of CFIUS. That signals a much broader impact should CFIUS’s authority be expanded.

The committee’s primary stated concern was that Broadcom would gut Qualcomm’s research and development spending, handing a competitive edge to China’s Huawei Technologies Co. in the race for 5G technology that will enable faster data connections. The merits of this argument are debatable, and the national security implications are a stretch. Gaining a foothold in 5G technology is a big reason Broadcom wanted Qualcomm in the first place, so the company was unlikely to stint on investments. Broadcom spent more than \$3 billion on R&D in fiscal 2017, about 19 percent of its revenue. That’s significant, but a lot less than Qualcomm, which spent about 25 percent of its sales, or about \$5.5 billion.

These nuances aside, it was difficult for Broadcom to mount a convincing response to CFIUS’s criticism. Buying companies and slashing costs is an essential part of its business model and a key reason it is so beloved by shareholders. If its latest offer for Qualcomm of \$79 a share—or about \$100 billion, including debt—had proceeded, Broadcom would have had to slash expenses to keep to its plan to maintain an investment-grade credit rating. It might also have needed, or wanted, to divest Qualcomm’s licensing business—a cash cow that helps fund much of the company’s R&D but is tied ▶

● Value of foreign mergers with and acquisitions of U.S. companies



◀ up in legal spats including a battle with Apple Inc.

The thing is, most corporate acquirers, including those with U.S. mailboxes, use cost cuts and divestitures to make the takeover math work. CFIUS's apparent condemnation of this practice could have a far-reaching, chilling effect on mergers and acquisitions. Chinese takeovers of U.S. companies have already slowed to a trickle amid the committee's pushback. Now all foreign buyers will need to hit pause on their acquisition activity while their advisers work out if all research cuts are bad or only those for 5G technology research.

The Trump administration's treatment of Broadcom may also discourage foreign companies from making the announcements about U.S. investment and jobs that the president so likes to tout. This is at least the third prominent deal—following Canyon Bridge Capital Partners LLC's blocked bid for Lattice Semiconductor Corp. and Ant Financial

Services Group's failed pursuit of MoneyGram International Inc.—where the buyer appealed to Trump's domestic economic agenda only to be shot down amid CFIUS scrutiny.

When Broadcom made that trip to the White House in November, it was still trying to close its acquisition of Brocade Communications Systems Inc. Broadcom has since disclosed that its relocation to the U.S. was part of an agreement with CFIUS that allowed that transaction to move forward. That means it will have to follow through with its planned move to America, even without Qualcomm. This should be a warning for dealmakers and would-be friends of Trump: He's going to take "America First" to the extreme. —*Brooke Sutherland, Bloomberg Gadfly*

**THE BOTTOM LINE** By blocking Broadcom's attempt to capture Qualcomm, despite Broadcom's plan to relocate to the U.S., Trump is putting a wall around American companies.

## North Korea's Chinese Lifeline

● UN sanctions have hurt mining businesses on the border. Could talks between President Trump and Kim Jong Un help?

Sun Hongtao, the youthful-looking president of Sino-Mining International Ltd., is in a funk, sitting in a cold, empty office in the Chinese town of Changbai in Jilin province. Two miles from where he sits, across the border in North Korea, is the huge Hyesan Youth Copper Mine. Sun's company has invested more than \$123 million in upgrading equipment at the mine with the aim of tapping its rich reserves. But for more than a year, because of United Nations sanctions imposed in 2016 targeting North Korean minerals, all production at the mine has stopped. "What can we do?" Sun asks. "We can't just leave all our equipment and the money we've invested behind in North Korea."

President Trump and North Korea's Kim Jong Un are considering holding what would be an unprecedented summit meeting. A critical goal for North Korea is ending economic sanctions imposed to punish the country for developing nuclear weapons. An end to sanctions would transform the largely dormant 880-mile-long China-North Korea border. Towns such as Changbai could become key players in a huge new mineral business. They could also host trade in textiles, shoes, and other light goods, lifting North Korea's economic prospects and helping integrate the country into the world. "These border towns are the main channels

supplying the North Korean economy," says Kim Byung-Yeon, an economics expert on North Korea at Seoul National University in South Korea. "They have great potential for development."

Changbai is surprisingly quiet. There are few cars on the road that runs along the Yalu River, which marks the border with North Korea, and the town has a sleepy feel. A red-and-gold banner warns against taking photographs of China's impoverished neighbor and other "provocative behavior." Bundled up against the cold and watched over by a North Korean soldier, North Korean women wash clothes through a hole broken in the river ice. Behind them is Hyesan, a city marked by dilapidated, one-story houses surrounded by wooden fences and dirt roads. Taller buildings that appear in better condition are maintained only because they face China, says Li Jianhua, a former cross-border lumber trader. On a hill sits a huge statue of a North Korean flag, with replicas of soldiers at its base, commemorating a victory against the Japanese in 1937.

Only two trucks cross the border bridge, which extends for 148 meters (486 feet) across the river, on a recent afternoon in early March. Chinese traders drive little mechanized pallet vehicles carrying bananas and oranges into North Korea, with food imports still allowed under the raft of UN and ▶

▶ Women wash clothes through a hole in the river ice on the China-North Korea border



◀ U.S. sanctions. A shop in Changbai sells banned-in-China bottles of liquor made with tiger bone, as well as North Korean cigarettes—the brand favored by Kim Jong Un, the female clerk says. Outside the Chinese customs office in town, a sign in Korean and Chinese admonishes: “Warning: Sheltering those who illegally cross the border and trafficking women and children is strictly forbidden.”

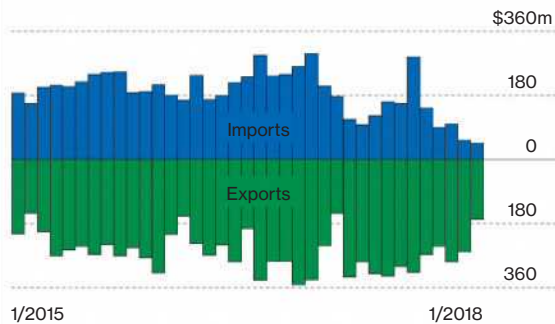
Across the river in Hyesan, unemployment is high and methamphetamine addiction is common, the former lumber trader says. In recent years as much as 90 percent of North Korea’s households have survived outside the collapsing state economy by buying and selling everything from smuggled DVDs of South Korean soap operas to Chinese-made rice cookers in small private markets, says Kim, the economist. But with the export of key minerals such as copper and iron stopped by sanctions, the country’s foreign exchange reserves are shrinking. “The economy survives through its trade with China,” he says. The sanctions “have hit the Achilles’ heel of North Korea.”

Less than a decade ago, the prospects of North Korea’s mineral industry appeared to be improving. The country’s rich reserves of gold, copper, zinc, coal, magnesite, and molybdenite (estimated to be worth as much as \$6 trillion) lured big Chinese companies. China Minmetals, Liaoning Machinery Group Holding, and Tangshan Iron & Steel Group invested billions of dollars in equipment and infrastructure to modernize mines and ensure more regular power supplies, according to the Open Source Center of the CIA. These companies usually accepted promises from their North Korean state-owned partners of eventual payment in resources rather than cash. By 2011, Chinese companies made up three-quarters of the more than 350 joint ventures operating in North Korea, with the majority in mineral extraction.

In September 2011, Wanxiang Resources, part of the Hangzhou, Zhejiang-based private auto parts giant Wanxiang Group Corp. and parent company of Sino-Mining, held a ceremony with North Korean officials in Hyesan to celebrate the start of mining operations. With an estimated 250,000 tons of reserves, the Hyesan mine is the largest copper mine in North Korea; the plan was for it to produce 2,000 tons a day, all of it going to China, Wanxiang Resources announced. The deal was a sign North Korea was “becoming more open,” said Wanxiang Group founder Lu Guanqiu in an interview several months after the ceremony. “North Korea is a great commercial opportunity for us,” said John Zhang, then chief investment officer at Wanxiang Resources, in the same interview.

## Sanctions Weigh on an Old Partnership

China’s monthly trade volume with North Korea



DATA: CHINA'S GENERAL ADMINISTRATION OF CUSTOMS

Wanxiang Group, which has invested in dozens of U.S. auto-related companies, including an electric vehicle maker and a lithium ion battery maker, earlier sold its holdings in Sino-Mining because it was worried about blowback from doing business in North Korea, Sun says. A recent bond filing by Wanxiang says it still has a relationship with Sino-Mining through a “close family member.” Wanxiang, which confirms it sold Sino-Mining before 2015, says it can’t comment on the mining company’s present ownership.

Since the clampdown on the mineral trade, Sun has reduced his staff from about 60 people to only two in Changbai—a nervous, chain-smoking office manager and his assistant. Sun, who visits for a few days each month from company headquarters in Shanghai, says he comes “to make sure my employees here are OK.” On his desk are a half-dozen bags of edible tree fungus, a local specialty, which he will take back to Shanghai for gifts.

If the Trump-Kim talks take place, and if they are successful (two huge “ifs”), Changbai will be well-positioned to benefit. Local officials have already built infrastructure for a newly restarted mineral trade, including an economic zone directly across from the border crossing, with office buildings for mining development companies. An almost 5,000-meter-long tunnel through a nearby mountain connects the town with a network of provincial highways and railways. Sino-Mining has installed much of the equipment necessary to quickly start digging copper ore from Hyesan. Still, Sun isn’t getting his hopes up. “Who knows if Kim will ever really be willing to give up his nuclear weapons,” he says. “For now, I just wait.” —*Dexter Roberts, with Michael Smith and Dandan Li*

**THE BOTTOM LINE** With infrastructure in place, mining in Changbai, China, on the North Korean border, is well-positioned to take off if there are successful talks between Kim and Trump.

**“These border towns are the main channels supplying the North Korean economy”**





# HondaJet is thankful to be the most delivered jet in its category in 2017.



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## LOOK AHEAD

● Startup accelerator Y Combinator holds its Winter Demo Day in Mountain View, Calif.

● Tencent reports earnings. Investors will be looking for payoffs from its retail investments.

● San Francisco hosts the annual Game Developers Conference, a showcase for PC and video games.

# Forget the Ad Copy. Let's Make Some GIFs

● Advertisers are paying six figures to place branded video clips in Tenor's search results

On Valentine's Day, if you entered "love" into popular GIF search engine Tenor, the top results would have included a doughnut leaning on a coffee cup with the slogan "We're better together," and a heart-shaped dessert with the phrase "Donuts before dudes." While neither may represent most people's idea of *amour*, they're top of mind for Dunkin' Donuts, which paid to have the GIFs created and placed in the hope that viewers would pass them along to friends.

Dunkin', an early adopter, now has company. AT&T, KFC, Nestlé, Nissan, Sprint, and at least 15 other brands have signed up with Tenor Inc. since it began pitching sponsored GIFs a few months ago. Clients typically pay Tenor, which attracts 300 million people a month, \$100,000 to \$500,000 to place GIFs they've created in results the search engine deems relevant. The fees climb as more users share the sponsored GIFs in messaging apps. "Brands have never been able to get you to send an ad to someone else," says David McIntosh, Tenor's chief executive officer. "It's like cutting out a Wendy's ad from a newspaper and sending it to a friend. That's essentially what people are doing."

Tenor has almost as many users as Twitter, and it's gotten there a lot faster. The four-year-old search engine's related app, GIF Keyboard, is pre-installed on the messaging app built into the latest version of Samsung Electronics Co.'s Galaxy smartphone, and it's available for most other popular messenger software. McIntosh says Tenor aims to add sponsored GIFs to the Samsung version within a year.

Although the \$94 billion digital ad business has developed other ways to creep into messaging ▶



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TECHNOLOGY

25

March 19, 2018

Edited by  
Jeff Muskus

Businessweek.com

◀ software, including custom emojis, GIFs give advertisers a way to associate themselves with a particular feeling or cultural moment. (Sometimes there's no better way to express excitement than sharing a clip of Jonah Hill silently screaming and frantically waving his hands.) Other GIF search engines, notably early leader Giphy, have pursued different ways to capitalize on the massive audience of the "graphics interchange format," an internet fixture since the early days of the web. Tenor is the first to create an ad platform for GIF searches.

McIntosh was working on a search tool for video clips when he met co-founder Erick Hachenburg, who'd sold an online video game startup to Electronic Arts Inc. From the beginning, they say, Tenor was aimed at mobile messaging. Their team first saw the commercial opportunity when they made attention-grabbing GIFs to promote *Taken 3* for Twentieth Century Fox Studios. "We can tell quick-serve restaurants that we have millions of people around the world every day saying good morning with a GIF," says Jason Krebs, Tenor's chief business officer. "If you tell that to a marketer in the breakfast category, their eyes light up." The company isn't profitable but has sustained itself

on \$32 million in venture funding.

Roger McNamee, a Tenor investor and co-founder of private equity firm Elevation Partners, is thinking bigger. Major advertisers are seeking new venues, he says, as the likes of Google and Facebook Inc. struggle to wall off their ads from graphic images, hate speech, and viral lies. Tenor, which has 50 employees in San Francisco, New York, and Los Angeles, says it uses algorithms and about 50 foreign contractors to scour its search engine for offensive, misleading, or ill-sorted material.

While GIF advertising remains a tiny slice of Tenor clients' marketing budgets, it's starting to prove itself, says Steve Gaffney, vice president for marketing at Sprint Corp. A GIF that Gaffney's team ordered up for the Super Bowl, featuring a punchy robot named Evelyn, was included in an ad during the game, as well as on Tenor. The search engine delivered double the expected shares, Gaffney says, though he doesn't say how many. "This was a test," he says, but "based on our success, it won't be our last." —*Selina Wang*

THE BOTTOM LINE Tenor, which has an audience comparable to Twitter's, has persuaded big-name advertisers to pay \$100,000 to \$500,000 for better placement in its GIF search results.

**"If you tell that to a marketer in the breakfast category, their eyes light up"**

## A Sleepy Medium Wakes Up

● Audiobooks king Audible is driving the fastest growth in publishing. Now for the negotiations

Don Katz first heard of Jeff Bezos in 1996, shortly after leaving journalism to start his audiobook subscription company, Audible Inc. One of Katz's early investors was John Doerr of venture firm Kleiner Perkins Caufield & Byers. The firm was taken by the Japanese idea of *keiretsu*, a network of like-minded companies that support one another through partnerships and equity stakes. Audible and Amazon .com Inc. seemed like ideal candidates, Doerr told Katz when suggesting a team-up with Bezos: "He likes books, too."

Katz flew to Seattle and met Bezos for coffee. Audible's success, Katz acknowledged, would rely on an impending internet revolution, where both portable digital media players and the practice of downloading files over high-speed data networks became commonplace. Bezos told Katz he was focusing on selling physical books, because it'd be a quicker way to go mainstream. Audible, he predicted, was an

idea that would take a decade to mature.

The two men kept in touch. At various points, Bezos stepped up involvement in Audible, until Amazon bought the company outright in 2008, leaving Katz to run it as an independent subsidiary. By the time of the acquisition, Audible had created a market for book lovers doing the dishes or on a jog. "I began to think you could take all this time, which is dead time, and potentially make it reading time," Katz says.

As Amazon has in the years since, Audible first built the infrastructure for a novel form of media consumption, then slowly trained customers to adopt it. While the traditional media industry was apathetic or resistant, the company gradually increased the production of its own material. Audible has continued to bet heavily on this approach, starting a division late last year to produce original content on a much larger scale.

Today, Amazon is the book industry's *bête noire*, while Audible and its rivals represent a tiny bright spot for the beleaguered publishing industry. Audiobook sales totaled \$2.1 billion in 2016, the most recent year for which data are available, according to the Audio Publishers Association. That's about 18 percent higher from the previous year and two and a half times the market size when Amazon bought Audible.

Audible accounts for about 41 percent of all audiobooks sold, including digital and physical formats, according to researcher Codex Group LLC. Amazon also sells audiobooks directly through its website and, with Audible, accounts for more than half the market. Audible doesn't disclose financial information, but says its annual subscriber growth is in double digits. Most customers pay \$15 for a monthly subscription that comes with a single audiobook. (A la carte, they often cost more than \$20.) The company's library includes 400,000 titles.

For years, the company operated without any real competition on the fringes of the \$26 billion publishing industry. Google and Walmart Inc., though, have recently announced plans to sell audiobooks online. Publishers are growing more aggressive about retaining the rights to audio versions of their books, and the price of such rights is increasing quickly. "We don't like to work with Audible. Working with Amazon is always a treacherous affair," says Dennis Johnson, co-founder of Brooklyn-based Melville House Publishing. "We're certainly concerned with their dominance in the marketplace."

Katz says there's been outcry at every technological innovation in media, from recorded music to the paperback book. He argues the creation of the digital audiobook industry benefited even his critics.

There was an audiobooks market, kind of, when Katz began working on Audible in the mid-1990s. They came as either huge boxes of cassettes or CDs, or in more accessible versions that were brutally abridged. Katz, who'd written three books by that time, was appalled by sloppily condensed audiobooks where narrators adopted the flattest affects possible. "They did things to books that, from a writer's perspective, were unconscionable," he says.

The idea for Audible occurred to him as he was hitting a wall with a book project about how technology was going to change culture. He found the ideas convincing but struggled to write about trends that hadn't yet taken hold. He also worried that he'd peaked with *Home Fires*, a 1992 book tracking a single Long Island family from World War II to the '90s. He decided to turn his latest project into a startup instead.

## The Bright Spot

Change in publisher revenue by format, 2012 to 2016



DATA: ASSOCIATION OF AMERICAN PUBLISHERS

Enlisting the help of a college roommate who was working in Silicon Valley, Katz developed a proposal for a company that would make digital audio players, then build a store of digital audiobooks to download onto them. He raised \$3 million in funding, half from Doerr's firm, and set up shop in a former dentist's office in Montclair, N.J. It was slow work. By 1999, Audible had about 3,000 listeners.

Of course, in the Pets.com era, that seemed like enough of an audience to take the company public. It raised \$38 million in an initial public offering in July 1999, and watched the price of its shares double on the first day of trading. But when the dot-com bubble collapsed the following year, Audible went down with it. In its wake, the late comedian Robin Williams, who'd accepted equity in Audible as payment for his work on a spoken-word comedy project, said Katz had paid him "in Confederate currency." Nasdaq delisted Audible's shares in 2003.

By then, Amazon had bought 5 percent of the company, and Apple Inc. provided an even bigger lifeline when it integrated Audible's proprietary file format into early versions of the iPod. Thanks largely to the iPod, Audible's revenue surged almost sevenfold from 2001 to 2006, Katz says.

It wasn't enough. The company had lost money every year but one and lived in fear of a hypothetical well-financed competitor spending it into oblivion. In 2006, Katz began talking in earnest to Bezos about being acquired. At the time, Amazon was preparing its first major foray into digital media with the Kindle. In 2007 it bought Brilliance Audio, another audiobook publisher. In early 2008, Amazon agreed to buy Audible for about \$300 million in cash. It was two years behind the timeline for maturity that Bezos had laid out when the two men first met.

Since the deal, Katz has built a prominent profile in Newark, N.J. He gives free Audible subscriptions to public school students, is turning an historic church into a 400-employee "technology center," and enthusiastically endorses the city's pitch to put Amazon's second headquarters there. Amazon recently said Newark was one of 20 cities it's considering as a location. Katz laughingly demurs when asked whether he's called Bezos to plead the city's case. "Everyone at Amazon ►



● Katz

◀ knows my beliefs about Newark," he says.

It's sometimes unclear how close Audible wants Amazon to come. The parent company has provided relief from the public markets, capital, and access to its tech. Audible's engineers got an early look at the Echo speaker to start planning their integration into Amazon's voice-control platforms, and current and former Audible employees say the connection helped with recruitment. Yet Katz wants to ensure Audible is seen as its own entity with a separate culture. "Overplaying the Amazon part of our store tends to track away from reality," he says.

In some cases, the company could stand to benefit from greater oversight. In an email to employees last November, Katz acknowledged complaints that the workplace was "less of a safe space for women than it has been intended to be." Two senior executives resigned after an ensuing investigation, and the company says it will introduce new anti-harassment training, declining to comment further.

Audible is firmly entrenched as the king of its small hill. It's the only recognizable audiobook brand, and because customers pay for monthly subscriptions rather than buy each book a la carte, they're less prone to comparison shop. Audible customers, who range from subway riders to folks washing their dishes, spend an average of two hours a day with the app.

The company's hand in the retail market is even greater than it first appears. For years, Audible and Apple had a deal where Audible would provide the actual files that Apple sells through iTunes, giving Audible a cut of every sale from its most significant competitor. The deal included an exclusivity clause preventing Apple from sourcing audiobooks from other companies, and Audible agreed not to provide its files to competing platforms. Last year the two companies ended the deal after European publishers complained it was anticompetitive.

Michele Cobb, executive director of the Audio Publishers Association, says this is likely to spur competition. "There are just a lot more players than there were three years ago," she says. The most powerful rivals may be Google and Walmart, though neither company has yet mounted a serious challenge.

Competition to make audiobooks has ramped up in recent years, adding to Audible's library. There were more than 50,000 audiobooks produced in 2016, according to the APA, more than twice the number two years earlier.

The appetite for new titles has pushed up the price of audiobook rights, according to publishers. "The cost of rights has exceeded the growth in the marketplace," says Troy Juliar, chief content officer of Recorded Books, which publishes about 4,000

audiobooks a year. Literary agents are increasingly interested in retaining audio rights, and publishers often refuse to sign book deals without them.

If publishers frequently choose to work around Audible, the company has also looked to lessen its reliance on publishers. In 2016 it launched a podcast service. Last year it announced it was investing \$5 million in theater productions that could be easily converted into a smartphone format.

David Blum, who spent most of the past decade running Amazon's Kindle Singles operation, now runs Audible's original publishing operation. Blum's official charge is to increase the number of Audible projects that aren't simply readings of the printed word. Margaret Atwood, author of *The Handmaid's Tale*, recently worked with Audible to write and record a spoken-word coda to the novel, and comedian David Spade is developing an audio-only memoir. "We're really trying to break the boundaries," Blum says, "and go to writers and creators and artists to think outside the traditional boundaries of what is a book." —*Joshua Brustein*

**THE BOTTOM LINE** In the decade since it was acquired by Amazon, Audible has dominated the \$2.1 billion audiobooks market. Now, Walmart and Google are entering the field.

## Making All That 'Smart' Stuff Less Dumb

● Most internet-connected devices are easy to hack. SecureRF says it can fix that



Some of the smallest electronics have big security problems. One of the biggest known brute-force attacks in internet history, in 2016, took down broad swaths of the web across North America and Europe with phony traffic signals generated by tens of thousands of smart baby monitors, webcams,

## ■ TECHNOLOGY

and the like. These typically innocuous devices lack the security of your laptop or phone, making them 8 billion possible sources of trouble.

Louis Parks says he has the answer. Parks runs SecureRF Corp., a 20-employee startup in Shelton, Conn., that sells software aimed at safeguarding the so-called internet of things. The pitch revolves around efficiency: SecureRF's code is clean enough to run powerful software on what can often be pretty weak hardware. "The nature of our math allows us to work with smaller numbers and simpler processes," he says.

There's a surprising amount of math involved. Online security typically relies largely on exchanges of public and private "keys," large numbers that can be used to generate shared secret codes, authenticating identities and encrypting communications. Smart devices are often easy to hack because they don't have the battery life to handle powerful chips and struggle to use standard keys. Instead, such devices typically rely on passwords that don't secure traffic between them and the internet.

SecureRF's authentication and encryption are easier for processors to handle without being easier to hack. Whereas standard software requires calculation of numbers with as many as 256 binary digits, or bits, SecureRF's streamlined algorithms work just as well with 8-bit numbers. The result, says the company, is security that runs 100 times faster on low-power chips than conventional software, while using half the memory. Although other groups have been working on low-power security software, they've been academic efforts mostly in the realm of pure research. SecureRF is licensing its technology for use with Intel Corp. and rival chipmakers Arm Ltd. and STMicroelectronics NV. "I think they're making the right moves," says Mike Demler, senior analyst at researcher the Linley Group. Until now, he says, smart-device security "always focused on the chip itself, not the communications between chips."

Parks's company has spent more than a decade quietly researching ways to defend a range of mobile communications technologies, including radio-frequency identification chips and near-field communication. The team shifted its attention when smart devices began to proliferate in the early 2010s. Now it's working to refine its software and counting on fees from semiconductor makers, starting at a few cents per chip, depending on volume. Your next baby monitor may protect more than your child. —*Michael Belfiore*

THE BOTTOM LINE SecureRF's software is the first aimed specifically at hack-proofing the low-power processors that run internet-connected appliances and other gear.

## Energy

## Microgrids

With much of Puerto Rico still without power—almost six months after Hurricane Maria struck the island—German startup Sonnen is offering its \$10,000 to \$23,000 energy-storage systems without charge to about a dozen blacked-out schools, churches, health-care facilities, and community centers. The Sonnen equipment links solar- and battery-powered buildings to distribute energy where it's needed. The company's 2,900-house development with Mandalay Homes in Prescott Valley, Ariz., will be the largest virtual power plant of its kind when completed this year. "Sonnen is definitely one of the pioneers," says Brett Simon, an energy storage analyst at Greentech Media Inc. —*Michael Belfiore*

## How It Works



A Sonnen energy-storage system powers S.U. Matruillas, a school for grades K through 9 serving more than 150 students in the remote town of Orocovis, Puerto Rico.

1 Each part of a SonnenCommunity network stores solar energy in an internet-connected SonnenBatterie, a 4.5-foot-tall, 400-pound lithium ion battery.

2 Sonnen's cloud software tracks use and routes energy from locations with a surplus to those that need more. The system can also store and distribute energy for local electric utilities.

## Funding

Sonnen, a 400-employee company founded in Wildpoldsried, Germany, in 2010, has received €98 million (\$121 million) in funding from investors including General Electric Co.'s venture arm.

## Origin

Co-founders Christoph Ostermann and Torsten Stiefenhofer built their first battery prototype as a side project in 2008, when they were partners in a residential heating startup.

## Early Tests

The first SonnenCommunity, set up in 2016, connects about 10,000 homes throughout Germany. Because the company acts as a utility there, those without solar power can also become customers.

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## LOOK AHEAD

● Cloud-storage company Dropbox expects to go public; it's targeting a market value of at least \$6.3 billion

● Shareholders of snack food maker Snyder's-Lance vote on being acquired by Campbell's Soup

● As part of a restructuring plan, Deutsche Bank will sell shares of its asset management unit DWS

3

Succession

FINANCE

31

Season Finale!

The  
Jamie  
&  
Lloyd

SHOW

The bosses at JPMorgan and Goldman Sachs have laid out their succession plans. One man looks like he'll be around longer than the other

In another universe, they might have starred in an odd-couple comedy about a pair of New Yorkers who rise to fame and fortune: Jamie Dimon, the voluble, sometimes ill-tempered alpha male from Queens; Lloyd Blankfein, shorter and bald, the wisecracking sidekick from Brooklyn. Now the men atop the world's two preeminent banks—Dimon at JPMorgan Chase & Co., Blankfein at Goldman Sachs Group Inc.—have announced plans for an orderly handoff. It's part of a wider succession moment

sweeping through finance a decade after the financial crisis, as men in their 60s and 70s prepare their companies for the next act.

Dimon and Blankfein had a good run. They began as chief executive officers within six months of each other in 2006, with the global mania in financial assets nearing its peak, and emerged from the crisis that soon followed with their reputations not just intact but burnished—at least among fellow Wall Streeters. Each weathered ►

March 19, 2018

Edited by  
Pat Regnier and  
Nick Summers

Businessweek.com

◀ turbulence, from Goldman being labeled a vampire squid to trading blowups such as JPMorgan's London Whale debacle, in which it lost \$6.2 billion. One by one, they watched rival bankers fall to poor performance or scandal, from Bank of America Corp.'s Ken Lewis in 2009 to Wells Fargo & Co.'s John Stumpf in 2016, leaving them as the longest-tenured of big bank CEOs.

Now their succession planning tells you where their respective companies are headed and who can claim the title of Wall Street's last man standing. Succession is a delicate topic. It's hard, however necessary, for executives who've spent their careers climbing an organization's ranks to have to plan for their own departure. The history of banking is strewn with examples of CEOs who overstayed their welcome (Lewis, for instance), to the detriment of company and shareholders. "These guys are very control-oriented, and they want to work as long as they can," Michael Karp, head of recruitment firm Options Group Inc., told Bloomberg in 2016.

But eventually it becomes unavoidable. In January, JPMorgan said Dimon has another five years as CEO and named the heads of the bank's two largest businesses, Gordon Smith and Daniel Pinto, as co-presidents, signaling that if something should happen to Dimon, 62, in the near term, either Smith or Pinto would fill his shoes. But if Dimon takes the full half-decade before retiring, Smith and Pinto will be in their 60s, meaning that a younger group of deputies—Marianne Lake, Mary Callahan Erdoes, and Doug Petno—are more likely to succeed him.

On March 12, Goldman Sachs had its own announcement. Co-President Harvey Schwartz abruptly announced his resignation, ending a 15-month race with David Solomon, who's now sole president and Blankfein's heir apparent. That's one thing that makes near-term succession plans tricky: When one top performer gets tapped, another star often heads for the exits. While Blankfein, 63, hasn't said when he will retire, the *Wall Street Journal* has reported that he could step down as soon as year-end, as the bank nears its 150th anniversary.

The changes mirror actions taken elsewhere on Wall Street. In February, Blackstone Group LP, the giant investor in private equity and real estate, named Jon Gray president and chief operating officer—and therefore the likely heir to CEO and co-founder Stephen Schwarzman (page 34). In recent months, private equity shops KKR, Carlyle, and Apollo Global Management all have announced big promotions.

Goldman's Solomon, 56, is a dealmaker who

rose up in the company's investment banking division, eventually becoming its co-head. (He also moonlights as an electronic music DJ.) His ascent shows that Blankfein, who gave the decisive nod in Solomon's favor to his board, is aware that Goldman Sachs can't afford to go with another trader-in-chief. Blankfein rose through the ranks as a gold salesman and later ran the fixed-income business before becoming CEO. As the post-crisis era of low interest rates and placid markets dragged on, Goldman began to underperform peers that didn't rely as much on gains from trading.

In September the bank revealed a plan to boost revenue by \$5 billion, in part by funneling resources into lending to consumers through its Marcus unit. It's the beginning of a pivot that will soon have Goldman offering retail banking products such as insurance, mortgages, and car loans—in a sense, it will look a little more like JPMorgan. These are plain-vanilla offerings that Goldman managers of the past would sneer at. But Goldman Sachs's future seems to be in businesses where success comes from cultivating long-term relationships, not treating clients like trading counterparties. It's a humbling admission for Wall Street's powerhouse investment bank.

At JPMorgan, Dimon is very much still in charge. He's been adamant that his successor will come from within the company, and so in that sense he's promoting continuity. JPMorgan was seen as a port in the storm during the crisis, swallowing two failing banks, and Dimon has pressed his advantages in the years since, seizing share from competitors in areas from trading to credit cards and plowing billions of dollars of profits into technology. JPMorgan shares have climbed more than 200 percent in the past decade, walloping the 69 percent increase of Blankfein's company. And while Blankfein seems content to post his opinions on Twitter from time to time, Dimon has taken stands on topics from the minimum wage to medicine, even planning a health-care startup with Warren Buffett and Jeff Bezos to try to reduce drug costs.

If all goes according to schedule, Dimon will have lasted 17 years, guiding the bank through at least three distinct environments: the crisis, recovery, and what looks like an era of rising interest rates. When he finally does walk away, Dimon has one wish, he said in 2014: "That people say, you know, we're going to miss the son of a bitch." —*Hugh Son, with Dakin Campbell*

**"These guys are very control-oriented, and they want to work as long as they can"**

THE BOTTOM LINE Blankfein appears to have designated a clear successor, while the competition for Dimon's job remains wide open.

# Will Women Ever Get A Shot at Leading Goldman?

● Ask its next top man

In January the co-president of Goldman Sachs Group Inc. said at a conference that the bank needs to do a better job elevating women to top posts. "You make progress, but the progress as you're looking at it day-to-day feels slow, and it feels slow because you're a big organization," David Solomon told the Women in Corporate Leadership Initiative. He couldn't give a good reason when asked why women haven't climbed higher. "But you know over time that will change," he added. "It's our job to change it."

It's not changing yet. On March 12, Solomon was named sole president of the bank. That makes him the front-runner to succeed Chief Executive Officer Lloyd Blankfein, edging out a small—and all-male—group of rivals. Harvey Schwartz, who'd been co-president, is leaving. Other contenders included Vice Chairman Pablo Salame, finance chief Martin Chavez, and former Chief Operating Officer Gary Cohn, who's in the process of stepping down from his job as President Trump's economic adviser.

Most Wall Street institutions have the same gender problem. No woman has ever run a major New York bank. Less than a quarter of U.S. executives and senior managers at Citigroup Inc., JPMorgan Chase & Co., and Goldman were women in 2016. Morgan Stanley last released data for 2015, when women made up just 17.9 percent of its leaders.

"I've seen women who are very talented, who have big revenue roles, big leadership roles, and we just haven't seen them get across the finish line," says Ana Duarte-McCarthy, who ran diversity efforts at Citigroup until she left in 2016. "It's not a lack of talent."

If Solomon does become CEO, part of his job will be making sure the next succession contest doesn't look like the current one. For now, only two of Goldman's 11 executive officers are women: co-general counsel Karen Seymour and compliance chief Sarah Smith. On the broader management committee, which has 31 members, there are four

women: Seymour and Smith, plus Isabelle Ealet, who is co-head of securities, and Gwen Libstag, who oversees business conflicts. Dina Powell, whose background is in government and philanthropy, will join the committee this year when she returns to Goldman Sachs from a stint at the White House.

"While progress has been made to increase the number of women at Goldman Sachs, there is more work to be done," spokeswoman Leslie Shribman says. "We have several initiatives in place to increase the number of diverse candidates coming into the firm and to retain and promote diverse talent once they are here, and we will continue to do more." This month marks the 10th anniversary of 10,000 Women, a Goldman Sachs program sponsoring female entrepreneurs worldwide.

Solomon presented ideas on diversity to the board in June. He wants the group of junior employees entering the bank to be closer to half female, up from its current percentage level in the 40s. Solomon also brought in Sarah-Marie Martin as a partner from Credit Suisse Group AG.

"Many of the Wall Street firms are still boys' clubs where men hold on to power and promotions," says Roy Cohen, a Wall Street career coach who counted Goldman Sachs as his biggest client for years. "Some firms recognize that there's an issue but are also reluctant to engage."

It's a challenge Goldman's leaders have been talking about for years. "In my 25 years at Goldman Sachs, I've learned one thing about markets: You don't create any value if you are unwilling to make an investment," Blankfein told a United Nations audience at an International Women's Day event in 2008. "The fact is that no country will ever achieve its full potential if half of its talent pool is stymied or underrepresented."

—*Jordyn Holman and Max Abelson*

**THE BOTTOM LINE** Solomon has emerged as the front-runner to be the next CEO of Goldman Sachs, besting an unofficial group of contenders that contained zero women.



● Seymour



● Smith



● Ealet



● Libstag



● Powell



◀ Gray

## Blackstone's Crown Prince

● How a dealmaker with an eye for property became the heir apparent at the buyout giant

How do you get to the top of the private equity business? Turns out, it's by getting really, really good at flipping real estate.

This month, Jon Gray, 48, became president and chief operating officer of Blackstone Group LP. The job sets him up to one day succeed Chief Executive Officer and co-founder Stephen Schwarzman, who's steered the private equity firm over 30 years from a \$400,000 initial investment to \$434 billion in assets. The traditional core of the private equity game is corporate buyouts, supercharged with debt. Blackstone set itself apart by diversifying into hedge funds and real estate, and providing credit to companies. Gray, as head of the real estate division, expanded the portfolio into a \$115 billion property giant that's Blackstone's top profit driver.

He did it in part with two audacious bets at what should have been the worst possible

moment, just before the real estate crash and financial crisis. In 2007, Blackstone paid \$39 billion for Equity Office Properties Trust, Sam Zell's collection of 580 commercial buildings, in what was then a record leveraged buyout. The firm also bought the Hilton hotel chain for \$26 billion. Blackstone and its investors eventually earned profits of more than \$20 billion from those investments. But it was a grind: Gray had to get his partners to kick in \$800 million more before the Hilton transaction turned around.

Gray may not, at first glance, seem like much of a risk taker. He joined Blackstone right out of college and never left. People who've worked with him describe him as preternaturally composed. "He's that right combination of somebody you want your daughter to bring home when she's going on dates, somebody you trust with your money, and somebody with steel balls," says Thomas Saylak, who was Gray's boss as co-head of real estate at Blackstone until 2002. "He has the ability to make hard decisions under stress."

Gray will have plenty more to stress over as Schwarzman's second-in-command. Schwarzman still has vast ambitions: He's said Blackstone can get to \$800 billion in assets in five years, about double what it manages today. "I don't envision sharp turns here," says Gray, speaking in his soon-to-be-old ▶

**"He revolutionized the real estate business"**

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◀ office on New York's Park Avenue a week after his promotion was announced on Feb. 13. "Steve has said this is like the restaurant business. If you continue to serve good food, your customers come back and new customers show up."

Blackstone and its private equity brethren are some of the most important investment engines in the world. Critics of the buyout model point to the rich fees the firms charge investors and say profits come at times from cutting jobs at the companies they load with debt. What's undeniable is the industry's reach. Blackstone invests for some of the biggest pension funds in the U.S., university endowments, and sovereign wealth funds. It's owned everything from SeaWorld to the Weather Channel. This year it bought a controlling stake in the financial data unit of Thomson Reuters Corp., which competes with Bloomberg LP, the publisher of this magazine. It's bought and sold the iconic Waldorf Astoria and owns Chicago's Willis Tower. It snapped up foreclosed homes after the financial crisis.

It's a business that's remarkably profitable for its practitioners. Schwarzman earned \$786.5 million in 2017, and Gray made \$274 million. Since Blackstone went public in 2007, its stock, including dividends, has returned 115 percent, vs. 128 percent for the S&P 500.

Gray is seen by peers as an innovator in real estate financing. "He studies and understands macroeconomic trends," says Jeff Blau, CEO of Related Cos., a New York-based developer. "Through all that research, he comes to a position on a city, an industry, or an asset type, and bets big on that. It enables him to put out a huge amount of capital." Early on, Gray saw that publicly traded real estate companies could be valued by the market at less than the sum of their parts—over time he led so-called take-privates of about 30 such companies. After swallowing them up, he would offload bunches of assets at high prices to pay down debt and cut Blackstone's investment cost. That's partly how he made the high-wire act with Equity Office Properties work. He sold \$27 billion of the portfolio when office values were still close to their peak.

"He revolutionized the real estate business," says Chris Nassetta, CEO of Hilton Worldwide Holdings Inc. In other areas of the Blackstone empire, Gray will oversee businesses with long-standing, aggressive rivals. Money has poured into buyout funds, driving deal prices up and potential returns down. The credit business pits Blackstone against similar managers and well-capitalized Wall Street banks. Hedge funds are an increasingly difficult proposition, with some of the world's best-known managers calling it quits in a world unwilling to pay high

## Gray's Area

Blackstone assets under management, as of Dec. 31, 2017

Real estate \$115b	Private equity \$106b	Hedge funds \$75b	Credit \$138b
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Sources of Blackstone pretax profit (economic income), 2017

Real estate \$1.7b	Private equity \$999m	Hedge funds \$395m	Credit \$367m
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DATA: COMPILED BY BLOOMBERG

fees for middling returns. The firm's size may give it an edge. "The investors want to put a lot of money to work, and that favors those who have economies of scale," says Steven Kaplan, a professor at the University of Chicago Booth School of Business.

Another challenge will be to keep the profitable peace. Private equity firms are "filled with the most achievement-oriented people, and they don't always play nicely together," says Jeffrey Sonnenfeld, an expert on CEOs and leadership who teaches at the Yale School of Management. "To manage that is very hard, and Blackstone so far has been otherworldly good at this." Above Gray's desk is a photo of a basketball hoop next to a sign with the word "Perseverance." Gray says it reminds him of a high school basketball season when he rode the bench. "He has a disarming personality and comes across as calm," says Blau, who's known Gray since the early '90s. "He's been able to, from a very young age, interact with older owners of businesses who could easily view him as some young whippersnapper they don't want to deal with."

Outgoing President Tony James remains as executive vice chairman. More than two years ago, James began inviting Gray to meetings he wouldn't normally sit in on. "Tony included me in a lot of things that probably made it a little more complicated and cumbersome for him," Gray says. "This is a big job. Understanding a lot of the plumbing was very helpful."

And then there's Schwarzman. The 71-year-old shows no signs of abandoning his post soon. He's raised his global profile, counseling heads of state from President Trump to China's Xi Jinping and establishing the Schwarzman Scholars program in China, modeled on Oxford's Rhodes scholarships. Sounds like a tough boss to manage up to. It may help that Gray has "built up parts of the business that were not Steve's world," Sonnenfeld says. "He doesn't crowd Steve's aura." —*Jason Kelly, with Melissa Mittelman and David Carey*

● Blackstone's cumulative total return since its 2007 IPO

# 115%

THE BOTTOM LINE Gray made his name with deals that took advantage of Blackstone's ability to put a lot of capital to work. He'll keep his job by managing some of the biggest egos on Wall Street.

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## LOOK AHEAD

● Finance ministers and central bankers of the G-20 countries meet in Buenos Aires on March 19-20.

● The Fed's interest rate-setting committee meets, with Jerome Powell presiding for the first time.

● Japan publishes February inflation figures on March 22. Will January's uptick be sustained?

# Where The Jobs Are

● What will happen when the U.S. unemployment rate falls below 4 percent, which is expected to occur by this summer? One way to tell is to look at cities where joblessness is already lower than that. Bloomberg News reporters traveled to Iowa, Georgia, and Maine. What they saw there is encouraging. They discovered that employers have found ways to cope with tight labor markets and still make money. Businesses have pulled in workers from the sidelines—including retirees, immigrants, and the homeless—and retooled processes to use less labor. Some have raised pay considerably for certain jobs, but so far there are no signs of an overall wage explosion. That should embolden those at the Federal Reserve who want to raise interest rates slowly to give growth a chance.



## ● Portland, Maine

● Population  
66,937

● Unemployment rate  
1.8%

From polished sea-salt caramel balls to truffles packaged with hand-tied bows, the treats on sale at Wilbur's of Maine Chocolate Confections in Freeport exude artisanal charm. While that's a source of pride for owner Andrew Wilbur, whose parents started the business, he's staring down a dilemma. Manufacturing workers are hard to come by in Freeport, which is 15 miles north of Portland and part of its statistical area. At 1.8 percent, the unemployment rate is the third-lowest in the country. "It's made me think, Do I go to more mechanization?" Wilbur says from inside his production plant, where three employees are making candy in what look like mini cement mixers.

Wilbur has raised wages for his 40 employees by more than 20 percent over the past three years, but he's passed hardly any of his costs onto consumers. Business at his three brick-and-mortar outlets is already unchanged or down, and he would have lost online and wholesale customers if he'd raised prices substantially, he says.

It takes a full year for these employees to get up to speed and five for them to hit what Wilbur, without a hint of irony, calls "the sweet spot." With inexperienced workers starting at \$12 to \$14 an hour, onboarding is becoming a major expense. Lowering his voice a little, Wilbur admits that he's changed some of his packaging to make it less labor-intensive, including doing away with hand-applied labels.

Shipwreck & Cargo, a souvenir shop in downtown Portland that stocks items such as lobster-printed boxers and Maine blueberry tea, staffed its floor

March 19, 2018

Edited by  
Cristina Lindblad

Businessweek.com





PHOTOGRAPHS BY GREGORY HAL PERIN FOR BLOOMBERG BUSINESSWEEK, POPULATION DATA AS OF JULY 1, 2016, UNEMPLOYMENT RATES AS OF DECEMBER 2017, BACHELOR'S DEGREE FIGURES FOR POPULATION 25 OR OLDER AND AS OF 2012 TO 2016, FASTEST-GROWING OCCUPATIONS ARE THOSE WITH THE LARGEST PERCENTAGE INCREASE FROM 2008 TO 2016; DATA: CENSUS BUREAU, BUREAU OF LABOR STATISTICS, FEDERAL RESERVE BANK OF ST. LOUIS

with only two sales assistants during the busy summer season instead of the usual three. The supply of workers has dried up just as the tourism industry is on an upswing, says store manager Jennifer Smith. "You want the right people, standing and smiling in front," says Smith, who adds that the applicant pool has gotten smaller and less qualified in the five years she's been running the shop.

The leisure and hospitality sector is the backbone of the local economy, but professional and business services have been engines of growth in recent years. Weekly wages in the Portland region have been moving up gradually, climbing in line with the national average through the first three quarters of 2017, the latest figures

show. Inflation in the Northeast has been running below 2 percent.

One big reason employers are struggling to fill slots is that Maine's population growth has leveled off. The state has the highest median age in the country at 44. "Last year, I was unable to get how many people I needed. I was probably short one and a half people," says Tammara Croman, the manager of Portland's Pomegranate Inn, whose eight guest rooms are outfitted with exuberant floral wallpapers and works by local artists. She says the operation ran at full capacity last summer, though with too-few housekeepers, it wasn't able to accommodate as many early check-ins. "We end up having to hire people who we wouldn't ►

◀◀ Portland's historic district  
◀ Wilbur's

● Average weekly wages:



● Share of population with a bachelor's degree or higher:

**63%**

● Fastest-growing occupation: Human resources manager

◀ normally," says Croman, who's already put out feelers for the summer.

Applicants with no relevant experience are asked to come in for three-week trials, which gives Croman a chance to see if they're cut out for the work—a mix of housekeeping and customer service. "It allows you to see the person's work ethic, if they're showing up on time, if they're doing a good job," she says.

The workforce challenges have been "top of mind for a while, and I don't know if we see an end in sight," says Quincy Hentzel, head of the Portland Regional Chamber of Commerce. That said, it isn't all bad. "Businesses are extremely appreciative of their good employees and working really hard on retention," she says. "That's wonderful."

A tight labor market also means that employees can afford to be picky. At Wilbur's chocolate shop, two store managers left last year because they had better prospects in administrative work. While the business managed to hire replacements, mounting payroll costs are weighing on profit margins. Pointing to a large, hand-painted chocolate Easter bunny in his factory, Wilbur shakes his head. "We probably make a lot of people happy," he says, "but I'm not sure that we cover the bills." —*Jeanna Smialek*

## ● Marietta, Ga.

● Population  
60,941

● Unemployment rate  
3.7%

Lanre Bakare, a 36-year-old Nigerian immigrant, was homeless and had little marketable work experience when he was accepted into a training program run by CobbWorks Inc., a federally funded nonprofit that matches workers and businesses in the construction, logistics, information technology, and health-care fields. Now he earns \$40,000 annually as an analyst managing vendors and supplies at residential construction sites in Cobb County, Ga., and the surrounding area. Eleven months into the job, Bakare still marvels at his salaried status and is looking forward to that most dreaded of employment rituals: the performance review. "I'm really excited," he says. "We're going to talk about if they are going to increase my job, what are my possibilities."

CobbWorks has been around since 2000 but has recently expanded its outreach, training

people with spotty work histories or criminal backgrounds who employers wouldn't have considered a few years ago. Companies can no longer afford to be as picky. Unemployment in Cobb County, whose seat is Marietta, a city of 61,000 about 20 miles northwest of downtown Atlanta, was 3.7 percent in December. Weekly wages in the area rose more slowly than the national average through the first three quarters of 2017, the latest figures show. Inflation, meanwhile, has been moving up relatively quickly in the Atlanta area, climbing 3.3 percent in February compared with the nation's 2.2 percent.

Marietta's biggest employer, hospital network WellStar Health System, says it's not feeling the labor crunch because of a decade-long campaign to ensure its pay and benefits are competitive. Attrition at WellStar is below the national average for the sector, according to spokesman Keith Bowermaster. The city's No. 2 employer, Lockheed Martin Corp., is relatively insulated from local labor trends because the market for aerospace engineering work is national.

But some smaller businesses in the area are scrambling. That's particularly true in the Cobb Galleria and adjacent Cumberland Mall areas, a few miles south on I-75, where office buildings, hotels, stores, restaurants, and a new ballpark for the Atlanta Braves compete for workers. "We've had fast-food restaurants offering bonuses," says Roger Tutterow, an economist at Kennesaw State University. He's also seen signs that labor shortages are constraining certain industries, noting that the number of building permits issued last year was half what it was during the boom that preceded the housing bust, even though demand for new homes is running high.

Several Marietta companies report they're improving benefits to hang on to employees and attract new ones. InfoMart Inc., a 137-person operation that performs background screenings for companies, began paying 100 percent of its employees' health insurance premiums this year, up from 75 percent. It also rehabbed its office space to make it more "collaborative-looking," says Senior Vice President Tim Gordon, who's especially keen to attract millennials. InfoMart also allows its tech employees to work from home four out of five days a week.

Just outside the city limits, Gas South LLC, a natural gas retailer, raised its minimum wage to \$15 an hour in late 2016 and now offers every employee—including those in its call center—a one-month paid sabbatical every five years on top of regular vacation time. It also pays its workers'

● Average weekly wages:



● Share of population with a bachelor's degree or higher:

**37%**

● Fastest-growing occupation:  
Forging machine operator

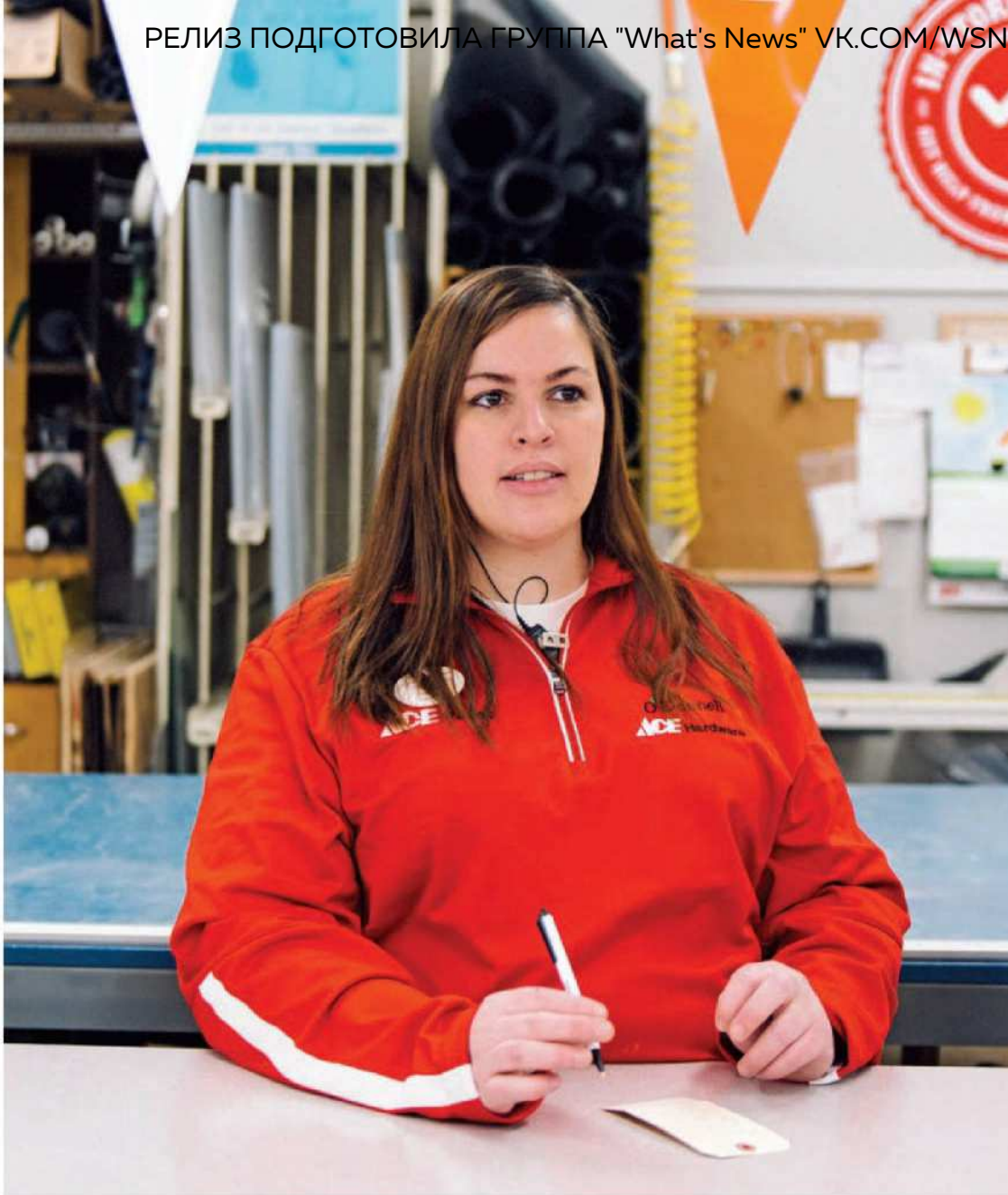


health insurance premiums and has equipped its call center employees so they can work from home. “We did some research into the cost of living and discovered that some of our people were really struggling,” says Chief Executive Officer Kevin Greiner. “With more money comes less stress. It helps us recruit and keep quality people.”

Paul’s Pot Pies is one of several storefronts lining Marietta’s well-appointed town square, which is outfitted with a gazebo, flowering trees, and boxes of blooming tulips, daffodils, and hyacinths. Its proprietor, Paul Lubertazzi, added \$2 to the hourly pay of his minimum-wage workers eight months ago because he says he was afraid he’d lose them to other businesses. A pickup in sales of his frozen pastry pies, which cost \$9 to \$25, helped pay for the increase. But the cost of many of his ingredients, particularly vegetables, has risen too, which is why he plans to raise prices sometime this year: “I wanted to do it in January, but I’m holding off,” Lubertazzi says. “People do complain.” —Margaret Newkirk

▲ Bakare

◀ Lubertazzi



◀ Tjernagel

## ● Ames, Iowa

● Population  
66,191

● Unemployment rate  
1.5%

“Join our team,” beckons the chyron in foot-tall red lettering outside the Taco John’s in Ames, Iowa. Across the street, a cactus-shaped sign at TacoTime declares that it, too, is hiring.

“Help wanted” signs are a common sight in Ames, which boasts the lowest unemployment rate in the nation—1.5 percent. From behind the beige laminate cashier counter of the Taco John’s, manager Justin Cornelius says this outpost of the Tex-Mex chain raised pay by 50¢ an hour in the fall. Still, turnover has increased, because workers have more

options than they did a few years ago. Cornelius himself is a fill-in; he’s been on loan from a Des Moines restaurant since December. Usually, it takes four to six weeks to find a permanent manager. In Ames it’s been 10 weeks and counting.

Two miles north, at O’Donnell Ace Hardware, manager Tausha Tjernagel says her store has lifted wages every six months for the past year and a half. She’s now starting full-time workers with no experience at \$11 an hour, well above the state’s \$7.25 minimum. Even so, Tjernagel has had to ask employees to be flexible to fill holes in the schedule. Older part-timers who’d prefer a weekday morning shift are spending their Saturdays ringing up lawn fertilizer or stocking shelves with hammers and nails. But that’s better than letting checkout lines get longer, which is what several town residents say is happening at other retailers. Says Tjernagel: “We make it so that it’s not noticeable to our customers.”

Wait times aren't the only pain a supercharged labor market is causing in this city of 66,000, home to the world's largest gnome statue and Iowa State University. The school is Ames's largest employer, as well as a magnet for companies across the Midwest that are fighting the region's brain drain. Locals say prices haven't been picking up rapidly, and inflation in the Midwest as a whole continues to run below 2 percent. Average weekly wages grew slightly faster than national wages through the first three quarters of 2017—though a separate data series on hourly earnings showed a pop in Ames in

January, which is early evidence that faster gains may be materializing.

There are other signs the local economy is running hot. A home price index shot up 7 percent in the fourth quarter of 2017. Kellie Mullaney, a career development adviser at Iowa State, recalls that when she and her husband bought their home three years ago, listings sold in a day: "It seemed like the price range we were in, everyone else was in, too."

To get around the housing constraint, businesses are trying to make it easier for workers to commute in from elsewhere. Mary Greeley Medical Center—one of Ames's largest employers—is working on setting up a ride-sharing program for employees who live in nearby Story City or Des Moines, where the unemployment rate is 2 percentage points higher.

The Ames Chamber of Commerce has been targeting the 6 percent of the local population who's underemployed. It's promoting a community college program in Des Moines that will train people, often at no charge, for jobs in advanced manufacturing. Staffers have been pushing it at local food banks and through local faith leaders, hoping to absorb any labor market slack.

Some companies are trying to snap up workers before they hit the job market. At Iowa State's College of Engineering, internship postings by Ames companies rose 20 percent in 2017, far exceeding the 2 percent increase in postings overall, says Mullaney.

A collection of modern buildings perched in the middle of a former cornfield abutting the campus is a freshly built monument to employers' growing desperation. Workiva Inc., a software company that's referred to locally as the "Google of the Midwest," expanded its presence in the research park in 2014, and John Deere & Co. opened a "strategic technology office" last year.

The lobby of Vermeer Corp.'s two-year-old office, where 3D-printed art displays hang on the wall opposite minimalist lounge chairs, looks more like a trendy hotel than the outpost of a manufacturer of heavy machinery for the agriculture, mining, and construction industries. Vermeer's headquarters are more than an hour's drive away, in Pella, Iowa, but the company enlarged its operation here in part because managers wanted to keep in touch with summer interns, who were getting recruited to other companies amid intense demand. "If we want the top talent, we have to be competitive," says Sara Hunter, whose job is to build relationships between Vermeer and the university, while strolling through a massive warehouse where students can come to design test equipment. "That pipeline is key." —*Jeanna Smialek*



● Average weekly wages:



● Share of population with a bachelor's degree or higher:

**47%**

● Fastest-growing occupation: Physical therapist

◀ Iowa State University's research park

◀ Cornelius

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## LOOK AHEAD

● Russians, going to the polls on March 18, will likely give Vladimir Putin a fourth term as president

● President Trump welcomes Saudi Crown Prince Mohammed bin Salman to the White House on March 20

● Congress has until March 23 to pass an omnibus spending bill before the government runs out of funding

5

# 'I Alone Can Fix It'

● Trump remakes the cabinet in his own image, and gets the White House he really wants

In accepting the Republican nomination for president in 2016, Donald Trump described a nation plagued with problems and declared: "I alone can fix it." More than a year and a half later, as the administration empties of some of his closest aides and top officials, he's certainly more alone. Among the record number of departures are key moderates who were recruited to help guide an inexperienced commander-in-chief and temper his more controversial impulses. As they're replaced with like-minded loyalists, Trump is finally getting what he may have wanted all along—a presidency of one.

The departure of White House economic adviser Gary Cohn, who resigned on March 6, and the ouster of Secretary of State Rex Tillerson a week ▶

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March 19, 2018

Edited by  
Matthew Phillips and  
David Rocks

Businessweek.com

◀ later make clear that the president is done with dissenting voices. Both are being replaced by men more aligned with Trump, at least stylistically. CIA Director Mike Pompeo, a conservative former congressman from Kansas, is likely to take over as America's top diplomat, while Larry Kudlow, a former Wall Street economist and CNBC commentator, will replace Cohn as Trump's top economic adviser. Pompeo shares many of Trump's hawkish tendencies, particularly toward Iran. Kudlow, like Cohn, is a free trader, but he has more of a shoot-from-the-hip style and backed off from his criticism of steel and aluminum tariffs after Trump said he would exempt Canada, Mexico, and possibly others.

Aides anticipate more changes, including the potential departure of national security adviser H.R. McMaster. Chief of staff John Kelly has also had a rough month, damaged by his handling of the case of a key aide, Rob Porter, the White House staff secretary who resigned after accusations of spousal abuse. The purge will have long-lasting effects, fundamentally shifting U.S. diplomacy and economic strategy. And it marks an end to Trump's attempt to build a cabinet of diverging opinions.

"Because he's had all these different voices around him that have all these different ideas, it ended up being just a grand experiment," says Harry Kazianis, director of defense studies at the Center for the National Interest. "I think the president realizes the experiment has failed, and it's time to push forward in the direction that he's always wanted."

That direction is toward a set of core positions: protectionist trade rules, hawkish foreign policy, and a tougher immigration stance. Trump's priorities have been on clear display. A few hours after firing Tillerson, he flew to San Diego to examine prototypes of the border wall with Mexico. There are also reports that Trump is pushing his trade representative, Robert Lighthizer, to craft an aggressive set of tariffs against China. In coming months, the president plans to sit down with North Korea's Kim Jong Un to discuss nuclear weapons, negotiate with various countries seeking exemptions from metals tariffs, and decide whether to upend the Iran nuclear deal by imposing fresh sanctions.

In many ways, this is the presidency Trump envisioned all along, one where he gets to run the country like he ran his business. The Trump Organization functioned with him at a desk, surrounded by a handful of loyalists who either carried out his orders or were out of a job. "I'm really at a point where we're getting very close to having the cabinet and other things that I want," Trump told reporters on March 13, the day he fired Tillerson. Trump said he made the decision to

hold talks with Kim "by myself" and didn't consult Tillerson in advance.

Critics say the turmoil has left the U.S. foreign policy apparatus ill-equipped to face a growing number of global threats. "The key challenge we face as a country is credibility," says Brett Bruen, a former State Department official. "We don't have credible voices that can explain what the president is thinking at any one time, let alone trying to move concertedly in a direction that—as Tillerson found out all too well—could change at a moment's notice and without any consultation."

Bruen, who served as the National Security Council's director of global engagement from 2013 to 2015, says Trump's inability to nominate an ambassador to South Korea amid a crisis on the peninsula is a telling sign of how "exceptionally unattractive" it is to work for Trump. As of March 14, the administration had filled fewer than half of the more than 600 leadership positions that require Senate confirmation, according to the nonpartisan, nonprofit Partnership for Public Service. More than 200 slots had no nominee, and an additional 145 were awaiting confirmation. Eight of the top 10 positions at the State Department are unfilled. Trump has said he intends to leave many open, because he will ultimately drive the policy. "I'm the only one that matters," he said in a Fox News interview last year.

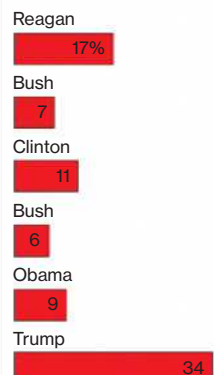
Although turnover has been a constant of the Trump White House from the start—when national security adviser Michael Flynn left after just 23 days—the past month has been frenetic. Along with Tillerson, Cohn, and Porter, recent departures include Communications Director Hope Hicks and her deputy, Josh Raffel, a close ally of Jared Kushner and Ivanka Trump. Trump also fired Steve Goldstein, the undersecretary of state for public diplomacy and public affairs. (The day before Tillerson was fired, Trump's longtime personal assistant, John McEntee, was also dismissed for reasons that remain unclear.)

Tillerson had planned to play a major role in preparing the president for his meeting with Kim in May. After all, negotiating with dictators is something of a Tillerson specialty, honed from his decades at Exxon Mobil Corp. squaring off against Chadian dictator Idriss Deby, former Venezuelan strongman Hugo Chávez, and other autocrats. In the days before he was fired, Tillerson, on his first trip to Africa as secretary of state, launched into a succession of phone calls with foreign leaders to inform them of Trump's intent to meet with Kim.

Tillerson's departure adds to fears that if the North Korea meeting fails, the U.S. will stumble closer to war with the Kim regime. While Tillerson insisted the U.S. didn't want regime change in North

**"The experiment has failed, and it's time to push forward in the direction that he's always wanted"**

● Staff turnover\* during the first year of a president's first term





Korea, Pompeo has been more antagonistic. Last July he said he was hopeful of finding a way to “separate that regime from this system” and that North Koreans would be “happy” to see Kim go. Comments like that, certain to raise North Korea’s suspicion that Trump’s real intention is to usher Kim from power, may sabotage the meeting before it happens.

The biggest change in policy will likely be toward Iran. In Congress, Pompeo was one of the strongest critics of the 2015 nuclear deal. Tillerson had been in negotiations to strengthen it, handled mostly by his policy planning chief, Brian Hook. That’s now in limbo. Hook’s job in recent weeks had been to come up with fixes to keep the U.S.

in the deal while also pleasing the president, an almost impossible task by definition. Trump cited his differences with Tillerson over Iran as one reason he fired him. “When you look at the Iran deal, I think it was terrible,” he told reporters on March 13 outside the White House. Tillerson thought otherwise. “I wanted to either break it or do something, and he felt a little bit differently,” the president said. “So we were not really thinking the same.” In Trump’s Washington, that’s now a fireable offense. —*Toluse Olorunnipa and Nick Wadhams*

**THE BOTTOM LINE** The administration is shedding its moderating influences and lurching toward the disruptive policies Trump has always said he prefers to pursue.

# The Arabic-Speaker Who Might Lead Israel

● Moshe Kahlon’s economic stewardship makes him a top contender to one day replace Netanyahu

As the sun sets over the town of Migdal Haemek, just outside Nazareth in northern Israel, a white Nissan pulls up to a community center. A slim, neatly dressed man with graying hair steps out of the car, and a dozen people surge forward to take selfies and get a closer look. Inside, the stage is set for a gathering to thank the visitor, Israeli Minister of Finance Moshe Kahlon, for helping the hardscrabble town of 28,000. “And now, in honor of the prime min—” says Eli Barda, the town’s mayor. “Wait, I’m going to get in trouble here. In honor of the...minister.”

It was a slip, but one that resonates in Israel these days. Prime Minister Benjamin Netanyahu faces three corruption probes, and his government almost collapsed in early March in a tiff over the budget. With his future looking shakier than ever, the country’s political class has begun to quietly seek a successor. Kahlon is among a handful of names that rises to the top of the list. “I don’t dream, I’m realistic,” he says in his Tel Aviv office a few days after the Migdal Haemek event. “Being prime minister is difficult and carries a lot of responsibility,” says Kahlon, the 57-year-old son of poor immigrants from Libya. “But I see myself as capable of any job.”



The hardest part of leading Israel, of course, is dealing with the Palestinians, and in that Kahlon’s heritage—he grew up speaking Arabic and Hebrew at home—gives him an advantage. At a meeting last year with Palestinian Prime Minister Rami Hamdallah, an aide warned Hamdallah in Arabic to be wary of the Israeli finance minister. Kahlon turned around, smiled, and gently suggested in the Arabic he learned from his parents that the aide ►

▲ Kahlon (right) with Ma’lot-Tarshiha Mayor Shlomo Bohbot at a March 8 event honoring the finance minister

◀ might consider being more respectful. The room erupted in laughter, and now Kahlon is greeted with kisses and slaps on the back when he visits the West Bank.

Kahlon quit Netanyahu's Likud in 2012 to found his own party, and he's looking to places such as Migdal Haemek to increase his power base. Like many smaller towns in Israel, it's full of modest apartment blocks hastily thrown up in the 1950s to accommodate Jewish refugees after Israel's founding. In November, Kahlon's Ministry of Finance allotted 1 billion shekels (\$291 million) to build housing over the next five years—one of dozens of such programs he's backed since taking over the ministry in 2015. At the rally, a beaming Mayor Barda tells him, "You are an example of someone who climbs the ladder without forgetting where you came from."

Kahlon rose to prominence as communications minister about eight years ago, when he crafted rules for mobile phones that have helped cut consumers' bills by 90 percent since 2009. As finance minister, he's overseen an improving economy: Growth is up, unemployment is down, and incomes have steadily risen, especially among the poor. Kahlon brings "credibility and levelheadedness" to the job, says Yaron Zelekha, who was economics chief under Netanyahu and now runs the accounting program at Ono Academic College near Tel Aviv.

An effort to rein in the cost of housing has been less successful than Kahlon's phone policies. Discounts on land for developers who promise to sell apartments at below-market prices have helped stabilize costs, but they're still up sharply since Kahlon took office. "His election slogan was 'I will reduce housing prices,' and he is completely failing," says Omer Moav, an economics professor at the University of Warwick in England.

Although he was a rising star in Likud, Kahlon felt the old guard would block the social-welfare policies he backed. So he broke with the prime minister and launched Kulanu—or "all of us"—which today has 10 seats in parliament. "I was one of Likud's most popular leaders and could have stayed comfortable," he says. "I had a choice: to stay and sell out my values, or take a chance and maintain them. I chose the latter." Last year, Kahlon was the sole cabinet member to challenge Netanyahu in a fierce debate over creating a new public broadcaster—a plan the prime minister's allies opposed because they said it would be packed with anti-government voices.

In recent weeks, Kahlon's threat to bolt the coalition brought the government to the brink of collapse. He wanted to see the 400 billion-shekel budget passed quickly, but ultra-Orthodox parties

in the coalition refused to approve the plan without a separate bill exempting seminary students from military service. Kahlon's defection would have triggered early elections, because Netanyahu needs Kulanu's support in parliament to maintain a majority. But on March 13 the parties agreed to allow the budget vote to proceed after a compromise that delayed a final decision on the exemption bill.

Polls indicate that if Netanyahu were to step down, there's no clear public preference for a successor. Other contenders include former Minister of Finance Yair Lapid, Zionist Union leader Avi Gabbay, Minister of Education Naftali Bennett, and Minister of Defense Avigdor Liberman. Recent surveys show Lapid's centrist party would make strong gains if elections were held now, though Likud would still be the largest group in parliament. Kulanu would likely lose a couple of seats.

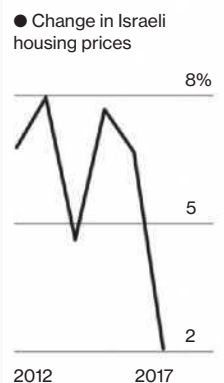
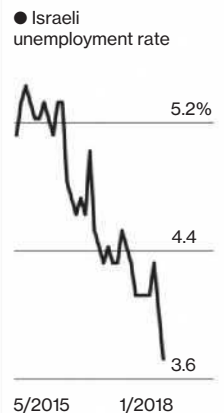
Kahlon, one of seven children of parents who emigrated from Libya in 1949, frequently invokes his humble beginnings as he faces off against members of Israel's elite. At 14 he started fishing in the morning to support his family, eventually leaving school to work in construction and at the metal workshop of a nearby kibbutz. He spent five years in the military before opening a successful auto parts store. In his 30s he returned to school, ultimately earning degrees in political science and law in Israel before attending an executive management program at Harvard Business School. Kahlon "carries the scars of poverty, and he has a real desire to make sure everyone gets a chance," says Miri Levy, his neighbor growing up in Givat Olga, a beachfront town about 50 miles north of Tel Aviv.

Regarding relations with the Palestinians, Kahlon has made few public pronouncements, and some in the West Bank say he can't be trusted. Sam Bahour, an adviser at Palestinian think tank Al-Shabaka, says Palestinians shouldn't put a lot of hope in Kahlon as his views don't differ much from the mainstream of conservative Israeli thought. Kahlon wants to "maintain the political status quo," Bahour says.

For his part, Kahlon stresses communication, cooperation, and finding ways to boost the Palestinian economy. "It is our destiny to live here together," he says. With political ties at an impasse and Palestinians reluctant to embrace joint economic projects, "we need to leave the window open, even if it is only a crack," he says. "When the time is ripe for more political talks, a path for communication will already have been paved."

—Gwen Ackerman, with Fadwa Hodali

THE BOTTOM LINE As Netanyahu grapples with corruption investigations, Minister of Finance Moshe Kahlon has fortified his power base by lowering prices for cell service and building homes.



## Bragging Rights On Trump's Turf



● An election in Pennsylvania gives Dems a playbook for winning back Trump voters

If Conor Lamb's apparent win in the heart of Trump country is any indication, the Democratic Party will have to widen its ideological tent to accommodate a diverse slate of candidates running in what's shaping up as a Democratic wave in November. Lamb, a 33-year-old former Marine and federal prosecutor, clung to a 627-vote lead on March 14, the day after a special congressional election in southwestern Pennsylvania. If seated, he'll be among the most conservative Democrats in the House.

After spending much of the past decade focusing on progressive social issues, Democrats are throwing out ideological purity tests and fielding moderate and conservative candidates in places where Trump ran strong in 2016. It's working: Winners include Senator Doug Jones in Alabama and Governor Ralph Northam in Virginia. Lamb's strong performance in a district Trump won by almost 20 percentage points is a shock to the GOP, but it's also a challenge to Democrats, who may have an unruly majority if they win back the House.

Lamb would likely join the Blue Dog caucus of 18 moderate and conservative House Democrats. He supports fracking, opposes banning assault rifles, and says abortion goes against his Catholic faith, though he wouldn't restrict access to it. He soft-pedaled disagreements with Trump even as he promised to vote against House Minority Leader Nancy Pelosi for speaker. On the other hand, he supports Obamacare and is critical of last year's tax cuts.

Lamb's embrace of labor unions and trade restraints helped him steal momentum from his opponent, Rick Saccone, over Trump's tariffs on steel and aluminum. Cecil Roberts, the fiery president of the United Mine Workers of America, encapsulated Lamb's blue-collar appeal on March 11 at the Greene County Fairgrounds, calling him

"a God-fearing, union-supporting, gun-owning, job-protecting, pension-defending, Social-Security-believing, health-care-creating, and sending-drug-dealers-to-jail Democrat."

In other words, Lamb is not your daddy's Democrat. He's more like your granddaddy's—a throwback to an era when the two major parties were not as ideologically polarized as they are today. For much of U.S. history, party loyalty was often about regional identity, ethnicity, or family legacy, not ideology. Lamb frequently tells Republicans, "I'm a Democrat because my grandfather was a Democrat, and he was because FDR was."

Lamb's popularity in a district where Democrats didn't even field a candidate in 2014 and 2016 has some people arguing that moving rightward is the key to victory in November. But Democrats can take the House even without winning districts as red as Pennsylvania's 18th. They need just 24 more seats for a majority, and Republicans hold 23 that Hillary Clinton carried in 2016. Winning all or most of those, plus a few purple districts, would do the trick. (Lamb will likely run in a different district—the 17th—in November, because the state Supreme Court is redrawing the map to end gerrymandering.)

In the special elections for Congress held since Trump took office, Democratic candidates have averaged about 12 percent more of the vote than history would suggest they'd receive. They need only 4 percent above their historical average in the fall to take the House, says John Anzalone, a pollster and campaign strategist in Montgomery, Ala., who worked on the Obama and Clinton campaigns.

Steve Phillips, a San Francisco civil rights lawyer and author of a 2016 book, *Brown Is the New White*, argues that the Democrats will win by energizing their base, not by luring Trump voters. Some Democrats are "still caught up in, 'What can we do to change the minds of Trump supporters?'" he says. "They should be more forceful about championing the values that Trump is attacking."

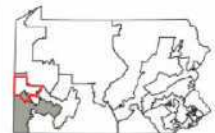
Lamb also demonstrates the benefit of playing it safe. Rather than criticize Trump, he mostly let others do the talking. He focused on his support for unions and his service as a captain in the Marines. For a political newbie, he ran a masterful race. He raised more money than Saccone locally and withstood a last-ditch push against him by outside Republican groups. Lamb is probably not the future of the Democratic Party. But for Democrats itching to get back in power, every seat helps. —Peter Coy and Arit John

THE BOTTOM LINE In the House of Representatives, Conor Lamb would likely join the Blue Dog caucus of moderate and conservative Democrats.



● Lamb

● Pennsylvania's congressional map  
■ 18th District, 2016  
□ Likely 17th District, 2018



# Amazon's Botto

## Corporate America is running scared

**Amazon makes no sense. It's the most befuddling, illogically sprawling, and—to a growing sea of competitors—flat-out terrifying company in the world.**

It sells soap and produces televised soap operas. It sells complex computing horsepower to the U.S. government and will dispatch a courier to deliver cold medicine on Christmas Eve. It's the third-most-valuable company on Earth, with smaller annual profits than Southwest Airlines Co., which as of this writing ranks 426th. Chief Executive Officer Jeff Bezos is the world's richest person, his fortune built on labor conditions that critics say resemble a Dickens novel with robots, yet he has enough mainstream appeal to play himself in a Super Bowl commercial. Amazon was born in cyberspace, but it occupies warehouses, grocery stores, and other physical real estate equivalent to 90 Empire State Buildings, with a little left over.

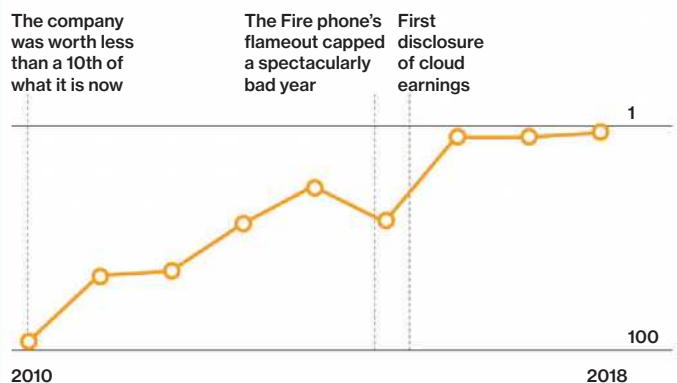
Investors have grown to love Amazon.com Inc. despite, or perhaps because of, its contradictions. Shareholders pushed its value above Microsoft Corp.'s for the first time on Valentine's Day and to an all-time high of \$774 billion on March 12. Only Apple Inc. and Google parent Alphabet Inc. remain more valuable, and unlike them, Amazon breaks all the rules of the modern corporation. It's also wielding its power against an unprecedented range of other businesses.

Bezos' brainchild has been fast-growing, influential, and anomalous for most of its 24 years, but it's entered a new phase. Its dominance can't be contained to a few areas such as books, electronics, or even computer networks. Remember my colleague Brad Stone's book *The Everything Store*? That title may have undersold Bezos' ambitions. He seems to want to

establish his place in every industry. Parcel delivery, supermarkets and packaged foods, apparel, trucking, auto parts, pharmaceuticals, real estate brokerages, makeup, concert ticketing, swimming pool supplies, and banking are just a sampling of the fields battered at various points in the past year because of Amazon's encroachment or even rumors of its interest in entering them. Amazon declined to comment for this story.

The company has grown so large and difficult to comprehend that it's worth taking stock of why and how it's left corporate America so thoroughly freaked out. Executives at the biggest U.S. companies mentioned Amazon thousands of times during investor calls last year, according to transcripts—more than President Trump and almost as often as taxes. Other companies become verbs because of their products: to Google or to

### Amazon's global market value ranking



# omless Appetite



Xerox. Amazon became a verb because of the damage it can inflict on other companies. To be Amazoned means to have your business crushed because the company got into your industry. And fear of being Amazoned has become such a defining feature of commerce, it's easy to forget the phenomenon has arisen mostly in about three years.

**In 2014 everything was going wrong.** Amazon introduced the Fire smartphone, one of the bigger flops in the history of consumer electronics. It posted its steepest quarterly loss before taxes and interest—an ignominious milestone for a company with a history of slim or no profits. Revenue growth in the 2014 holiday season was the second-worst since 2001, and executives started to sound downright pessimistic, as if the business was starting to mature or even stall. They promised the company would be more discerning about spending on projects that might not pay off for years or decades. At one point, Amazon's top finance executive even tried to blame disappointing sales on students trying to save money by renting textbooks. It was a lame excuse befitting a stodgy company struggling to adapt, not a rising technology superpower.

Investors lost patience. Over the course of 2014, Amazon's stock price fell more than 20 percent, making the company much less valuable than Walmart Inc. or China's Alibaba Group Holding Ltd., an Amazon look-alike that went public that September.

## By Shira Ovide

A year later, however, Amazon had leapfrogged to No. 6 on the list of most valuable companies. Since the end of 2014, its market value has quintupled. This was a case of preparation meeting opportunity. As the company started to clear key thresholds in several of its important businesses, it also revealed that it was sitting on a gold mine made of clouds.

In April 2015, Amazon had what technology analyst Ben Thompson called a second initial public offering. It disclosed for the first time the staggering profitability of Amazon Web Services, which started in 2006 as an experiment to rent out computing horsepower to companies that needed it. It proved to be a big idea that allowed young businesses to get off the ground more quickly and cheaply than before. Large companies, notably Netflix Inc., also started using AWS—first for side projects, then eventually to support essential operations.

Amazon had always been the clear market leader in this kind of cloud computing service, but few outside the company were prepared for just how valuable AWS had become. Inside Amazon was a division with the muscular profit margins of Starbucks Corp. and higher annual sales than the entire Chipotle Mexican Grill restaurant chain.

The AWS disclosure changed the way investors and stock watchers valued Amazon. Suddenly there was evidence the company could be consistently and nicely profitable if it chose that route. It was also among the biggest signs that Amazon's head-scratching investments could pay off in a huge way. In 2015, AWS was responsible for two-thirds of total ►

◀ operating profit. Last year it was more than 100 percent.

Two other long-gestating Amazon businesses also found their groove in 2015. The company tested the loyalty of its 10-year-old Amazon Prime program by holding its first Prime Day, a fake shopping holiday during the summer retail doldrums. The program, which delivers fast, free shipping and other benefits to members, gave Amazon not only a predictable stream of membership fees but also a psychological advantage with shoppers. Once they pay their annual dues, they have an incentive to buy as much as possible from Amazon. A year later, on the second Prime Day, total orders rose 60 percent above the first outing. Like Costco Wholesale Corp., Amazon had found a way to compel customers to pay them for the privilege of buying more stuff.

The year 2015 was also a milestone for the last of what Bezos calls his "three pillars," as Amazon topped \$100 billion in sales for the first time. About half the merchandise sold on Amazon's vast online mall comes directly from the company. But the other half is sold by millions of independent shops that open mini-storefronts on the site, a panoply Amazon calls its Marketplace business. It's the equivalent of Walmart setting up swap meets in its parking lots and mixing stuff from its own shelves alongside the pickings of strangers' card tables. The independent merchants bear most of the costs of distributing orders, and Amazon collects about 15 percent of the price of their merchandise, plus more fees if they want to be, say, included in Prime. (That's another 15 percent.) Those rents amounted to \$32 billion of revenue last year, or about half of Target Corp.'s yearly sales.

That holiday season, Amazon recorded its first quarterly operating profit of more than \$1 billion, an achievement it's notched five more times since. Management theorist Jim Collins coined the term "flywheel" to describe a virtuous cycle that makes successful companies ever more successful. For Amazon, it took 20 years for the flywheel to kick in. Bezos now loves to explain how happy customers (who happen to be locked in) give Amazon the ammo to add products and cut prices, which in turn draws more customers, more merchants, and the efficiencies to lower prices further, including by squeezing more money from partners.

**No other company in Amazon's ballpark is growing as quickly.** Its roughly \$180 billion in annual sales remains dwarfed by Walmart's \$500 billion, but sales at the big-box retailer inched up 3 percent in the year ended on Jan. 31. Amazon's revenue rose at least 25 percent in 2017, excluding sales from Whole Foods. That also means Amazon is growing faster than it did three years ago, when it was half its present size.

All the things Amazon did before 2015 seem hopelessly small compared with its more recent ambitions. In late 2014

it introduced Prime Now, an added Prime tier, in New York City, promising one- or two-hour deliveries of a small variety of consumer staples. Today, Prime Now operates in more than 30 U.S. cities and delivers a much wider range of goods, including electronics and restaurant meals. Three years ago, Amazon owned or leased about 100 million square feet of space around the world, including 109 distribution warehouses and 19 U.S. package-sorting facilities. Now the square footage tops 250 million, and it has 150 warehouses.

In the past few years, Amazon has also started leasing its own cargo planes, obtained a license to handle ocean freight, and committed billions of dollars to developing India's nascent e-commerce market. Its Hollywood studio collected an Academy Award, and its Echo smart speaker basically invented a whole new product category, becoming the envy of Apple and Google. Oh, and last summer, Amazon paid \$14 billion to buy a supermarket chain.

A few years ago, Amazon's getting into supermarkets would have seemed like evidence that its corporate strategy was scatterbrained and profit-averse. After all, the company spent a decade laboring over a grocery delivery service with little success. But the deal for Whole Foods was hailed as a coup. That's the story of Amazon in its new, terrifying phase: Outsiders look at the same sorts of facts that used to prompt derision, and tremble.

For many companies, perhaps what's scariest is that Amazon has lots of room to grow, even in retail. In the U.S., more than 90 percent of all retail sales still happen in physical stores. In some big categories, including home furnishings, personal-care products, toys, and food, the brick-and-mortar numbers are even higher. As the share of online shopping continues to increase, Amazon seems likely to benefit the most. It's responsible for roughly 44¢ of every dollar Americans spend online, and it's now mixing in retail stores.

Besides the 470-odd Whole Foods locations, since 2015 Amazon has opened more than a dozen bookshops and dozens of mall kiosks that sell Kindles and other branded gadgets. There are also 30 Amazon outposts on or near college campuses, offering snacks, phone chargers, other impulse items, and a central point to pick up packages. Some 238 cities entered bids for Amazon's second North American headquarters. And the company is experimenting with a cashier-less convenience store as well as drive-through locations where people can grab groceries they purchased online.

**Just as it was difficult to predict that Amazon would buy** upscale supermarkets, it's tricky to be certain which industries the company might torch next. On Feb. 27, it bought Ring, a maker of home security cameras, and shook the rest of that industry. On March 12, Bloomberg News reported that Amazon plans to team up with a bank to offer a credit card to U.S. small businesses, an area dominated by American Express Co. Shares of AmEx dipped about 1.4 percent.

**Insatiable Amazon**

**2nd**

largest private U.S. employer after Walmart

**254m**

square feet of real estate, equivalent to about 90 Empire State Buildings

55% of the total is new since 2014

**34%**

share of global cloud computing revenue



**44%**

of U.S. online spending



**When Amazon announces an expansion or new business, rivals and investors tend to panic**

**Biggest intraday drop in share price**

▼ -20%

**One-day loss of market value:**



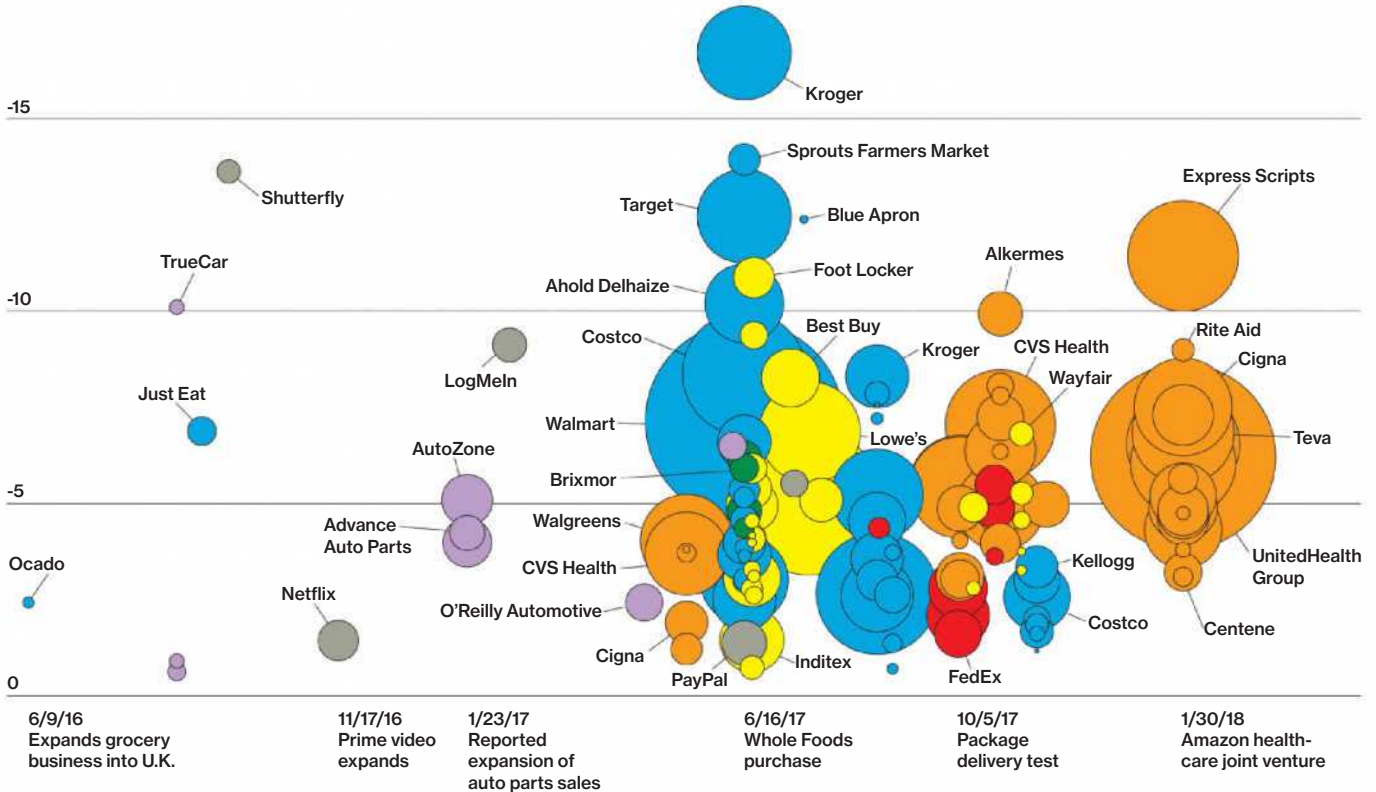
At one point, United Natural Foods lost about 26 percent of its value

United Natural Foods

Supervalu

**Industry:**

- Automotive
- Food
- Health
- Industrial distribution & package delivery
- Real estate
- Retail & apparel
- Tech



**Company milestones ▲**

There are more hints in the smoke. Amazon has shown interest in other categories of physical stores, including custom-made clothing, furniture, and home appliances. Like groceries, those are big retail areas that remain stubbornly offline. Amazon has also spent much of the last several years assembling the pieces of a delivery operation that analysts say might allow it to directly challenge FedEx Corp. and United Parcel Service Inc., companies with combined sales of about \$126 billion. And health-care companies have been wringing their hands about Amazon's potential foray into drug distribution or the possibility of its becoming a middleman for health-care benefits. Walgreens Boots Alliance Inc., the drugstore retailer, recently began negotiating a full takeover of AmerisourceBergen Corp., one of the largest distributors of prescription drugs. One major motivation is the desire to outpace a possible Amazon entry into the pharmacy business.

Amazon is far from invulnerable. All the same old red

flags are there—a puny 2.7 percent e-commerce profit in North America, massive outlays to establish delivery routes abroad—but few are paying attention. Anyone buying a share of Amazon stock today is agreeing to pay upfront for the next 180 years of profit. By one measure, it's generating far less cash than investors believe. And its biggest risk may be the fear of its power in Washington, New York, and Brussels, a possible prelude to regulatory crackdown.

Few tech companies manage to stay this kind of dominant for long, and Amazon can't sneak up on anyone anymore. It has more outside threats than ever, and there remains a very real risk that it will choke on its own ambition. For now, however, little is being done to contain its or Bezos' power or aims, and it's difficult to imagine the company lacking a seat at any table it wants. On March 7, Amazon fixed a bug that left its voice-assistant software, Alexa, cackling aloud, unprompted. Shame—that summed things up nicely. **B** —Ovide is a columnist for Bloomberg Gadfly.

# “I was 84 when I came to prison for the first time”



54

● MS. F  
89

HAS STOLEN RICE,  
STRAWBERRIES,  
COLD MEDICINE

SECOND TERM,  
SENTENCED  
TO A YEAR AND A HALF

HAS A DAUGHTER  
AND A GRANDCHILD



# FOR MANY OF JAPAN'S ELDERLY WOMEN, PRISON IS A HAVEN

PHOTOGRAPHS AND TEXT BY SHIHO FUKADA



"I was living alone on welfare. I used to live with my daughter's family and used all my savings taking care of an abusive and violent son-in-law."

Every aging society faces distinct challenges. But Japan, with the world's oldest population (27.3 percent of its citizens are 65 or older, almost twice the share in the U.S.), has been dealing with one it didn't foresee: senior crime. Complaints and arrests involving elderly people, and women in particular, are taking place at rates above those of any other demographic group. Almost 1 in 5 women in Japanese prisons is a senior. Their crimes are usually minor—9 in 10 senior women who've been convicted were found guilty of shoplifting.

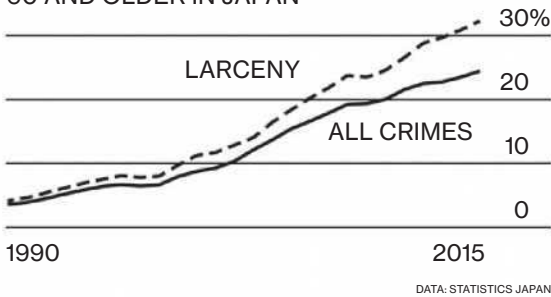
Why have so many otherwise law-abiding elderly women resorted to petty theft? Caring for Japanese seniors once fell to families and communities, but that's changing. From 1980 to 2015, the number of seniors living alone increased more than sixfold, to almost 6 million. And a 2017 survey by Tokyo's government found that more than half of seniors caught shoplifting live alone; 40 percent either don't have family or rarely speak with relatives. These people often say they have no one to turn to when they need help.

Even women with a place to go describe feeling invisible. "They may have a house. They may have a family. But that doesn't mean they have a place they feel at home," says Yumi Muranaka, head warden of Iwakuni Women's Prison, 30 miles outside Hiroshima. "They feel they are not understood. They feel they are only recognized as someone who gets the house chores done."

Elderly women are also often economically vulnerable—nearly half of those 65 or older who live alone also live in poverty relative to the broader population, for example, compared with 29 percent of men. "My husband died last year," one inmate says. "We didn't have any children, so I was all alone. I went to a supermarket to buy vegetables, and I saw a package of beef. I wanted it, but I thought it would be a financial burden. So I took it."

Neither the government nor the private sector has established an effective rehabilitation program for seniors, and the costs to keep them in prison are rising fast. Expenses associated with elder care ►

Bloomberg Businessweek

SHARE OF CRIMINAL OFFENDERS  
60 AND OLDER IN JAPAN

◀ helped push annual medical costs at correctional facilities past 6 billion yen (more than \$50 million) in 2015, an 80 percent increase from a decade before. Specialized workers have been hired to help older inmates with bathing and toileting during the day, but at night these tasks are handled by guards.

At some facilities, being a correctional officer has come to resemble being a nursing-home attendant. Satomi Kezuka, a veteran officer at Tochigi Women's Prison, about 60 miles north of Tokyo, says her duties now include dealing with incontinence. "They are ashamed and hide their underwear," she says of the inmates. "I tell them to bring it to me, and I will have it washed." More than a third of female correctional officers quit their jobs within three years.

In 2016, Japan's parliament passed a law aiming to ensure that recidivist seniors get support from the country's welfare and social-service systems. Since then, prosecutor's offices and prisons have worked closely with government agencies to get senior offenders the assistance they need. But the problems that lead these women to seek the relative comfort of jail lie beyond the system's reach. **3** This reporting was supported by the Pulitzer Center on Crisis Reporting and the International Women's Media Foundation.

SENIOR INMATES AT IWAKUNI  
WOMEN'S PRISON



● MS. A  
67

FIRST TERM, SENTENCED  
TO TWO YEARS,  
THREE MONTHS

HAS STOLEN  
CLOTHING

HAS A HUSBAND,  
TWO SONS, AND THREE  
GRANDCHILDREN

"I shoplifted more than 20 times, all clothes, not expensive ones, mostly on sale on the street. It's not that I was in need of money. The first time I shoplifted, I didn't get caught. I learned that I could obtain what I wanted without paying for it, which I found fun, amusing, exciting.

"My husband has been supportive. He writes me regularly. My two sons are angry—my three grandchildren don't know I'm here. They think I'm hospitalized."



● MS. T  
80

FOURTH TERM,  
SENTENCED TO TWO  
AND A HALF YEARS

HAS STOLEN COD ROE,  
SEEDS, A FRYING PAN

HAS A HUSBAND, A SON,  
AND A DAUGHTER

"When I was young, I didn't think about stealing. All I thought about was working hard. I worked at a rubber factory for 20 years and then as a care worker at a hospital. Money was always tight, but we still got to send our son to college.

"My husband had a stroke six years ago and has been bedridden ever since. He also has dementia and suffers from delusions and paranoia. It was a lot to take care of him physically and emotionally because of my old age. But I couldn't talk about my stress with anyone because I was ashamed.

"I was imprisoned for the first time when I was 70. When I shoplifted, I had money in my wallet. Then I thought about my life. I didn't want to go home, and I had nowhere else to go. Asking for help in prison was the only way.

"My life is much easier in prison. I can be myself and breathe, however temporarily. My son tells me I'm ill and I should be hospitalized in a mental institution and take it easy. But I don't think I'm ill. I think my anxiety drove me to steal."



● MS. N  
80

HAS STOLEN  
A PAPERBACK,  
CROQUETTES,  
A HAND FAN

THIRD TERM, SENTENCED  
TO THREE YEARS,  
TWO MONTHS

HAS A HUSBAND,  
TWO SONS, AND SIX  
GRANDCHILDREN

"I was alone every day and feeling very lonely. My husband gave me a lot of money, and people always told me how lucky I was, but money wasn't what I wanted. It didn't make me happy at all.

"The first time I shoplifted was about 13 years ago. I wandered into a bookstore in town and stole a paperback novel. I was caught, taken to a police station, and questioned by the sweetest police officer. He was so kind. He listened to everything I wanted to say. I felt I was being heard for the first time in my life. In the end, he gently

March 19, 2018



tapped on my shoulder and said, 'I understand you were lonely, but don't do this again.'

"I can't tell you how much I enjoy working in the prison factory. The other day, when I was complimented on how efficient and meticulous I was, I grasped the joy of working. I regret that I never worked. My life would have been different.

"I enjoy my life in prison more. There are always people around, and I don't feel lonely here. When I got out the second time, I promised that I wouldn't go back. But when I was out, I couldn't help feeling nostalgic."



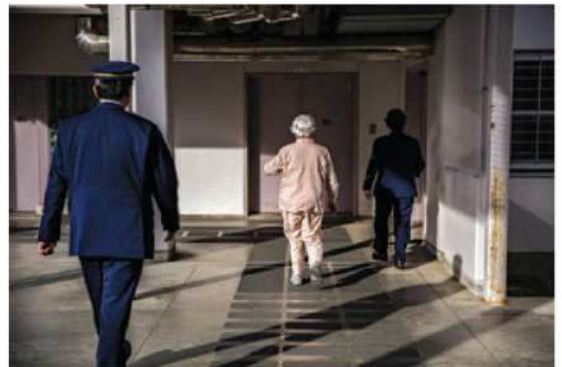
● MS. K  
74

THIRD TERM, SENTENCE  
UNDISCLOSED

HAS STOLEN  
COCA-COLA,  
ORANGE JUICE

HAS A SON AND  
A DAUGHTER

"I was living on welfare. It was hard. When I'm released, I will manage to live with 1,000 yen [\$9] a day. I don't have anything to look forward to outside."



● MS. O  
78

THIRD TERM,  
SENTENCED TO ONE  
YEAR, FIVE MONTHS

HAS STOLEN  
ENERGY  
DRINKS,  
COFFEE, TEA,  
A RICE BALL,  
A MANGO

HAS A DAUGHTER  
AND A GRANDSON

"Prison is an oasis for me—a place for relaxation and comfort. I don't have freedom here, but I have nothing to worry about, either. There are many people to talk to. They provide us with nutritious meals three times a day.

"My daughter visits once a month. She says 'I don't feel sorry for you. You're pathetic.' I think she's right."

**Pauper. Tycoon. Godman** The yoga superstar **Baba Ramdev** has a net worth of zero. He also controls a multibillion-dollar corporation

**By Ben Crair**



KEEP IT DRY

**PATANJALY**

**DANT KANTI**

- DENTAL CREAM
- MEDICATED ORAL GEL





**Twenty-three years ago, when he was a poor young yoga**

instructor living at the foot of the Himalayas, Baba Ramdev pledged to spend the rest of his life as a *sanyasi*—a Hindu ascetic. He forswore possessions and renounced the material world.

But today he can be found in the most material of places. Turn on an Indian TV, and there's Ramdev, a supple yoga megastar in saffron robes, demonstrating poses on one of the two stations he oversees. Flip the channel, and there's Ramdev in commercials selling shampoo and dish soap. Walk any city on the subcontinent, and there's his face in stores selling the wares of Patanjali Ayurved Ltd., the multibillion-dollar corporation he controls.

Ramdev has said his goal is to sell an ayurvedic item, based on India's ancient medical traditions, for every household need: toothpaste made from cloves, neem, and turmeric; hand soap made from almonds, saffron, and tea tree oil; floor cleaner made from the "natural disinfectant" cow urine. Since 2012, Patanjali's revenue has climbed twenty-fold, from \$69 million to \$1.6 billion. It's the fastest-growing company in Indian consumer goods, and Ramdev predicts he will overtake the subsidiaries of multinational giants such as Nestlé SA and Unilever NV as soon as next year. "The 'gate' in Colgate will shut," he once gloated. "Pantene will wet its pants, the lever of Unilever will break down, and the little Nestlé bird will fly away."

It might seem like an impossible arrangement—observing an oath of poverty while also being one of India's top entrepreneurs. But Ramdev is a master of contortion. Patanjali is an omnipresent brand in India, and though everyone refers to it as Ramdev's company, he's not technically its owner or chief executive officer. It would be scandalous for a *sanyasi* to profit from a corporation, and Ramdev neither owns shares nor takes a salary. He says his net worth is zero. The company calls him merely its "brand ambassador," a title that belies his power.

"If you had to choose the top five living extraordinary Indians, people who have changed the landscape," says Chiki Sarkar, publisher of New Delhi's Juggernaut Books, "Ramdev would make the list." Other modern yogis have large, loyal, and lucrative followings, but Ramdev is the only one to build a sprawling for-profit enterprise in his image. On a three-axis chart of holiness, capitalism, and lumbar flexibility, he occupies a point beyond anyone else on Earth.

Despite his success, Ramdev's life has gone strangely unexamined. No one even knows the year he was born. (He's probably in his early 50s.) "He's so visible, and yet so little understood," said Priyanka Pathak-Narain, a Mumbai journalist whom Juggernaut hired in 2016 to write his biography. She sees him as "a perfect lens through which you can examine India today," sitting as he does at "the nexus of business, religion, and politics." Patanjali's ayurvedic brand has soared in the climate of Hindu nationalism that lifted India's ruling party, the right-wing Bharatiya Janata Party, to victory in 2014. Ads for the cow-urine floor cleaner,



PATANJALI

DANT KAN

DENTAL CREAM

for example, urge consumers to “save the country from the economic exploitation of foreign companies” and “join the movement to save the cow, our holy mother.”

Ramdev says his worldview is “scientific, secular, and universal”—but he also claims yoga can “cure” homosexuality and has openly fantasized about beheading people who refuse to chant nationalist slogans. He courts attention with publicity stunts, such as televised wrestling matches, while also fighting scrutiny. When he heard last summer that Pathak-Narain’s book, *Godman to Tycoon*, contained unflattering details, he sued and had its distribution blocked in court. (I spoke with the author once, by phone, before a judge issued a gag order.)

Ramdev objected, in particular, to what Pathak-Narain calls three “mysteries” involving the deaths or disappearances of close associates over the course of his career. Ramdev was never named as a suspect in any of the investigations, and he didn’t want to comment when I asked him about the book. “Such people have only one motivation,” he said, “and that is publicity through maligning others.” He offered a much simpler story of his success—a myth more than a biography, which is what you might expect for a person who “is worshiped as a Godman,” as his court filings against Pathak-Narain claim. “This earth, sun, and all of nature are doing their jobs without any expectation,” Ramdev said, burping midway through the sentence. “So I am doing my job.”

**When I got to Delhi in the fall, I dropped my bags and set out for** a Patanjali shop I’d seen from the airport taxi. I was intercepted, however, by a young man named Kumar Rishi, who had a tattoo of Bob Marley on one biceps and Jack Sparrow on the other. “Baba Ramdev is my hero,” he said when I told him where I was going. He offered to take me to another, better Patanjali shop, and though I knew not to trust touts, I went along and purchased a tube of toothpaste for 40 rupees (60¢). Several hours later (after Rishi took me to a temple, a restaurant, a war memorial, the prime minister’s residence, and, finally, a travel agency, where a likely accomplice tried to bully me into a trip to Kashmir), I was back at my hotel to give it a try.

The label of Patanjali’s signature toothpaste, Dant Kanti, lists 13 different herbs. I squeezed some onto my toothbrush and was surprised that it was brown. It was the color of dirt and decay, the very things I wanted to keep out of my mouth. The flavor, however, was pleasing and unlike any toothpaste I’d tasted in the West: spicy with clove, bright with spearmint, and a little bit bitter with neem. I soon got used to the color and found myself happily spitting brown foam into my hotel sink every morning.

As an American reporter, I expected it would be difficult to arrange an interview with Ramdev, given the controversy over the book and the frequent speeches he gives railing against the West. But after just a few emails, his press officer invited me north, to Haridwar, a holy city along the Ganges where Patanjali has its corporate headquarters, as well as an ayurvedic hospital, a yoga school, factories, and a research lab.

Hindus believe Lord Vishnu once left a footprint on a wall



Some of Patanjali’s hundreds of ayurvedic products



in Haridwar, and thousands of pilgrims assemble daily by the water for festivities and prayer. On the riverbanks, I saw dozens of gaunt men in saffron loincloths, with wild hair and windsock beards, seeking alms: sanyasis, like Ramdev. They are figures of great respect and moral authority in Hindu culture, and while many Indians agree sanyasis can't accumulate wealth or property, there's no official set of rules governing their conduct.

Ramdev's home is on the outskirts of the city—in a walled garden he shares with bees, butterflies, and armed security guards. I entered the estate through two huge gates with golden lion-head door knockers, and drove down a brick path toward a complex of tidy white buildings. Ramdev received me in a comfortable parlor, with an ample porch and several couches and armchairs. "Nowhere in our religious books and scriptures is it written that a sanyasi should be a mendicant," he said, referring to the kind of beggars I'd seen along the Ganges.

Ramdev clopped around on strapless wooden sandals called *khadau*, which must be gripped by knobs between the toes. He wore a tangerine-colored cloth around his waist and another around his shoulders. His black beard mushroomed from his face, and his ponytail was so tight it tugged the corners of his eyes. Our interview began in English, but he soon switched to Hindi and had his spokesman translate. "Yogis in Indian culture have always been guiding society in the right direction and devoting their life for the welfare of society," he said. "And that's why, being a yogi, I also run an enterprise. Because that is my solemn duty to this country."

Ramdev said he runs Patanjali not as a CEO runs a corporation, but rather as a guru runs an ashram. "This is not a corporate house," he said. "Patanjali is basically a spiritual organization." It's a workplace like few others. A Hindu guru is often a figure of absolute authority to his followers, and Patanjali employees treat Ramdev as such. He forbids them to eat meat or drink alcohol. He tells them their labor is a form of *sewa*, or spiritual service, and expects some to accept lower salaries as a result. When he arrived at our interview, his spokesman rushed to touch his feet—a sign of respect for a godman.

This loyalty allows Ramdev to control Patanjali despite his lack of official corporate power. The person most often identified as the company's CEO—even though his personal website gives his title as "managing director"—is Acharya Balkrishna, a longtime associate and Ramdev disciple. On paper, Balkrishna owns 98.6 percent of the company. According to *Forbes*, he's the 19th-richest man in India, with a net worth of \$6.1 billion.

**Ramdev met Balkrishna around 1990, when they were both** students at a traditional religious school in the north of India. Ramdev became a teacher, but, according to an authorized biography, he left his job in remorse after an incident in which he savagely beat a student.

He reunited with his old schoolmate in Haridwar in the early part of the decade. Balkrishna had become close to a yoga teacher called Karamveer Maharaj, who accepted Ramdev as a protégé on two conditions: that he remain celibate and never accept money if he began to give lessons

himself. The three men journeyed to the Himalayas, where they meditated in caves. In 1995 they took over the operation of an ashram in Haridwar, and Ramdev made his renunciation. Balkrishna ran the ayurvedic pharmacy, while Ramdev and Karamveer continued to teach yoga.

At the time, yoga was becoming trendy in the West, but in India it was still considered an elite activity. Ramdev and Karamveer offered free workshops that attracted the lower and middle classes. Ramdev learned to wow audiences by standing on his head or deploying his mesmerizing "belly roll." He'd suck in his breath so his abdominals contracted into a lump of muscle around his navel and then ripple the lump from side to side, as if it were trying to escape from under his skin.

His instruction was bracingly straightforward. He stripped yoga of arcane spirituality: no need to read the sutras or meditate for hours. He simplified the poses so almost anyone could do them safely, and he often said individual poses could be used to treat specific maladies. His yoga was both a religious pursuit and a tool to master one's health—a powerful message in a country with poor public-health services and crises of obesity, diabetes, and heart disease.

In 2002, when a religious TV station announced a new yoga program, Ramdev auditioned to be the host. The producers passed, but Ramdev was determined to get on the air. He bought 20 minutes on a rival channel, drew huge ratings (and enough donations to recoup his costs), and was hired to lead a morning show. His timing was fortuitous: From 2001 to 2017, the number of Indian households with TVs doubled. Many millions of lower- and middle-class Indians, who'd never had the time or money to practice yoga, started to follow Ramdev in their homes. Credited with launching a yoga revival in India, he's sometimes compared by Westerners to Richard Simmons or Jane Fonda. But his impact is more substantive. Stuart Ray Sarbacker, a professor of comparative religion at Oregon State University who's studied Ramdev's career, calls him "the most prominent face of yoga in the entire nation."

Ramdev's yoga was also political—a way to stoke Indian patriotism. "Joining every person with the yoga tradition also has hidden national benefits," he once said. He saw himself as the successor to anticolonial leaders such as Mahatma Gandhi, who'd argued that economic self-sufficiency was a vital precursor to independence. "Freedom does not only mean independence from the Britishers," Ramdev said, "but it also means freedom from an unhealthy body."

In speeches and on TV, the yogi blamed India's unhealthy bodies on foreign products, which he called "poison." The nation suffered from "self-confusion," and he promised to restore it to strength through the "traditional sciences practiced by our great hermits." An India where everyone practiced his yoga would be an India without disease or sin. He told his followers that yoga could treat HIV and cancer. He extolled an India redeemed from historical humiliations and returned to power by its own traditions. "The biggest goal ►

◀ is to bring prestige to India and Indian identity within the country and the world," Ramdev said in 2014. "And that journey begins from yoga, from ayurveda." From simple beginnings, the sales pitch would become extraordinarily lucrative.

**In the early days of the ashram, Balkrishna and Ramdev biked** through fields and forests, collecting ingredients for the pharmacy. Balkrishna would send ayurvedic doctors to Ramdev's yoga camps, where they'd offer free checkups but charge for medicine. As Ramdev's fame grew, so did Balkrishna's revenue. By 2005, Balkrishna was raking in so much money—and handling it so loosely—that Indian authorities raided the pharmacy as part of a tax-evasion investigation. But a local official, Jitender Rana, told Pathak-Narain his superiors ordered him to desist. "Too many people in power were protecting Ramdev," the book quotes him as saying. "I came to my senses and left." (Patanjali declined to comment, and attempts to reach Rana were unsuccessful. The Indian magazine *Tehelka* offered a similar account to Pathak-Narain's in 2012.)

Ramdev's behavior also started to trouble Karamveer, his fellow yoga instructor. "Idealism is easy when you have nothing," Karamveer told Pathak-Narain. "It's what you do when you have fame, money, or power that matters." He left the ashram in 2005. Ramdev had promised he would teach yoga for free, but he began charging people to sit closer to the stage, according to Bhakti Mehta, a TV executive. She traveled with Ramdev to Britain in 2006, where, she said, he required an £11,000 (then \$20,000) donation for a home visit and stood on a cloth that could be rolled up to easily collect the money people threw at his feet. "We saw how power-hungry he really was," she told Pathak-Narain. (A Patanjali spokesman declined to discuss this or other aspects of the book.)

Around this time, an early business partner, an ayurvedic doctor who'd let Ramdev and Balkrishna run their pharmacy under his license, was murdered. This was Pathak-Narain's first "mystery," and while the case remains unsolved, there's no indication Ramdev or Balkrishna were involved.

The biographer's second mystery occurred in 2007. The ashram's figurehead at the time was an elderly guru named Shankar Dev, and on a day that Ramdev was out of the country, he disappeared. Dev left only a note that said, "I have taken some loan from you for this trust but cannot repay it. Please forgive me. I am leaving." Dev was never seen again. (After seven years, Indian authorities ruled out foul play.)

Discontent was curdling among the pharmacy's 400 workers. In spring 2005 a quarter of the staff went on strike to demand pay in line with the minimum wage. Ramdev and Balkrishna laid off the strikers, who then alleged that the ashram's medicines contained unlisted ingredients, including crushed human skulls. A lab test found human DNA.

Ramdev turned his yoga philosophy into a defense. His name was almost synonymous with yoga in India, and he said an attack on him was an attack on tradition. He accused "powerful interests" of tampering with the samples: "It is a conspiracy to stop my experiment to promote a science that is India's

glory." Politicians rushed to his defense, and the strikers were forced to clarify that their campaign was not against ayurveda or yoga. A retesting of the samples gave Ramdev a clean slate.

Victory seemed to stoke his ambition. He and Balkrishna saw a future for the pharmacy well beyond medicine. He imagined a line of ordinary household products that could help a person "connect with the soul" and "move toward divinity." The two had always managed the ashram and their businesses through trusts, but in 2006, Ramdev registered Patanjali as a corporation.

**As the company began to develop commercial products,** Ramdev's fervor took a brief, meteoric, and disastrous detour into politics. The ruling party, the Indian National Congress, was beset by scandal, and voters were looking for change. Ramdev, with a huge public profile, was the kind of outsider who could shake up the system. In 2010 he launched his own party and said he would field candidates in every district nationwide in the next election. "We must have a total revolution!" he declared.

Ramdev accused foreign companies and wealthy individuals of robbing India of its wealth, and he demanded extreme solutions, such as the death penalty for corruption. His closest political ally was an activist named Rajiv Dixit. As more Indian voters warmed to their message, however, Dixit's star threatened to eclipse Ramdev's own. On Nov. 30, 2010, at age 43, Dixit dropped dead from a heart attack. (This is the third mystery in Pathak-Narain's book.) Dixit's death was never investigated by police, but rumors of wrongdoing quickly attached to Ramdev. He eventually denounced them, and at the time, they didn't slow his rise.

On June 4, 2011, channeling Gandhi, Ramdev began a hunger strike in Delhi to protest corruption. Forty thousand people showed up, spooking the government, which ordered police to raid the gathering. In the melee, one person died, and Ramdev tried to escape by disguising himself in women's clothes.

Images of Ramdev in his getup—his beard as bushy as ever—spread widely, to much snickering. Many voters found it hard to imagine him as the nation's leader, and his movement fizzled. He returned his attention to Patanjali, whose line was expanding beyond medicine and beauty into juices, grains, and spices. He hired a food-processing veteran named S.K. Patra to be the president of Patanjali's comestible operations and the CEO of Patanjali Ayurved. "Baba Ramdev simply embraced me and asked when I can join," Patra says of their first meeting. "He said that God has sent me to Patanjali to serve humanity."

Patra began emulating the multinational corporations that Ramdev so despised. He hired foreign consultants to unknot the dozens of enterprises and organizations that fell under the Patanjali umbrella. He standardized plant procedures, created committees to oversee fundamental tasks such as quality control, and overhauled Patanjali's distribution network.

From 2011 to 2014 the company's revenue quadrupled, to \$188 million, and the number of products grew from 50 to 500, including ghee and honey. Ramdev insisted the company

pump profits back into the business to lower prices and create new products. "Baba was very sharp, with robust common sense and business acumen," Patra says. (It's grudging praise. Patra, who left the company in 2014, also says Ramdev paid him only half what he was owed.) When Nestlé had to recall its popular Maggi Instant Noodles in 2015 over lead concerns, for example, Ramdev quickly unveiled Patanjali Instant Noodles.

It was a shrewd move for a businessman, but questionable for a yogi claiming to look after people's health. Ramdev said his noodles were healthy, but India's Food Safety and Drugs Administration found they had an ash content triple the legal limit. Customers didn't much care. "Whatever he produces, nobody thought that it is shit," Patra says. "They thought it is a god-given product."

"We have had no quality cases or quality problems," Ramdev told me. But Patanjali products have been dogged by such concerns. In April, the Indian Armed Forces stopped selling a popular Patanjali juice to soldiers after it failed lab tests. The next month, the *Hindustan Times* reported that a Patanjali health product, *shivlingi* seeds, had also failed tests. In June, Nepal forced the recall of six products over microbial concerns.

In our conversation, Ramdev dismissed these reports as the work of "Western interests." He also waved off negative stories about working conditions at Patanjali. "We have never broken any law, and we have never done any wrong to anyone, and violence is out of the question," he said. It was a "conspiracy" to defame him, he said, when police issued a warrant in 2013 for the arrest of his brother Ram Bharat, whom the *Economic Times* has called Patanjali's "informal CEO," over the alleged kidnapping and imprisonment of a watchman suspected of theft. The case against Bharat was dropped after witnesses recanted. But he ran into trouble with the law again in May 2015, when Patanjali security forces brawled with truck drivers at the company's food-processing complex, leaving one trucker dead. After video emerged of Bharat appearing to encourage the guards, he was arrested and held in jail for 14 days, though he was never charged.

The controversies haven't harmed sales. Revenue surpassed \$1 billion for the first time in the company's 2017 fiscal year. Other gurus moved to copy Patanjali's success and start their

own product lines; the *New York Times* named the trend India's "Baba cool" movement and called Ramdev its "king."

The Associated Chambers of Commerce and Industry, an Indian trade organization, has called Patanjali "the most disruptive force in the fast-moving consumer goods market." In 2016, Credit Suisse Group downgraded its rating for Colgate-Palmolive (India) Ltd. based solely on the success of Patanjali's Dant Kanti. A few months later, Colgate started selling its own herbal toothpaste. Hindustan-Unilever Ltd. hired local doctors the same year to revamp its ayurvedic brand, Ayush, with products such as turmeric anti-pimple wash.

**Ramdev has floated plans for business lines in clothing, private security, animal feed, solar power, and restaurants.** He also wants to export Patanjali products to the U.S., U.K., and around the globe. While he no longer speaks of directly entering politics, he enjoys greater influence in India than ever.

After his hunger strike destroyed his relationship with the incumbent government, he found an ally in the ascendant BJP. In 2014 he campaigned alongside the party's conservative politicians. (At one rally, he was caught on camera rebuking a candidate who'd asked him about fundraising. "Are you a fool for asking and talking about money when cameras are on?" he asked, seething.) After the BJP won, and Narendra Modi became prime minister, Ramdev claimed to have "prepared the ground for the big political changes that occurred."

Modi realized yoga and ayurveda could be valuable in stoking religious and nationalist sentiment. He elevated the government department promoting yoga and ayurveda (and which regulates Patanjali products) to a cabinet ministry; lobbied the United Nations to start an International Yoga Day; and exempted yoga-focused charitable trusts from some taxes.

Ramdev has called Modi a "close friend" but maintains that Patanjali hasn't benefited from the friendship. "We do not take or want any favors from the government," he told me. But a 2017 report by Reuters found that since Modi came to power, Patanjali has received more than \$46 million in discounts on land deals in states governed by the BJP. The company has acquired almost 2,000 acres, which it says it will use to build new factories and cultivate herbs. The state of Haryana also offered Ramdev "all perks of a cabinet minister, including cars, bungalows, staff and security from the state," a government spokesperson told the local *Telegraph* newspaper, but Ramdev said that, as a sanyasi, he had to decline.

Last year, Modi presided over the opening of the Patanjali Research Institute in Haridwar. The jewel of its corporate empire, the facility is described as a place for ayurvedic medicines to be researched and tested with the same rigor as pharmaceuticals in the West. "Swami Ramdev's herbs help you overcome all problems," Modi told the crowd, as Ramdev smiled beside him in his saffron. The prime minister then directly addressed Ramdev: "I have greater faith in the power of your blessings, and those of the people, than I have in myself." The material world went unmentioned. The sanyasi had reached a higher plane. **E**



**Ramdev's 2011 hunger strike marked the peak of his political viability**

AAA

ACCELERATED RETURN NOTE (ARN)

BALLOON INTEREST

BANK BILL SWAP BID RATE - BBSY

BLUE LIST

BOND

BOOK-ENTRY SECURITIES

BOOTSTRAPPING

CALL PREMIUM

COMMERCIAL BLANKET BOND

DEBENTURE

DEBT

ELECTION PERIOD

EMBEDDED OPTION

EURO DEPOSIT

EUROBOND

EUROYEN BOND

EVENT-LINKED BOND

EXCHANGEABLE DEBT

EXTENDABLE BOND

FACE VALUE

FED MODEL

FEDERAL FUNDS

FINE PAPER

FIXED DEBENTURE

FLAT BOND

FLOATING INTEREST RATE

FULLY TAXABLE EQUIVALENT YIELD

FUNDED DEBT

G7 BOND

GEN-SAKI

GENERAL OBLIGATION BOND - GO

GILT-EDGED BOND

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Pizzas at Di Gesù, a popular bakery in Altamura, Puglia



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## The Fantastical Pizzas of Southern Italy

A food critic joins chef  
Francesco Mazzei on a  
pie-in-the-sky adventure  
through his home region

*By Richard Vines*  
*Photographs by Carol Sachs*

March 19, 2018

Edited by  
Chris Rovzar

Businessweek.com

**W**hen does dough, tomato sauce, and mozzarella stop being just ingredients and become pizza?

It's a philosophical question that has divided chefs and diners for decades. For some, only pies in the Neapolitan and Roman styles are acceptable—Sicilian, at a stretch. Others extend the goal posts as far as Chicago deep dish.

But pizzas have been eaten in Southern Italy for hundreds of years, and the rainbow of variations that can be found there—if you know where to look—rivals the rest of the world's best efforts. Its proximity to North Africa means that flatbreads have been popular for centuries. Forget calzones—I'm talking about pizzas and pittas created specifically for breakfast, or marvels the size of entire tables, or baked spirals of crust, begging to be torn into satisfying, savory chunks.

It's not easy to discover these secret pizzas in the towns and villages; the economically troubled region doesn't yet enjoy the number of tourists you find elsewhere in Italy. If you don't

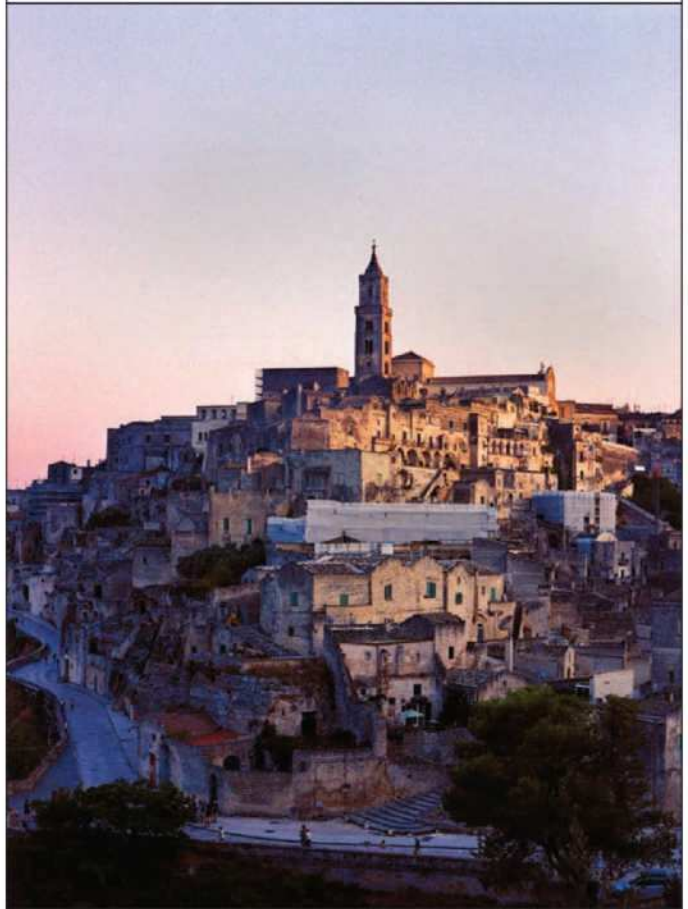
speak Italian, you're likely to struggle. When I go, I bring a guide: chef Francesco Mazzei, arguably the world's leading ambassador for the cuisine of his native Calabria. His London restaurants include Fiume, Radici, and Sartoria, and he's the author of *Mezzogiorno* (Preface Publishing, \$35),

a celebration of southern Italian cooking. Even better, he's suggested bringing along Pierre Koffmann, the three-Michelin-starred French chef whose protégés include Marco Pierre White and Gordon Ramsay.

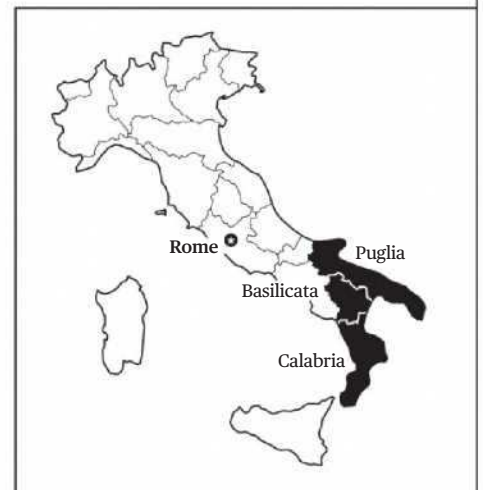
We pile into Mazzei's Maserati for a road trip that starts in Calabria, winds through Basilicata, and ends in Puglia—the three southernmost provinces on Italy's mainland. Our quest? To find the wondrous pizzas of his home culture, some of which have never been seen outside the region.

We cover 250 miles over four days, sampling perhaps 20 versions. I'll ultimately gain 5 pounds. Koffmann will tell me later that it took him months to get the weight off. "The pizzas were so good, I kept on eating," he says. "We think we know all about pizza, but I'm still surprised by the variety."

The city of Matera in Basilicata



Mazzei



## Calabria

*Our journey starts in the rugged and parched province that's the toe of the Italian boot. It's a wild region of mountains and remote villages that bear little resemblance to the sophisticated cities and resorts most visitors know. Mazzei grew up here and learned to make gelato in his uncle's shop. His family owns a tiny cottage on a hillside, with views across sun-scorched land to the Mediterranean. "Mezzogiorno' means noon, half-day, or lunchtime," Mazzei says. "But for me, it just means home."*

*When we visit, a forest fire rages so fiercely, the billowing smoke brings traffic to a standstill on the highway. We join other travelers, standing outside their cars watching the flames in awe.*

### Mpigliati con le sarde

Deep in the countryside, at the Petite Etoile hotel in the town of Spezzano Piccolo, Gemma Constantino cooks us a salty, beautiful pie that looks like a bundle of bread roses. It consists of strips of dough coated with a mash of *sardella*, a rich fish sauce with red peppers, and pilchards (small, herringlike fish) cured with salt and paprika. The strips are rolled and stuck

together before baking; to eat, you just tear off one of the rolls, which are great with an *aperitivo*. There weren't many other patrons, but the staff laid out a feast for Mazzei, who's a celebrity in the region. This pizza is a good example of the *cucina povera* of Southern Italy, where humble local ingredients are used to create deeply flavored dishes. The sweetness of the bread and the spiky fish flavors make this a

favorite of Mazzei's. "You'll find a lot of the best cooks we meet are women," he says.

### Cullura

The team at Petite Etoile also serves us a pizza dough made with pig fat, layered with *cime di rapa* (broccoli raab), rolled a bit like a strudel, then formed into a circle. Cullura is generally consumed cold and works as an everyday snack for farmers to take up to the mountains. "This is like a meal in itself," Mazzei says. "We Italians usually don't eat breakfast, so around 10:30 a.m., you are just ready for something to keep you going until lunchtime."

### Pitta

Pitta is a Calabrian flatbread that's crunchy on the outside and soft on the inside, and it includes toppings such as tomato, peppers, and herbs. We ►



An mpigliati con le sarde pie at the Petite Etoile hotel consists of dough coated with a mash of *sardella*, a rich fish sauce with red peppers, and tiny fish cured with salt and paprika

sample slices from one monster loaf served at a bakery in Castrolibero. When we arrive in the small town, the mayor and some residents turn out to greet us. About 25 people join us as we walk the narrow streets before finding ourselves in a room for a reception with pitta, cakes, and wine.

Cullura uses dough made with pig fat, which is stuffed with broccoli raab; it's generally served cold



### Pizza al taglio

This square pizza has a variety of toppings. It can be baked for a whole family to share or bought by the slice. The one we devour is from the Pan Caffè in Fontanesi-Santa Lucia, near Castrolibero, where large groups gather to share giant pies. "This is street food at its best," Mazzei enthuses. "You go out with your friends and eat all you can eat." Although remote, the room is filled with happy diners dividing their time between the food and the soccer match on a big screen. Mazzei steps into the open kitchen at one end of the room and rustles up a spaghetti dish with *garum*, an anchovy paste, and basil. Several diners abandon the match to film and photograph Mazzei on their phones. The wine flows; it's party time.

### Falagone

This half-moon-shaped treat, like a small calzone, is usually eaten cold, but

we sample some fresh from the oven at a new roadside bakery, Il Forno dei Sapori di Martorano Vincenzo, outside the hillside town of Cerchiara di Calabria. It's unusual to find such a spotless and well-equipped bakery beside a road out here, where your best hope in another country might be for a gas station with a convenience store. The owner greets us and describes his food with pride, though (as keeps happening) the actual chef is a woman. Falagones are popular in Calabria, where they're allowed to rest so the juices seep into the bread. Parents pack them for a seaside trip or for children going to school. Ours are filled with Swiss chard, onion, and sweet paprika. Another one comes with roasted peppers, potato, and onion.

### Pitta rustica

Also at Il Forno dei Sapori di Martorano Vincenzo, we discover prosciutto, caciocavallo cheese, and salumi sandwiched between two discs of pitta-style bread. It's popular for parties or as an afternoon snack. "This is a simple pizza made with whatever you find in the fridge," Mazzei says. "Every mum makes this for the kids." I retreat to a corner to drink some crisp, light wine made locally from the ancient Greco bianco grape. The Calabrians are so hospitable, it's an all-you-can-eat pizza fest, over and over.



A pitta rustica with prosciutto, caciocavallo cheese, and salumi between pitta-style bread

### Pasta da forno

Forget the "pasta" name; this is a pizza, and it's popular for breakfast. There's no tomato sauce atop the dough, no mozzarella, no onion. It's just crushed tomato with salt, oregano, and olive oil. This one is served to us at the smart Panificio Mauro, also in Cerchiara di Calabria. (In Italian, *panificio* means "bakery.") Traditionally, pasta da forno comes in a round black tray and is served cold. The absence of sauce helps keep the base crispy, making this a perfect snack to carry to school or to work.



Pasta da forno, a popular breakfast food at Panificio Mauro in Calabria, has no tomato sauce, no mozzarella, and no onion—just crushed tomato with salt, oregano, and olive oil



Strazzata, a summer-style pizza with peppers, tomato, and extra virgin olive oil, from Ristorante Pizzeria il Fosso, a small shack in a forest near the Basilicata village of Noepoli



## Puglia

*The heel of Italy is developing a reputation for its wines, and the food isn't far behind. Again, we're struck by the beautiful countryside and the ramshackle historic towns, like Altamura, with its narrow alleyways and medieval city wall. And then there is Bari, a buzzy port city second only to Naples in the south of Italy.*

### Focaccia altamura

We enter Di Gesù, a popular bakery in Altamura, to try this pizza with dough made only with semolina flour and baked in the city's oldest oven. Di Gesù is a thriving business now but traces its history to a small shop that opened in 1838. You can sense the pride put into the bread as it's pulled from the oven. It's

thick, like a deep-dish pie, with tomato, green olives, and extra virgin olive oil. "People who haven't spent time in the south of Italy don't know how good the food is," Mazzei says. "We have the best fish, the best meat, the best fruit. You don't need fancy cooking or luxuries like foie gras. You need to keep it simple and cook from the heart."

## Basilicata

*Basilicata, the instep of Italy's boot, straddles two coastlines. It's absolutely charming, both for its splendid beaches and ancient towns, where Greek, Spanish, French, and Arabian influences from the times of traders and invaders still remain.*

### Panzerotto di carne and panzerotto fritto

These two pie pockets look like calzones but smaller. The first is filled with minced pork and spices, then baked and seasoned with thyme, rosemary, and oregano while the melted fat is still hot. It's popular as a street food and also comes in a fried version, panzerotto fritto. The one we wolf down contains rich strands of mozzarella, sweet tomato, and basil. Luale, a bakery on the edge of a shopping mall in Policoro, serves both. It looks like a fast-food joint, but the store is clean and efficient, and the food is rich and layered. It's the kind of modern store you might easily pass by as you hunt for charm.

### Strazzata

We drive so deep into a forest, we feel certain we won't find our way out, let alone our way to the small restaurant we're seeking. But we do: Ristorante Pizzeria il Fosso is housed in what looks almost like a shack, yet it's the most charming of the 20-plus spots we visit. Maria Ferrara is in charge of the kitchen, where children play inside and dogs run amok. Mazzei tucks into the strazzata, a fresh, crispy summer pizza with peppers, tomato, and extra virgin olive oil, then delivers his verdict. "I love this place," he says. **E**

The thick focaccia altamura is studded with tomato and green olives





Stracciatella with raspberry

## Icy Hot

South America's fastest-growing ice-cream brand was born in Serbia

By Javiera Quiroga

Moritz Fried has gone many extra miles for his ice cream. In 2013, five months after he opened Moritz Eis, the first premium, all-natural ice-cream shop in Belgrade, he stored six sample flavors in an insulated box filled with dry ice and carried it on his lap for a 16-hour train ride to Prague.

He was taking the samples to Douglas Tompkins, the conservationist and co-founder of North Face Inc. and Esprit. They'd been friends since 2006, when Fried met him in Transylvania with a group of organic agriculturists. Tompkins, a certified ice-cream fanatic, wanted to taste Fried's creations.

The journey paid off. Tompkins loved the flavors, which ranged from vanilla, dark chocolate, and raspberry to orange-ginger, lemon-mint, and blackberry-lavender blends. The two agreed on a venture in which Fried would bring the business to Chile, where Tompkins then lived. (He died in a 2015 kayaking accident.) It would be the first stage of an expansion into the Americas.

Fried had founded the scoop shop after quitting his job at New Europe Capital Ltd., a private equity fund in London and Bucharest. "I am

an ice-cream lover," says the Austrian native. "I missed quality products and felt there was an excellent opportunity to create a good ice-cream store, since there wasn't one available" in Serbia. His stores have a minimalist architecture—as if Richard Neutra had built shrines to sorbet—while conjuring a 1950s-era soda shop, with employees in paper hats and all-white uniforms.

The real magic, though, is the all-natural ice cream, which has a creamy texture without emulsifiers, artificial flavors, or gluten. The upscale Chilean food magazine *Jigger* described the taste as "mystical ecstasy" and said its gelato-like quality made it "the perfect ice cream."

Fried now has five stores in Serbia, three in Romania, two in Hungary, and one in Montenegro. Former Serbian President Tomislav Nikolic and his wife order the ice cream at home, and Fried has catered weddings for the country's royalty and tennis star Novak Djokovic. The actor Pierce Brosnan loved the vanilla so much that, while filming *The November Man* in Belgrade, he went to the shop every day.

But Fried's fastest growth is coming 8,000 miles away, in Chile. The first location was opened in Cachagua, a vacation spot 100 miles northeast of Santiago where the country's wealthy go for the weekend. He expanded quickly to the exclusive Isidora Goyenechea neighborhood of the capital and the luxury-focused Casa Costanera mall. In January 2017, Fried opened his seventh shop in the country.

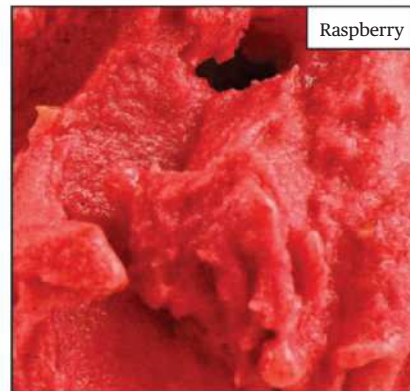
A scoop of Moritz Eis costs 2,260 pesos, about \$3.75. A take-home kilo (roughly equal to a quart) runs \$25, more than double the cost of ice cream from local chains such as Bravissimo or the high-end Emporio la Rosa. Fried's most popular flavor uses chocolate imported from Belgium. His vanilla comes from Madagascar. "The best ingredients can cost up to three to four times more than the second- or third-best," he explains.

Although there are 16 flavors at a shop at any given time, Fried has created about 200 over the years. He's testing new ones made from Patagonian fruits such as *maqui* berries and *murtilla*, or strawberry myrtle. A line of sugar-free ice creams using *tagatosa*, an all-natural sweetener derived from milk, has proven popular, too.

In April he'll open a shop in Split, Croatia, and he's already planning for the day he opens a U.S. location. Miami is at the top of list. "One of the reasons I started this was that I wanted business and lifestyle to converge," Fried says. "So I am always in good weather." **E**



Maracuyá



Raspberry



Dulce de leche

# Washington's Most Controversial Restaurant

Sushi Nakazawa is beloved in New York. Will the honeymoon end when it opens in Trump's D.C. hotel?

By Larissa Zimmeroff

The most famous address in Washington is 1600 Pennsylvania Ave. But starting in late April the Trump International Hotel just down the street will be the most polarizing—at least for foodies.

The hotel was supposed to open with a Spanish-Japanese-themed restaurant from chef José Andrés, but after candidate Donald Trump denigrated Mexican immigrants as “rapists” while announcing his run for the presidency, Andrés, an immigrant himself, pulled out of the deal. Food Network star Geoffrey Zakarian, who’d been planning a bistro inside the lobby, followed suit. Since then, restaurateurs Stephen Starr, Tom Colicchio, and Bryan Voltaggio have all passed on the chance to open a spot in the historic Romanesque building.

Yet where others saw a toxic brand, Alessandro Borgognone sensed an opportunity. The serial entrepreneur, who got his start at his family’s red-sauce joint, Patricia’s, in the Bronx, N.Y., loves taking risks. After seeing *Jiro Dreams of Sushi*, he contacted on a lark one of the documentary’s featured apprentices, Daisuke Nakazawa, about opening a Manhattan restaurant. Since its debut in 2013, Sushi Nakazawa has been one of the hardest tables to get in New York. Reservations open at 12:01 a.m.; they’re gone by 12:02.

During the year and a half of negotiations, Borgognone became friendly with Eric and Donald Trump Jr. and signed the lease for a space inside the hotel in the Old Post Office building in September 2016. “When people ask, ‘Where’s the restaurant?’ I say, ‘It’s two blocks from the White House.’ That’s the coolest part.”

But in a city where almost 70 percent of the population voted for Trump’s opponent, sentiment is more divided. Making matters worse, in late 2016, Borgognone gave an interview that called the District of Columbia a “meat-and-potatoes town”—even though Washington has been heralded as one of the most inventive dining cities in America.

Choosing to ignore the playbook of his new landlords, Borgognone gave an apology, and eventually, Andrés invited the business partners to his restaurant China Chilcano to



Preparing tuna



Borgognone

Uchino

welcome them to the city. “It’s in such a strategic place,” Andrés said afterward. “Anything that makes that building do well—I do believe, putting aside who owns it—will help D.C.”

The menu will be similar to New York’s, including salmon smoked over hay, tuna three ways, and uni topped with white truffles. Toro will be featured as well, but at the D.C. location, it will be sourced from Fujita, the legendary purveyor inside Tokyo’s Tsukiji fish market. The restaurant will pay four to five times more for the toro than it does for “normal” tuna, but prices will be the same as in New York: The 20-course *omakase* will cost \$150 at the bar, where chefs provide direct interaction, and \$120 in the dining room.

Nakazawa won’t be behind the chef’s counter. Instead, the executive chef will be 36-year-old Masaaki “Uchi” Uchino, who worked as an apprentice under Nakazawa in New York. Nonetheless, Trump Jr. sounds elated with the restaurant’s prospects. “Their Manhattan location is so special,” he wrote in an email. “I look forward to seeing how they will shake up the culinary scene in D.C.” Others are skeptical. “I think there will be a large number who will decline to go because of their political viewpoints,” notes *Washington Post* food critic Tom Sietsema.

The restaurant doesn’t feel like a Trump hotel, though. It has a separate entrance and its own bathrooms, and, whereas the hotel’s interiors are painted gold, the sushi bar’s décor suggests nature, with walnut and oak. Nakazawa handpicked the tableware, a form called Bizen-yaki, on a recent trip to Japan.

“We’re aware of what could go wrong,” Borgognone says. “The Trump name can affect us no matter how much we really believe in the restaurant.” **B**

# Needs More Salt

Jukebox musicals may be the hottest thing on Broadway, but *Escape to Margaritaville* is a bland ode to wastin' away. By Chris Rovzar

For the show's investors, it may not matter that *Escape to Margaritaville* isn't very good. It blends the greatest hits of Jimmy Buffett, a set of cheery cardboard characters, and a simple—if occasionally demented—plot into a concoction syrupy enough to taste sort of like a Broadway show. But like the worst versions of its namesake beverage, it's too watered-down to be much fun.

The production is the first in a coming onslaught of shows gambling on the songs of pop acts: In 2018, Broadway is set to stage music from the likes of Cher, the Go-Gos, and Donna Summer. The producers behind each hope to replicate the success of *Mamma Mia!*—which grossed \$625 million in New York and was spun into the most successful movie musical ever—and *Jersey Boys*, which has made more than \$2 billion worldwide.

But the jukebox musical can be a tricky cocktail to master. For every *Beautiful*, the Tony-winning Carole King story, there's a *Lennon*, which ran for a mere 49 performances. In *Margaritaville*, writers Greg Garcia (*My Name Is Earl*) and Mike O'Malley (*Shameless*) spin their tale around a doofy Casanova named Tully (Paul Alexander Nolan), who leads a beach band at a run-down resort in the Caribbean. His main hobby is engaging in an affair with a new tourist each week. Naturally, an uptight career woman, Rachel (Alison Luff), shows up to lay claim to his shell necklace—and his heart. One startling

natural disaster later, and Tully and his goof troop are forced to find their way on the chilly mainland. All the while, they sing creamy, anodyne versions of Buffett hits such as *It's Five O'Clock Somewhere*, *Son of a Son of a Sailor*, and, as if you could forget, *My Head Hurts*, *My Feet Stink*, and *I Don't Love Jesus*.

The talented Nolan has a caramel-smooth voice, and his oft-exposed pecs are the exact size and shape of cantaloupes. Luff is appropriately high-strung, and their hodgepodge gang (including standouts Eric Peterson and Lisa Howard as their downtrodden pals) carries the show as best it can. But the book lobs them little but cringe-inducing jokes until the second act, when a series of increasingly bizarre events—a zombie tap dance number, for example—provides some badly needed razzmatazz. It's as if Buffett and the other creators were so confident his fan base, the “parrotheads,” would snap up tickets, they forgot to reach for the top shelf for ideas.

Buffett has described the setup as “a vertical tailgate”: Fans book a room in the Marriott Marquis above the theater, drink at the bars, and then hit the show. A sign onstage sagely observes, “You can't drink all day if you don't start in the morning,” but the mood in the lobby is subdued. A handful of Tiki bars are set up, but few people line up for drinks. Even the merchandise is uninspired—couldn't they have borrowed those shot glass wordsmiths from Señor Frogs?

When it moved into the Marquis Theatre from a tryout in Chicago, *Margaritaville* replaced *On Your Feet!*, a high-octane musical featuring the pop songs of Gloria Estefan. That show, attracting a range of demographics, ran for 746 performances before setting out on an 80-city tour. To get folks to sing along to *Why Don't We Get Drunk and Screw* every night and bounce around the beach balls that abruptly fall like a wet towel during Act 2, *Margaritaville* will have to rely more directly on Buffett's army of flip-flop-wearing snowbirds. It might work. They already dutifully visit his corporate ecosystem of restaurants, hotels, and casinos. When Latitude Margaritaville opens in Hilton Head, S.C., later this year, they'll retire in his retirement homes.

Other coming jukebox musicals won't be so lucky. It seems as though producers have forgotten such epic flops as *Good Vibrations*, which strung together the hits of the Beach Boys and ran for only 94 performances. (Even beach balls couldn't save that one.) The quicker these saccharine, paint-by-number productions fall by the wayside, the sooner they'll make room for more inventive original work. In the meantime, better find that salt shaker. **B**





## The Dutch Oven, Disrupted

Combekk is a powerful new player in the very small field of pots. *Photograph by Eric Helgas*

### THE CHARACTERISTICS

Combekk is an anomaly: a Dutch company that makes all of its ovens in the Netherlands. While the original method of sand-casting iron to make heavyweight pots originated in 17th century Holland, there hadn't been a Dutch manufacturer of these tight-lidded cooking vessels since the 1970s. Then Combekk, based in Breda near the Belgian border, began making ovens entirely out of recycled metal 3 years ago. Its models are 6.5 millimeters thick (¼ inch), almost double the usual heft and a key to retaining heat and distributing it evenly.

### THE COMPETITION

A 6.3-quart, 28-centimeter (11-inch) Combekk oven costs \$450 and is noticeably heavier than the standby Le Creuset, which costs \$330 for a 6.5-quart version but is only about half as thick. The studs on the underside of Combekk's lid, designed to condense moisture so it drips down into the pot for even basting, are similar to those on the \$500, 7-quart pots made by Staub. Le Creuset and Staub have more colors available—there's no rose or mint green options from Combekk. But its enameling process makes for a finish that's almost impossible to chip.

### THE CASE

The extra-thick construction is great at distributing heat, but even better at retaining it. That's important whether you're waiting for a no-knead loaf to rise or searing a piece of beef. The Combekk will quickly become the most essential tool in your kitchen, thanks to a built-for-generations quality of construction that uses 100 percent recycled iron collected from, among other things, former train rails. The company also offers a model with an embedded thermometer to make sure you're braising, not boiling, without lifting the lid. \$450; [combekk.com](http://combekk.com)

# Scott Norton and Mark Ramadan

The founders of Sir Kensington's are shaking up the sleepy condiment aisle. *By Kate Krader*



Most college students think about ketchup only when burgers and fries are around. Inspired in part by reading a *New Yorker* article by Malcolm Gladwell about how firmly Kraft Heinz Co. dominates that sector of the condiment market, Brown University undergrads Scott Norton and Mark Ramadan decided to take up the challenge.

As economics majors, they'd already noticed that when it came to foods such as cereal and potato chips, there were plenty of options; why was ketchup any different? In 2008, in Norton's off-campus apartment, they concocted their own all-natural recipe, a spicy, not-too-sweet sauce made only with ingredients they could find at the supermarket. In 2010 they started selling bottles identified by a black-and-white illustration of a top-hatted gentleman, Sir Kensington. The duo had sales of \$40,000 in the first year to such outlets as Dean & DeLuca and Williams Sonoma.

Sensing that they were on to something, Norton and Ramadan turned their attention to other overlooked products, whipping up jars of mayonnaise in chipotle and Sriracha flavors, along with an array of mustards with high-quality accents, such as Vermont maple syrup. "We call our customers 'evolved eaters,'" Ramadan says. Their innovative thinking coincided with America's artisanal obsession, and in April 2017,

Unilever Plc acquired the brand for an estimated \$140 million, according to Bloomberg.

Sir Kensington's has become the No. 1 condiment brand at Whole Foods, and in natural food stores it beats out Heinz's organic ketchup. It's also replaced Heinz in institutions such as Madison Square Garden, in in-flight meals on United Airlines, and in meal kits such as Home Chef. Nicolas Jammet, a co-founder of the upstart salad bar Sweetgreen, says Sir Kensington's mayonnaise is a key to their best-selling Caesar dressing served at all 86 locations in the U.S. "We also like that they disrupted a category. And what a category to disrupt!" he says.

In April, Norton and Ramadan start shaking up another staple dominated by one brand: ranch dressing. According to a January 2018 Nielsen report, Hidden Valley controls more than 51 percent of the category, and ranch makes up 36 percent, or \$719 million, of the \$2 billion shelf-stable-dressing category. Unilever "could have said, 'Don't do this,'" Ramadan says. "But they've been supportive of taking the brand in a new direction." Sir Kensington's will introduce four flavors, including avocado oil, buffalo, and a "pizza ranch" that has all the flavors you'd expect on a classic cheese slice. **B**

b. 1986, San Francisco (Norton), 1986, Nice, France (Ramadan)

Celebrity fans include Jared Leto and ZZ Top's Billy Gibbons

Before founding Sir Kensington's, Norton spent 10 months biking through Asia; Ramadan ran a cocktail bar out of his apartment called MarkBar

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