BAY AREA ECONOMIC FORUM

THE FORUM REPORTS

A series of discussions on vital issues concerning the Bay Area

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Bay Area Mergers & Aquisitions:

Do they Matter?

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Panel Discussion

Federal Reserve Bank of San Francisco
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Bay Area Mergers & Aquisitions:

Do they Matter?

Sean Randolph

Our topic is the current, well-publicized trend of corporate mergers and aquisitions, and its significance for the economic vitality, health, and leadership of the Bay Area. This week, the latest high profile acquisition—of Transamerica Corporation—was announced, capping a long line of similar mergers. In the past 18 months, SBC has purchased Pac Bell, Northern Telecom has bought Bay Networks, AOL bought Netscape, Airtouch was aquired by VodaFone, and Ascend Communications by Lucent Technologies. And as we all know, Nationsbank's merger with Bank of America continues to reverberate in the financial sector. Many questions have been raised in the media and parts of the community about the effect of mergers and aquisitions on jobs, and whether this activity means the Bay Area is losing its economic edge or business identity. To better understand the processes at work, and their significance, we will begin the discussion with three distinct perspectives: economics; the viewpoint of larger established corporations; and from the new firms that are leading the information technology sector.

Ted Hall:
Looked at from a numerical standpoint the number of jobs involved in mergers and acquisitions is actually very small. We have selective memory with regard to who are the winners and losers; we tend to remember those companies that are acquired by outsiders and not those acquired by companies here. You could have played the tape verbatim in 1986-1987 verses 1998-1999, in terms of any objective measure of the economic consequences of mergers and acquisitions, or dislocation that was harmful to the Bay Area. From a fundamental economic perspective, the redeployment of assets is the very engine that allows growth to occur. If we bemoan the fact that companies went out of business we would be populated with buggy whip manufacturers, and that would hardly be constructive. So while people find it hard to accept that many of the people that are acquired in this process need to be redeployed, it is in everybody's interest for that to happen.

The real underlying issue, I believe, has more to do with the community's psychological need for a mechanism for leadership. What has happened, at least in the post WWII period in most American business communities and certainly in this one, is that civic leadership was largely accomplished through the mechanism of large corporate entities and their leaders. We went through a period of rapid growth and relative increase in the importance of large corporations in the U.S. economy following WWII, and their growth, visible success, and absolute size all resulted in most of those institutions becoming very prominent. The ethic of the era was for leaders in those positions to make a civic contribution. And this was for reasons that were not, frankly, altogether altruistic. It was in their business interest to do so. If the region grew so did their business.

San Francisco was the hub of the region and its civic leadership was executed by a relative handful of large, prominent corporate leaders. When I first became exposed to the San Francisco business community, that list was probably seven to ten people long. The list I remember most distinctly would have included Tom Clausen, Chief Executive of Bank of America, Ray Dahl, who was the CEO of Crown Zellerbach, the Chief Executive of the Southern Pacific Railroad, George Keller or his predecessor as the head of Chevron, the head of Pacific Gas and Electric, Pacific Bell, and then a few other really important companies that tended to move in and out of that inner group depending on the particular skills of their CEOs: Wells Fargo, Crocker Bank, and the predecessors of Transamerica.

> *"From a fundamental economic perspective, the redeployment of assets is the very engine that allows growth to occur. If we bemoan the fact that companies went out of business we would be populated with buggy whip manufacturers"*
>
> *-Ted Hall*

You would always have one, two or three very prominent participants in that process from Oakland: Henry Kaiser, when he was alive, but following that, Gene Trefethan and various successors at Kaiser Industries. Interestingly, if you went to Oakland in that era, virtually all the decisions were, in effect, made by leaders of one or more of the Kaiser companies because that was such a tremendous source of leadership. In any case, you could quickly get to a civic leadership list of less than twelve people and often less than ten. In that era, that was the accepted way of getting things accomplished.

What has happened is that the underlying structure of the economy has changed. Mergers and acquisitions are only one element of that. We have the decentralization of the Bay Area economy from the San Francisco hub to Oakland, Silicon Valley and San Jose—a dispersion of economic activity and population. This has changed the economic circumstances of these traditional core businesses. Crocker Bank was acquired by Wells Fargo, Southern Pacific RR found it difficult to adapt to the realities of competition from trucks and airplanes and ultimately went through several successive ownership changes. Crown Zellerbach was purchased by Sir James Goldsmith, a UK financier, and all of a sudden a third to a half of that traditional source of leadership in the mid-80's began to disappear. But all that really signaled was the completion of an inevitable process.

By the mid 1980's, this region began to suffer from a lack of clarity as to when and in what way it was going to achieve civic objectives. There was no longer a clear source of leadership, partly because it dispersed, partly because these companies had changed, and partly because the old model was no longer the acceptable format for making decisions.

So when you look all the way back at the issue of mergers and acquisitions in 1986 or 1987, it was really all about what happened to our identity, and to our mechanism for providing civic leadership. The more people started to look around and reflect on that, they also realized that most cities that accomplished anything had glorious moments where there had somehow been a conscience and a mechanism to affect community leadership. New York had begun the process of renewal largely as a result of an initiative taken by David Rockefeller which was called the New York City Partnership, a public-private partnership dedicated to civic goals but developed and created in a way that it had, at least for a period, the implicit endorsement of the community.

So here we are in the Bay Area. We no longer have a dominant city. Worse than that, we have a highly fragmented governmental structure of 106 different entities, compounded by a three hub structure of San Francisco, San Jose and Oakland, with the San Jose hub not really being a hub but more diffuse—because it really is Sunnyvale, Santa Clara and a lot of other elements. We also have a nine-county structure. Anyplace else in the United States where people grapple with the question of how you create civic leadership, it's a far simpler problem. In New York, there are only five boroughs. In Houston, there's Harris County, which is the size of Rhode Island, and the City of Houston. The City of Houston covers nearly eighty percent of the area of Harris County, so the ability to create an effective civic coalition is far less complex than it is in the Bay Area.

What people are actually worried about is, "what are we going to do without the community leadership of the Bank of America, what are we going to do without the voice of the apostle of A.P. Giannini in the form of Dick Rosenburg or Tom Clausen, or whoever?"

So it's a question of identity and of local control, as opposed to being a pocketbook issue of loss of jobs or loss of economic opportunity. I remember being at a Bay Area Council Executive Committee meeting on the Wednesday before Thanksgiving in the '80's. This was Wednesday afternoon at 2 o'clock. There were 14 members on the Executive Committee and twelve were there. We had the CEOs of Chevron, Hewlett-Packard, Bank of America, Wells Fargo, American President Line, Pacific Bell, and Pacific Gas and Electric all present. The ethic of that era was you wouldn't dare not show up because if the Chairman of Bank of America and the Chairman of Chevron were going to take the time to be there you sure as heck would take the time to be there too. We had a highly coalesced and committed business leadership but the recognition that it had no counterpart. So the idea was to attempt to form a leadership mechanism that would embrace both the public and private sector to deal with what we all believed, and I continue to believe, was the appropriate unit of work, which is the regional economy as opposed to the city or county or town level. The idea was to create a unified civic leadership platform. After a series of discussions between the Bay Area Council and the Association of Bay Area Governments, what emerged was the Bay Area Economic Forum.

Lenny Mendonca:

I'm happy to continue this conversation and try to make a bridge from the beginnings of the Bay Area Economic Forum. To begin thinking about this topic I took out a report that was released by the Forum in 1987 about the impacts of corporate restructuring on the Bay Area economy, looked at some of the statistics, and tried to see if any of them were particularly relevant today. The conclusion was that except for changing the names of the institutions, if you replaced 1987 with 1999 you could release the report again.

There are five things I'd say about the impact of M&A and corporate restructuring. The first is that recent restructuring and merger activity has been high profile, but is driven largely by economic forces that are not unique to the Bay Area. While there have been several high profile acquirees (Transamerica, AirTouch, BankAmerica, Wells Fargo), it turns out that more than half of regional restructuring activity in the Bay Area between 1995 and 1998 was in the form of acquisitions initiated by Bay Area firms, not firms from outside the Bay Area acquiring Bay Area firms. Of the 3100 merger transactions in California between 1995 and 1998, the Bay Area's share of those was exactly proportional to the economy of California. Fundamentally, the trends that are occurring more broadly in the global economy—towards larger scale consolidation on a global basis but disaggregation on a micro basis—are what is driving this activity. It's not unique to the Bay Area.

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>
> *-Lenny Mendonca*

The second point is that the negative impacts of restructuring, even the most visible job loss, are actually relatively minimal in the scale of the Bay Area economy. Total job reductions from high profile mergers in the Bay Area are less than the number of jobs that Providian and E-Trade are going to create in the next two years. It is important to recognize the relative scale of those things, and that they are occurring at a time when the Bay Area's economic and corporate foundation, while uncertain, remains strong. Unemployment in the Bay Area is only 3.5% as of the 3rd quarter of 1998, compared to 5.6% in California, and 4% for the nation. Bay Area Fortune 500 companies more than doubled their market value from 1995 to 1997, from 275 billion to 590 billion. Even in sectors where aggressive restructuring is occurring, it's often the case that the Bay Area's industry clusters and companies have a comparative advantage. So at the same time that there has been massive consolidation within the Bay Area's financial services industry, employment in the financial services cluster actually went up. And the Bay Area has the highest output per employee of any region of the country in financial services with the exception of New York.

The third point is that while it is difficult to predict the full impact of restructuring, my basic belief is that the continuous regeneration of the Bay Area's economy from this kind of restructuring will in fact benefit the region. As you know, a lot of this has to do with the opportunity to deploy capital efficiently into sectors where there is growth, and the Bay Area is a magnet for investment. The Bay Area only accounts for 2% of the U.S. economy, but has 35% of all venture capital invested, with 90% of that going into knowledge-intensive sectors where the Bay Area clearly has an advantage.

The fourth point is that in the Bay Area one of the most important elements of what's happening is the continuing dispersion of the center of economic gravity and the challenge to the City of San Francisco in terms of its relative importance within that economy. The total number of Fortune 500 headquarters in the Bay Area between 1995 and 1997 stayed the same at 24, but three of those were lost in the last year to the City of San Francisco. That reflects growth of a large number of companies, and a falling off of others. I was just looking at a report from 1979 - 1986 of firms that joined the Fortune 500. It includes names like Amdahl, Rohm, Tandem Computer, Zydex, Fireman's Fund, U.S. Leasing, Amfac, American President Companies and Pacific Telesis. So there was quite a bit of turnover even in that relatively short period. During the period 1995 - 1997, San Francisco's share of Fortune 500 companies market value declined from 42% to 36% and it's unlikely that trend, in terms of Fortune 500 headquarters, is going to reverse. San Francisco's share of revenues from the top 50 Bay Area companies dropped from 60% in 1985 to 43% in 1995. At the same time Santa Clara County's share rose from 13% to 42%.

> *"Location decisions really are often idiosyncratic and beyond the control of local policy makers. What we can do, however, is attempt to influence the competitiveness and quality of life in the region"*
>
> *Robert Parry*

Given that context I don't think it's particularly productive to focus on corporate restructuring per se as an activity of regional policy making, because it is occurring because of events that are not unique to the Bay Area. Trying to slow it down is in fact counterproductive. Instead, what we ought to be focusing on is trying to create an environment in which we can sustain the wealth development that has occurred in the Bay Area, particularly around knowledge-intensive industries, and the infrastructure that can support its continued economic development.

Robert Parry:

M&A activity is clearly national in scope; in fact it has become international and global. It clearly has affected a wide range of sectors. If you look just in the Bay Area we've seen it affecting Internet and other high tech companies. We've found it also among providers of medical products and services, public utilities and of course banks and other financial firms. In my view there are many drivers to mergers and acquisitions, but the two that I would focus on are deregulation and high technology.

First, deregulation. If you again use banking as an example, we had laws on the books that severely restricted the geographic location of financial institutions. Developments caused legislators to decide that these restrictions were no longer sensible. When we moved to interstate banking it was a powerful force that caused many mergers and acquisitions in the financial services industry. It is important to recognize that new technologies are transforming the cost structure of all industries. If you take financial services as an example, this is an information-based industry and we have seen many technological developments that have made it easier to collect, analyze and utilize information. This has had a profound impact, and has been a primary driver for merger and acquisition activity. I think that M&A's are basically a healthy response to these types of developments. In sectors that have been gaining in our economy, you see mergers and acquisitions that are driven by the promise (maybe not always fulfilled) of cost savings and other benefits associated with increased size and scope of operation.

Parenthetically, there is not a clear-cut case for a favorable impact of M&A's on costs. I frankly think that in the financial services industry you don't have to be at half a trillion dollars in assets to get the maximum benefits from cost savings. As a matter of fact, I could make a more compelling argument that the larger you are beyond a certain range, it's probably going to be more difficult to be efficient.

Not only are you seeing growth leading to mergers and acquisitions, but you're also seeing the opposite, where you have industries, like railroads, that are seeing mergers and acquisitions because technological change has resulted in excess capacity. It is also obvious that not all mergers and acquisitions will succeed. There was an article in *The Economist*, I think in January, that by their estimate half or even only a third of mergers and acquisitions have been successful.

I would make a point, similar to Lenny's, that risk taking includes the "right" to fail. To make mistakes in mergers and acquisitions is a fundamental component of our economic system. You can find examples in other countries where these types of activities have been resisted and see the costs of prohibiting them, whether they produce good decisions or poor decisions from the point of view of the companies themselves.

One issue, of course, is what the effects have been. Let me just focus in on the banking and financial sector. First of all, if you look at the impact on shareholders, it seems to me the only consistent winners have been the owners of the target banks. Almost every academic study I know of shows that, at least financially, it is the acquired institutions' shareholders that benefit. Longer-term it becomes extremely difficult to identify who the winners and losers are because you have to take into account what has happened in the economy and what might have happened had there been no merger.

What are the effects on customers? We could talk a lot about this. You are all familiar with the problems some customers have had with mergers in the financial services industry. But I think the stronger case is that customers have gained in terms of availability, quality and price of financial services. I also think it is wrong to focus very narrowly on what the financial services industry is. It is not only commercial banks, credit unions, and S&L's. It includes Schwab and other providers of financial services who are extremely effective competitors, and have produced a broader menu of services at a lower price to consumers.

The effect on the region? Lenny really hit that pretty well. When we go through the data, such as those for employment and income, and we think of the financial services industry broadly, I don't see much to be concerned about. As a matter of fact, I would say the financial services industry is one of the strong points of the Bay Area. Obviously, there are aspects of that industry, such as commercial banks or S&L's, where you have a more difficult case making that point, but when you broaden it you can make a very strong point.

Let me also talk about the loss of corporate headquarters. It is safe to say that not that long ago none of us would have thought that the Bank of America would be headquartered in Charlotte. On the other hand, about fifteen years ago I would have bet you that Los Angeles would eventually upstage the Bay Area in the financial sector. As it turns out, LA was the big loser in all this, but there were times in the past when you could have made the case that LA would have been the gainer. It seems to me that often location decisions really are idiosyncratic and beyond the control of local policy makers. What we can do, however, is attempt to influence the competitiveness and quality of life in the region, and that's obviously what the Bay Area Economic Forum is charged to do.

In conclusion, let me emphasize again that M&A activity, whether it is aimed at consolidation or expansion, really is an important part of a dynamic and growing economy, and we've got the most dynamic and strongest economy in the world and have had that for quite a while. For this region I think M&A's are mainly a sign of strength, and the reason we have so much merger and acquisition activity is that we, in this region, are at the cutting edge of key industries for the future.

Gordon Smith:

I can't disagree with anything that Lenny, or Ted or Bob already has said. M&A activity is in fact a healthy part of the economy. It is a little bit like debating whether or not an active fund manager is better than an index. At the end of the day there is room for reasonable people to disagree. It's a fact of life. Certainly the economic numbers of the Bay Area-after the question was asked 10 years ago whether it makes a difference-show, frankly, that it doesn't. There's a coming and going of new companies.

That said, civic pride, corporate responsibility, participation in planning issues seem to generally bring together the large corporations: BofA, Wells Fargo, PG&E, Chevron, McKinsey, folks that are major players in The City. And here is the frustration. The Bay Area Council and the Bay Area Economic Forum are trying to get this great economic engine from Silicon Valley to generate senior officers or senior staff, to contribute to this process. I think we rationalize that they are so busy writing code or doing IPO prospectuses that they don't have time to participate in any kind of regional planning. This is one of the concerns we have,as we try to do regional planning,that it is very difficult to get this fractionalized, balkanized economy participating. So it is the old mainstays—a Chevron, a Wells Fargo, a BofA, that are the folks that are trying to help it along.

There is no question that in this area headquartered companies will participate with contributions and do civic activities such as welfare-to-work programs. That may not come if the company is headquartered somewhere else. Fewer dollars are being given to New York City by Exxon than before, yet there are other people to fill in, in New York. Pacific Gas and Electric is owned by PG&E Corporation, which is only a block from here and was founded two and a half years ago and is rapidly building a national footprint. There is a lot more money flowing out of the state than there would have been if we were just a California company, and that means some other economy is benefiting, but I really haven't had any reduction in the amount of money I give out to charitable organizations or groups.

> *"The creative destruction process that has been so well-documented in economic history is in fact at its height in the Bay Area, because of the nature of the economic environment here and the nature of its industrial base"*
>
> *-Lenny Mendonca*

There are a lot of things you can point to that in a region, whether in Oakland or San Francisco, are lost through balkanization or being acquired by someone else. It isn't a Bay Area Economic Forum problem per se, but it is a problem, and I think Dick (Spees) knows at a very pragmatic level how they feel about losing a corporate citizen in Oakland, or how San Francisco feels about losing a corporate headquarters. It is a source of annoyance to city pride but it is nothing you can document in dollars and cents.

Sean Randolph:

This discussion has been set up to get a balance of views: with an overview from Lenny, a financial perspective from Bob, and the perspective of major, established corporations from Gordon. There's another piece of this picture that reflects what's particularly going on in the South Bay, but also throughout the region, in information technology.

Let me ask you Lenny: Would it be correct to say that there are two perspectives: from major main line corporations and from the Internet and information technology economy, with its hundreds and thousands of smaller companies constantly welling up out of this entrepreneurial stew in the Bay Area, where being acquired is often part of the corporate strategy. If so, that is part of the dynamics that support the growth of technology economy here. Setting aside the important issue of civic affairs, does that offset to some degree the loss of headquarters or mergers of more high profile corporations?

Mendonca:
Yes, it does. I think what you're witnessing is what we call a barbell economy. On the one hand you've got large global enterprises that are merging, many of whom are headquartered in the Bay Area-but as part of a global hub, not necessarily as a concentration of employment or a concentration of leadership. On the other hand you have large numbers of newer companies, particularly in technology intensive industries, being created and coming and going. The creative destruction process that has been so well-documented in economic history is in fact at its height in the Bay Area, because of the nature of the economic environment here and the nature of its industrial base.

If you talk to companies who are attempting to build and grow on that basis, their biggest challenge, they will tell you, is getting talented people. In fact, in many ways what is happening is the redeployment of talent and capital to more productive uses. I recently had a executive recruiter whose specialty is Silicon Valley tell me that at that time there were 400 CEO, 400 CFO and 600 Head of Marketing jobs available in Silicon Valley. Now many of those are for zero revenue companies, but nevertheless there is a talent shortage and a lot of what is occurring is the redeployment of that talent to more productive uses.

This is also true for the health care industry. Both within segments of the industry, as well as across sectors within health care, the industry is seeing substantial consolidation. That's occurring at the same time that there is substantial growth, with value being created in biotechnology, which is another important sector in the Bay Area. So healthcare is in fact quite susceptible to the same trends we were describing.

John J. Healy:
Let me give a little bit of background on Yahoo. Currently, we are about 1,000 employees and I was brought in about two and a half years ago just to look at investments and acquisitions. Our CEO had spent time in Motorola's investment and acquisitions group, so he saw first hand how those types of strategic movements could help a company, especially companies in our segment. Our segment moves so rapidly that we really can't build everything. As we stand now, we are about 20 heads behind on engineering hiring and just to hire fast enough, just to move fast enough, is almost impossible. One of our Board Members is Mike Moritz, who is one of the General Partners at Sequoia Ventures. They're one of the original backers of Cisco and Cisco has a very well-developed acquisition program with 25 people, and is very, very acquisitive. So we tried to become friends with the gentlemen over at Cisco and model our program somewhat after theirs. We see it as a method to grow: to bring technology and personnel in-house and deploy them very quickly.

We've made eleven acquisitions in the last 15 months. It's a lot, with a staff of five. We as a practice don't hire investment bankers. We do all the work ourselves, which is an interesting new model that is happening down here in the Valley. We think we know our business. We have a lot of experience in deal structuring and we know the markets better than any investment banker can, and we don't mind not paying a 20 million dollar fee with every transaction. We use bankers only when we have to, such as, on the large acquisitions where we have to get things called "fairness opinions."

How we view acquisitions and deal with them, and just the range of acquisitions, is very broad. The smallest one we've done is about 1.2 million dollars, the largest one we've done is Broadcast.com, and that was 6.0 billion dollars. So we have been all over the map. The way that Yahoo works is that we're a very integrated property, meaning that Yahoo mail integrates with Yahoo sports, which integrates with Yahoo finance, which integrates with yellow pages and things like that. So typically when we acquire companies we bring them here. We have done that with all of our acquisitions, except Broadcast.com, where there are about 350 people in Dallas. Our other large one—GeoCities at 5 billion—will bring people up from Santa Monica.

It is not like some other company where you have one product, like a Cisco where you have a router that does 5 megabits per second then you do another router that goes 10 megabits per second. In that situation, the engineering perspective doesn't necessarily have to be shared between those two groups and can be done almost anywhere. They can be on a boat in the middle of the Pacific developing these projects and, when the product is done, throw it into the Cisco distribution channel and then the Cisco marketing and sales guys sell it. With us everything is very integrated in our site. Our people have to talk with each other and we have to be very good and very quick at integration because our industry moves so quickly.

> *"We see it(aquisitions) as a method to grow: to bring technology and personnel in-house and deploy them very quickly."*
> *-John J. Healy*

In terms of the acquisitions, the speed of the industry is also one of the things that is unique—speed and the lack of capital commitment. Speed, in that probably 60% of our deals are in competition with someone else—meaning that someone else in our sector is also looking to buy this company. So we have to move rather quickly. In terms in valuation, everyone says they're crazy, and we agree they are crazy. But with the valuations people have put on our companies in the stock market, our currency is so highly inflated that we would be remiss to our shareholders not to use it now as a vehicle to purchase other companies and acquire technologies, personnel or what have you. And I don't think it's just in the Valley—it's up to Novato, down to Santa Cruz. There are so many Internet companies that are going public, and their currency is so highly valued that they should also be doing acquisitions. Most of the ones that do acquisitions would probably bring those companies and their personnel to this area.

Randolph:
So is this a fairly typical strategy for a company in the Internet industry or the information technology industry: to grow through acquisition because it is more effective in many cases than trying to actually develop a product in-house from scratch or bring that kind of talent on one at a time?

Healy:
It's the philosophy of the business that has a lot to do with it. As I have said, our business moves so quickly. We go through an analysis when we look at something. For example: we bought a calendar company, where you can keep your calendar on Yahoo and set up all your events and so forth. So we looked at 3 different things: We looked at how long it would take to build; what resources the building would take; and what kind of capital expense are we going to incur. Then we looked at what we call a "lease" model, where we basically partner with a company that's in this space, and ask what are the risks and rewards of that. And then we look at the buy option. In the "lease" model, what scares us is that so many of these companies are new. Many are probably only 20 to 50 people and if we struck a business relationship now, someone like CNet or Excite can come in and swallow them tomorrow. Then we could be out of luck in terms of our product suddenly being gone. That's also one of the things we look at in terms of partnering with people: what's the long-term, how strategic is it, and what's the long-term viability of the underlying relationship.

> *"As the economy restructures civic institutions have to adapt. We need innovation in civic leadership models"*
>
> *-Ted Hall*

Randolph:
Looking at this strategy of growth through mergers and acquisitions, if you take an example like Broadcast.com or GeoCities, how does that strategy play out?

Healy:
The best example would be Broadcast.com. Yahoo right now is very text-oriented. It has limited multimedia capabilities, very limited audio and video capabilities, and a lot of that is due to the bandwidth, the pipes that the data flows down. A lot of people are at home on conventional copper phone lines and the actual bits and bites you can get down are limited. Now, you sit there for 30 seconds and watch a picture while it downloads, but that's going to change with companies that put cable modems into the ground, and satellite, and DSL technology that's coming through the copper phone lines. Everyone can see a day when you have an almost unlimited bandwidth and are going to be able to receive audio and video over the web.

What Broadcast.com does, is go out and aggregate audio and video information the same way Yahoo goes out and aggregates text-based information. Yahoo goes out and gets stock quotes, information from Reuters about business events, and so forth. Broadcast.com can set up companies to broadcast their quarterly conference calls and earnings reports over the web. Broadcast.com just a few months ago was named the exclusive broadcaster of quarterly conference calls for the NASDAQ 100. This is one of the areas we see where there is going to be a lot of development. Who could build something like that in-house? We couldn't. How long would it take? How much money would it cost? A lot on both ends, so this is a way for us to get people who are very experienced in this. There's a content acquisition piece to this because they know who has the best audio content, video content, how to structure the deals and how technologically to put it out over the web. That's something we could learn, but this pace, again, is moving at such a velocity that it would probably take us two years to get where they are now and we just can't wait.

Randolph:
With that, let's open it up to comments.

Parry:
I want to add to the point on health care. I've got a list here of the 25 largest mergers and acquisitions in 1997, whether they are the acquirer or the target. Blue Shield was an acquirer; McKesson is a vigorous acquirer. There are lots of really complicated things going on in the health area. This industry is going through technological change and adjustment at a pace that is absolutely incredible. Where all that is going to settle we don't know, but I would assume we are doing reasonably well.

Mendonca:
The Bay Area's R & D spending per company in biotech is greater than Seattle, Los Angeles, New England, and Texas combined.

Steven Roberti:
Gordon touched briefly on corporate giving, and I can guarantee you that Ed Whitacre and Hugh McColl are not going to sit on the United Way Board of Directors. When corporations say they give 2M, the corporation may give a million dollars, but the workers give the other million. This is going to have an effect on our overall resources to help those in need in our community.

I also think some of the corporate leaders have lost the pioneering spirit. Why are we in California, the largest state, not buying companies in Texas and New York?

Parry:
I'm not sure about that. If you look at the acquisitions that are occurring in the high-tech areas, I think we probably stand very well relative to any other state, and if you're looking for dynamism and innovation, the fact that we have such a large portion of our employment focused in these high-tech areas would suggest we probably are not taking a back seat to any state. The other thing I'd point out, is that while it may be important to have a CEO of a large organization on the United Way Board, the health of the economy is very important to giving. If the cost of preventing or trying to prevent this type of dynamic change in your economy is an economy that doesn't perform well, it won't add to corporate giving. Healthy economies will give more, and economies that don't do well can't afford to give well.

> *"You can lose a corporate headquarters without losing a good corporate citizen"*
> *-Joyce Taylor*

Hall:
Two quick comments to Steve's point. I'm confident that the data will show we are not net losers. So for every example like Bank of America, they are wringing their hands in Minneapolis with what happened with NorWest, and for all the civic pride in New York City for having the world's largest and most attractive retail securities firm in Merrill Lynch, they are wringing their hands over the fact that Charles Schwab has a market value substantially in excess of Merrill Lynch and there is no question which way they are heading.

In the end, this suggests that as the economy restructures, civic institutions have to adapt. We need innovation in civic leadership models, and United Way clearly cannot depend on a set of fixed structural assumptions about concentrations of leadership and employment.

Sunne McPeak:
I would like to build upon what was just said. Last week when the acquisition of Transamerica was announced, I had a reporter with a microphone in my face saying, "So, aren't you a little bit concerned about the loss of headquarters in the region?" We get those questions a lot. I always start with discussing sound economics: that mergers and acquisitions are happening because there is high productivity here in the region, and that it is a sign of strength. And then they go on to ask, "But what's happened as a consequence of the Bank of America headquarters moving or Pacific Bell and SBC merging?" I am very careful to point out that in the most prominent of those examples, the recent history has been that the CEO has been very interested in maintaining a presence. Which is true. They have empowered their highest executives in this region to speak for them. I also point out exactly what Ted did about NorWest and the fact that they kept the headquarters of Wells Fargo here in the Bay Area. You mention McKesson: McKesson has done fourteen acquisitions in the last year.

The transformation of the civic leadership model is one I'm struggling with, however. The very strength of the economy and the globalization that has brought into relief regional economies as the economic unit, has at the same time caused the chief executives to spend 50 to 70% of their time out of the country, and no longer have the time to engage in civic activity. Then what follows sometimes is, "We aren't here to participate so we're not sending in our check for dues." That is happening at the same time that we are recruiting companies, and the longtime founders and leaders of the Bay Area Council are making the decision to remain involved. Those companies are continuing to try to lead the way. My question is: what is that model, and how do we continue to reach out and emphasize the importance of civic leadership from the business community in this global world?

Joyce Taylor:
As an employee of one of the more recent mergers I have a different perspective on this. I spent about a year working in California on the merger. I was an SBC employee first and I have spent the last year and a half working for Pacific Bell. During that year I traveled throughout communities here in California to find out what was important to the community when a company merges. I heard about jobs, about service, telecommunications infrastructure, and contributions. On the jobs front, we promised that we would bring 1,000 new jobs to California; since the merger we have actually brought 2,900 new jobs, so we are well ahead of that commitment. On the service front, we promised we would either maintain or improve service here in California. We've done that as well, in fact exceeding the CPUC promise. On the contributions side of the house, you're right Ed Whitacre does not sit on the United Way Board, but Jim Callaway does. Jim is president of Pacific Telesis, and is very involved in the community here in the Bay Area; I'm very involved here in the community. In fact, that is my primary job.

So my message would be that you can lose a corporate headquarters without losing a good corporate citizen. In California, we have nearly doubled the amount of contributions we give since before the merger: 14M last year, 3M just here in the Bay Area. And finally in terms of infrastructure, we put 2 billion dollars last year into infrastructure in California. We also announced the most extensive rollout of DSL technology anywhere in the country; that's high-speed access to the Internet. So I think that often when people talk about mergers they look at and expect the negative. There are some very good things that come from mergers.

Richard Spees:
What I'm concerned about is who builds the "commons," the common infrastructure that makes this a livable region. I can remember, for example, that you would not have had BART if the Kaiser Companies had not gone "whole hog" in passing the bond measure. Who is stepping up to that type of leadership role today? Many mega-corporations, whether they're located here or somewhere else, are so involved in world activities and with the kind of competitive issues with which they have to deal every day. They are not devoting the resources to that type of community involvement. We feel it in Oakland, where we have lost all 65 of the Kaiser companies with the exception of Kaiser Permanente, and that loss is profound.

The second issue is, "Who is employed?" The issue really goes to the fact that many corporations are importing the people that are working in their companies, whether in biotech, Silicon Valley or elsewhere, because we haven't the quality of employees we need to fill those jobs. The manufacturing area is where we're really in trouble. For example, in biotech we're doing pretty well in R&D, but in manufacturing we've come down from being number 1 to number 5 nationally. So clearly we have a problem: We are not producing qualified workers for either headquarters or manufacturing employment.

Paul Fassinger:
We've focused on the last few years and the changes that we've already seen, but we should also look at what's coming. I think we have deemphasized the changes that you're starting to see to corporate structures, the sort of changes that technology is causing. Bob Parry mentioned that as well. Essentially you get to the point where corporations are changing the way their structures look, and having a headquarters in a city is different now than it might have been a few years back. The Chronicle says that while Transamerica is headquartered here, only 125 jobs in that big pyramid are actually Transamerica's. When you look at the corporate headquarters and the idea of corporate pride, that's really what hits the newspapers and what motivates people. Dick's right, that for a region the idea is jobs and who is employed here. They don't have to be headquarters jobs but they have to be good jobs and when you change corporate structures you really can't retain good jobs in different types of structures.

> *"You would not have had BART if the Kaiser Companies had not gone "whole hog" in passing the bond measure. Who is stepping up to that type of leadership role today?"*
>
> *-Richard Spees*

From the standpoint of corporate giving, it is interesting to note that there are differences between high-tech companies and traditional service and manufacturing companies in the ways they give and the amounts they give. I think what we need to see is a difference in the way corporate giving takes place, not to say that a president of a company is not going to serve on the United Way, and that's really important—but that corporations have to look at how they participate in the regions where they operate. If a Pac Bell isn't headquartered here for the parent company, but they continue to give because they are involved in the community, because this is where they do business, that's what's truly important. Perhaps it's about changing the culture of companies in Silicon Valley and making them recognize that's part of what they need to do. Volatile new organizations may not be aware of that yet.

McPeak:
Could you respond, Ted, regarding the leadership issue, the importance of regions as economic units, the time demands on the companies that are operating globally, and how that may inhibit their civic participation in the region in which they are located or headquartered.

Hall:
Well, in some mythical past, where the distance by which you could communicate and the distance by which you could delegate responsibility and organization was different, a disproportionate share of the economy was regionally defined, either by the reach of management, by government regulation or a variety of other things. Companies actually had common economic interests in a very fundamental sense. So if you think a rising tide rate raises all boats, you get together the business leadership and even the political leadership in a region (where the economy is essentially constrained to the region). It is self-evident that everyone wants to raise the level in that bathtub, so we all rise together.

What's happened is that the vast majority of the economic activity now-the definition of those pools of activity-is substantially different and the pools are widely dispersed. Therefore, people have to organize themselves to deal with whatever portfolio of footprints, "bathtubs," makes sense for their particular business. Now, any time you get any group of business leaders together, by definition their economic interests are no longer as aligned as they once were. This shouldn't be a surprise to any of us.

What is also true, however, is that the venues in which one competes are increasingly becoming region-states, or regional pools. What is the total universe of relevant communities on the global basis? It's less than 35. So part of the game, at least as it relates to interacting with the business world, to define ourselves and make clear to those in leadership how we stack up in this region to these other potential places where they could put their business. If I am the CEO of a global business, I am deeply interested in a portfolio of locations where I can put my business. For most of the people I know, that portfolio is probably seven or fewer. So part of the way we have to think about this is that we have a 14% claim, one in seven, on that interest. So we have to jettison this whole series of implicit assumptions of relative importance, relative commonality of interest and in fact present the problem in a way that is actionable from the point of the people you want to participate.

Second, we really do have to innovate and I don't have an easy answer for mechanisms for engendering civic participation and civic leadership that does not rely on a hierarchical corporate model. That problem is not solved easily. I actually believe that the civic sector in the United States, and I would even guess in this region, has more energy and money behind it than many other places in the world, and that is a source of comparative advantage. Think how many 501 (C) (3) corporations are there, and do you think ours are growing faster than they are in Germany? For sure they are.

Tien:
I think maybe the times have changed in terms of big corporations. With big corporations moving toward a national footprint or globalized perspective, what will be the global role of regional or local organizations such as BAEF?

Parry:
We often lament that we don't get the participation of some industries in our community organizations. Sunne talks about the Council, and we both talk about the United Way since we're on the Board. Also, at the Federal Reserve Bank, we have a Board of Directors and one area where we have difficulty getting people to serve as a director is from the hi-tech industry. Is it possible that the pace of change is so rapid and the competitive pressures so intense in these industries that they really can't spend time on projects outside of their primary business?

Hall:
The simple idea that underlies what I was trying to say—Bob is getting at it better—is the concept of enlightened mutual self-interest. The reason the Bank of America or the CEO of Pacific Gas and Electric got involved in these things was because it was in their commercial interest and it also had other important effects. It is not in the enlightened mutual self-interest of most high technology companies to pursue these activities. It does not link to their commercial goals.

Spees:
It was not in the commercial interest of Kaiser to provide community leadership. Who's going to pickup the Water Transportation Initiative today? Who's going to provide that leadership? To make it happen, we've got to have leadership from the business community. It can't be done just with the public officials. How do we bring that about in Silicon Valley or any other community?

Lynn Bunim:
Having listened to the discussion, I am struck by two things. We talk about creative leadership and we talk about principles and I see a strong linkage here both for the Bay Area Council and the Bay Area Economic Forum, if we start to look at these definitions of a "principal" differently. You have a new principal from Pacific Bell in the form of Joyce Taylor; you have every bit the commitment from Pacific Bell you had before. I think we have set the new template and the new model.

My point is that if in fact the CEOs really aren't in town anymore, maybe Sunne or Sean are better off redefining the "principal" and making sure it is somebody who spends 60 or 70% of their time in the region because that's the dialogue you want.

Smith:
Let me add a point. BofA touches everybody, PG&E touches everybody, Pacific Bell touches everybody. Not all of Silicon Valley touches everybody. We have a fundamental difference because of our infrastructure and the billions of dollars we spend every year. We can't afford to back away, but lots of folks in a start-up mode might. We have to be members of the community.

Healy:
I can only speak for Yahoo. Yahoo has got a very civic-minded culture and I think a lot of the technology companies do. It would probably help to put things in perspective. Realize that Yahoo has only been around 3 or 4 years. What was the civic contribution of any one of the largest established companies—a PacBell or BofA—in their beginning stages? As a company grows, it typically develops roots within the community. But even with a company like Yahoo, 3 years ago when I first started there were 100 people, and we had one person full-time that was dedicated to community issues. Yahoo has adopted a school by the name of Lester Shields. We have people that have adopted classes and have rewired the school. We do a lot of those things.

That comes from the top. Jerry Yang and David Filow, who started Yahoo, both gave over a million dollars each to Stanford where they've sponsored the Yahoo chair. These are young guys, 30 years old, who have made substantial money. It's not only that they made it, but now they're starting to give it back. There are a lot of companies like that in the Valley. There's a company we have done some work with that gives 5% of their total revenues to charity. That's just part of business. This gentleman is really into volunteer work and that's how he runs the business. So I think it's natural for the old and more established larger companies to have well-established programs that deal with community issues, but when it comes to Yahoo, we're just starting and to have someone dedicated to community outreach type things from the beginning bodes well.◆

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