Center for Labor
Research and Education

Institute of
Industrial Relations

University of California
Berkeley

LABOR and the NEW BUSINESS ENVIRONMENT

A GUIDE FOR UNION REPRESENTATIVES

a report on discussions held during the ***Seminar in Business Economics and Corporate Finance for Labor***

sponsored by Joint Council 7, Northern California Teamsters, in cooperation with the Center for Labor Research and Education, Institute of Industrial Relations, University of California, Berkeley

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with participating faculty from the Graduate School of Business and the Institute of Industrial Relations, U.C. Berkeley

LABOR AND
THE NEW BUSINESS ENVIRONMENT

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Preface

by Chuck Mack, President, Joint Council 7
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In the summer and fall of 1986, some members of our local unions in Joint Council 7 informed me of the hostile take-over bid at Lucky Stores, and the leveraged buy-out possibility at Safeway Stores. It was clear that both of these developments would have an impact on hundreds if not thousands of jobs of our members, and those in other unions as well. Lucky, for example, had 1,500 food stores and 68,000 employees. Lucky also owned Gemco, with 14,000 employees, of whom 4,000 were union members in the Bay Area.

We needed to determine how our local unions could best protect Teamster jobs. So we met with our Joint Council economist, Harry Polland, and our attorney, Duane Beeson, and we appointed a task force to look into the situation. We prepared and distributed to our locals a packet of contract clauses to help them negotiate for better job protection. And we considered both legislative and legal strategies that we might use to protect our members.

But we were ill-prepared, and realized that we needed to learn more about the changes taking place in the economy and in the structure of the businesses we negotiate with, and the theories and philosophies involved in these changes.

So we organized a back-to-school program, to look more carefully at the business community and the corporate structure. Our purpose was to share some expert knowledge and promote some new thinking and ideas.

We asked for and got the assistance of the Institute of Industrial Relations at U.C. Berkeley, which has been a valuable resource for our organization and for labor in general. The Institute helped us get the participation of the School of Business at U.C., and the Institute's Center for Labor Research and Education helped to pull everything together.

The result was a series of four sessions presented on Friday mornings, with the title of "Seminar in Business Economics and Corporate Finance of Labor." We wanted information on broad changes occurring in the world of investment and finance and business strategy. We wanted details on the source and the analysis of financial statements, and other data which is available whether or not the companies are pleading poverty or going into bankruptcy. We wanted to learn about the investment strategies and the rules and regulations involved in corporate take-overs and leveraged buy-outs.

We also wanted to develop a case study of the take-over attempt at Lucky Stores. For this we were fortunate to be able to rely on Therese Hansen, a graduate student in the program for the Master of Business Administration degree at U.C. Berkeley. Therese was a Teamster line worker at Tri Valley Growers not long ago. She worked her way up to management ranks at the company, and also graduated summa cum laude from Cal State, Stanislaus, before she came to graduate school at U.C. Berkeley. In addition to her work on the case study, she contributed a great deal to the organization of the seminar series.

We asked the seminar speakers who came from the School of Business at U.C. Berkeley to tell it to our labor audience like they tell it to their students. We knew that we wouldn't agree or be happy with all we heard, but that wasn't our purpose. We wanted to learn, and that doesn't require agreement in advance. Some sharp differences in viewpoint developed in these sessions (some are covered in this report), and that helped us to learn.

On behalf of Joint Council 7, I want to thank the Institute of Industrial Relations, its Center for Labor Research and Education, and the School of Business at U.C. Berkeley for their assistance in organizing and presenting the seminar sessions, and in drafting this report.

Our Joint Council and our affiliated local unions also appreciate the financial assistance given by our International Brotherhood, which permitted the printing and distribution of this report.

We didn't solve all the problems—far from it—but we developed a lot of useful information and insight, and we brought the issues into sharper focus in this seminar series. As one of the speakers put it, labor is on the defensive, and so we must build some momentum by pushing out our views to others. In the long run, the only effective protection for our members may be that which comes from legislated regulation and control of take-overs and mergers and acquisitions.

That kind of protection won't come out of the present vacuum. Our seminar helped us to learn how to speak out on these matters, and we hope this report will be useful to other trade unionists for that purpose.

FOREWORD

By Marty Morgenstern, Chair,
Center for Labor Research and Education,
Institute of Industrial Relations, U.C. Berkeley

When an organization comes to us with a program request, it is usually to train members or officials or staff in a specialized skill, like contract negotiating or cost analysis, grievance handling or arbitration, or one of many other subjects in the core curriculum of labor education. Recently, Chuck Mack, President of Joint Council 7 of the Teamsters, and Harry Polland, a San Francisco labor economist and long-time union consultant, visited the University with broader concerns in mind.

They wanted to talk about hostile takeovers, mergers, leveraged buyouts, divestitures, and other kinds of corporate reorganizing that have gathered momentum in recent years. These deals are organized by high-priced lawyers, arbitragers, investment bankers and brokers, who emerge with millions in commissions and fees and new stock holdings. The displaced managers bail out with million dollar golden parachutes and leave the new managers to drift through clouds of burdensome debt. In the process, tens of thousands of union members lose their jobs or their unions or both. If they manage to survive, they find out quite suddenly that their wages and job security and working conditions have been severely downgraded.

Government policies affecting the economy, including tax and regulation and trade policies, facilitate these corporate reorganization activities, in the sacred name of competition and free enterprise. At the same time, such government policies lower the status and the income of American workers. Even the most skilled negotiator cannot protect jobs and improve wages and working conditions when an army of unemployed people stands by, ready and willing to work under conditions that are below the prevailing standards. The problem is compounded when the work can be easily transferred to other countries and performed under still lower standards.

Chuck Mack and Harry Polland discussed these problems when they visited my office. We planned a program for the Teamsters and other union leaders, to take a close, unbiased, academic look at the new marketplace realities facing our nation's business and labor communities. Our plan was to gather together some of our University's best economics and business school scholars, and have them tell it straight. Nothing would be watered down or bent to fit a union viewpoint. We wanted just the facts, as the professors saw them, and as they were teaching them to their own graduate students.

Our curriculum was also designed to help union negotiators gain an understanding of corporate data and accounting procedures, and the changing world of investment and business strategies. To help accomplish this, we utilized a careful dissection and analysis of a hostile corporate take-over that was immediately relevant to the labor audience. We went on to examine some of the new conditions of international competition that have had a negative impact on labor, in the hope of developing insight that could lead to realistic counter-measures and alternatives.

Judging by the responses of the conference participants, the faculty, and the sponsors, the program was an overwhelming success. Many people deserve thanks for their efforts; first of all the faculty members, who were drafted just as the semester came to an end and grades were due. Each was provocative, interesting, learned, and open to questions and challenges from the audience. The Professors who were not associated with our Institute of Industrial Relations received a very modest honorarium, together with our appreciation and thanks.

Our own people from the Institute get only our sincere thanks. George Strauss, who was then our Director, was extremely helpful in suggesting and contacting (and sometimes blackmailing) the faculty members whose inputs were most needed. Clair Brown, Associate Director of the Institute, was dependable as always in providing an analytical framework to sharpen the issues and give them a more realistic and non-technical perspective. Bruce Poyer, Coordinator of Labor Education Programs at our Labor Center, handled the taping of all the sessions, and put in the long hours required to reduce and summarize the verbatim proceedings into the report that makes up most of this publication. Our Labor Center's Program Assistant, Cathy Davis, was invaluable in handling arrangements and providing the competent staff assistance that is always essential for a successful program.

Harry Polland masterminded and inspired every aspect of this project. He worked on the original outline, the selection of subject matter and faculty, did some of the teaching, and assisted in putting this publication together. Therese Hansen, a wise and diligent graduate student who also understands from experience about life as a rank and file working person, brought the program outline together, did the case study, stayed in contact with everyone, and provided the continuity that tied the various speakers and sessions together.

Chuck Mack, the energetic and highly competent leader of Joint Council 7 of the Teamsters, brought to the seminar audience his key people from northern and central California, and kept them involved through 16 hours of straight academic lecturing by one professor after another. There were no concessions for the pre-requisite courses or degrees that are usually required at U.C. Berkeley. Most of the faculty members from the School of Business hold and express ideas and opinions that are quite opposed to those held by the participants at this seminar. Not every union leader is willing to take a similar kind of risk for the sake of education. No University could ask for better or more involved students than these union leaders proved to be.

In sponsoring the program, the Joint Council gave us—University, Institute, and Labor Center—an opportunity to be constructively involved with the most serious and important problems facing American workers today. For this we thank Chuck, Harry, and the local unions and members of Joint Council 7, IBT.

Last but not least, we are grateful for the financial assistance provided by the IBT, which made it possible for us to publish this report and distribute it widely to other trade unionists, who have expressed a growing concern about the problems addressed in the seminar and summarized here.

LABOR AND THE NEW BUSINESS ENVIRONMENT

by Bruce Poyer, Coordinator
and Marty Morgenstern, Director
Center for Labor Research and Education
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"What we need most now is re-evaluation—not just of unions, but of institutions, like collective bargaining. In that 30-year period of unprecedented economic growth and stability in this country—from World War II to the time of the oil embargo in 1973—a lot of things worked well. In those 30 years of regulation and adversarial relations in collective bargaining, it all worked so well that it's very hard to give it up now. But what worked well in one world will most likely not work well in a new world, and we are going through a revolution today, with these take-overs, and leveraged buy-outs, and mergers, and plant closings, and off-shore production, and imports."

Robert Harris, Professor, School of Business, U.C. Berkeley, was speaking to labor officials at the first of four seminars on "Business Economics and Corporate Finance." Five other professors from the Graduate School of Business at U.C. Berkeley (and the Director and Associate Director of the Institute of Industrial Relations) also spoke during the seminars, which were proposed and organized by Teamsters' Joint Council 7, in cooperation with the Labor Center at U.C. Berkeley. The object was to learn more about changes taking place in the economy today, and their impact on labor—particularly changes in corporate investment strategy, which have led to the wave of mergers, takeovers, and buyouts. Underlying all the sessions was the question of how labor can best protect its members from the increasing impact of these economic changes. This report will first describe the highlights of the seminar presentations and discussions, and will then consider implications for workers in general, and for organized labor in particular.

EMERGENCE OF COMPETITION IN THE U.S. ECONOMY

Professor Harris detailed the nature of changes that have occurred since World War II, in both the domestic and the international economy. At first, the U.S. was dominant, and there was no competition; an American company like General Motors decided what and where it would sell, and added up the costs, and presented the bill. In the areas of the economy that were regulated, regulatory agencies did the same thing GM did—added up the costs and submitted to the public a bill by setting a rate. "But everything was changing elsewhere in the world. As rebuilding from the war proceeded, other countries rebuilt their capital bases, and educated and trained their skilled workers, and organized and revitalized their management teams to make the best possible use of their capital and their human resources." By the early 1970s, we had a global economy, very different from our old, dominant domestic economy. It was based on continual expansion of transportation and communication abilities—especially the communication of information to link facilities together, so that an assembly plant in California could be connected with a parts plant in Japan.

Gradually, the domestic stability that was based on the dominance of our economy broke down. Now we must compete, and we must re-evaluate. There is no turning back to what used to be. And there is no predictability about the future—about inflation or interest rates, or productivity, or GNP. What is gone is the old stability, that made things work so well before.

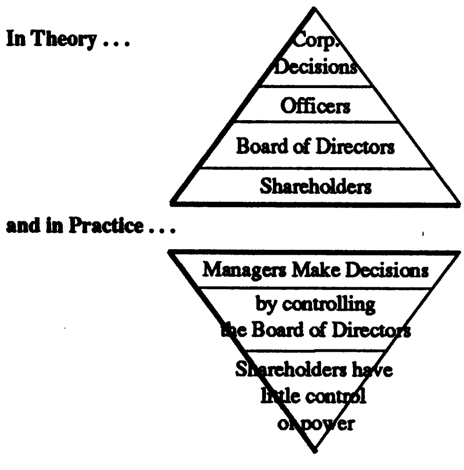
THE NATURE OF THE CORPORATE STRUCTURE

Professor of Business Administration Susan Foote next analyzed the legal framework for understanding both the theory and the reality of corporate structure and power. She pointed out that in theory a publicly held corporation is structured like a pyramid, with a broad base of shareholders at the bottom. The shareholders choose the Board of Directors, and the Board chooses the officers or managers, who are corporate functionaries at the apex of the triangle. The theory suggests that corporate management is directly responsive from the top back to the shareholders.

Unfortunately, Professor Foote said, it does not work that way in practice. The power pyramid is actually inverted, with the managers occupying the top spot. Many studies, going back to the 1930s, document that management controls both the composition of the Board of Directors and the information that the Board receives. The shareholders at the inverted apex of the pyramid in reality have little interest or power. They may own, but they don't control. When issues arise, they don't stay and fight them out, they just sell shares and buy something else.

Professor Foote noted several trends that raise serious new questions: First, the growth of institutional ownership of corporations by pension fund trusts, insurance companies, and University endowments, which now account for 70% of the value of stocks exchanged from day to day, and 45% of public stock ownership. Pension fund assets now exceed $1.3 trillion. The Council of Institutional Investors now represents 50 funds with $230 billion in assets. But the role of the pension fund manager in the corporate structure is still unresolved.

CORPORATE STRUCTURE



A second trend is increasing liability of individual members of corporate Boards of Directors. There have been huge increases in litigation against directors in the past decade. Corporate counter pressures include more barriers to suits and more protection from hostile takeovers, leading to further breakdowns in accountability, and leading also to more short run decisions being forced and made out of fear of takeovers.

A third trend involves an increasing dialogue on the corporate role—is it economic only? Many say no, that the corporation is more a political than an economic entity (noting the enormous range of PAC activity); that corporations should also be responsible to employees, customers, suppliers, and the community. Now, in addition, the corporate structure is being challenged within its own ranks for the first time, by the hostile takeover climate.

ANALYSIS OF FINANCIAL DATA

Baruch Lev, Professor, School of Business, gave the labor audience a quick graduate course in financial statement analysis. His critical view of the value and relevance of the avalanche of available data was balanced against conclusive evidence that financial statement data is extensively used—whether it presents good news or bad news. He used examples to explain the main elements involved in "An Integrated Ratio Analysis System," giving insight into profitability and risk factors, and the "leverage" of the firm—i.e., its ratio of debt to equity. He stressed that corporations issuing financial data have their own interests, and from time to time will play with the numbers; but even short of criminal manipulation, there is great leeway in accounting principles, and this leeway is utilized. Professor Lev noted that the Exxon reports (which he used for examples) include just about every kind of data on every insignificant detail of their operation—except data about employees. You get total wages and the number of employees, and you learn that in 1986, Exxon decreased the number of employees by almost 30%, without any major dislocation. But this is all you learn about employees from the financial statements. About management, you do get significant information from the proxy statements on the salaries and bonuses and stock options and benefits of the top executive officers.

ANALYSIS OF STRATEGIC INVESTMENT DECISIONS

What profit expectation will be sufficient to motivate a decision to invest? Ehud Ronn, Professor, School of Business, presented a "Net Present Value" analysis to answer this question. The corporation seeks to maximize its Net Present Value, or NPV, since this is the way its managers best serve the interests of its stockholders. Management seeks to develop projects with "Positive NPV"—i.e., those that result in some value exceeding their cost. Therefore,

$$\mathbf{NPV = PV - Cost}$$

with PV being the Present Value, or discounted value, of cash flow.

What is involved in the "discounting" of cash flow? Assume that the present risk-free interest rate is 7%, and we want to invest so that we can be assured of having $10,000 one year from now. What is the Present Value or PV of that $10,000? It is

$$\mathbf{PV = \$10{,}000/1.07 = \$9{,}346}$$

because if we invest $9,346 today at 7% risk-free annual interest, we would have the $10,000 a year from now. This is a process of discounting future cash flows, and bringing them to the present.

Now how do we calculate "Net Present Value?" Suppose we have an opportunity to invest $9,000 today and have $10,000 guaranteed a year from now. Is that a good deal? The calculation is

$$\mathbf{NPV = PV - Cost = \$9{,}346 - \$9{,}000 = \$346}$$

So it's a good deal, because we would pay only $9,000 for something which we previously determined should be worth $9,346. This is "positive NPV," which becomes very important in strategic corporate decision-making, because it permits the corporation to maximize its value.

In our first definition of PV above, we assumed a risk-free interest rate of 7%. But the real world of business is full of risk and uncertainty, and so we need a definition of PV which is more realistic. The definition becomes

$$\mathbf{PV = \frac{Expected\ Cash\ Flow}{1 + Risk\text{-}adjusted\ Discount\ Rate}}$$

In the numerator of this definition, Expected Cash Flow depends on some analysis of what might happen. If there is a boom, which we will assume here to be a 50% possibility, we might get $12,000 back on our original investment of $9,346. If there is a bust, which we will also assume to be a 50% possibility, we might get back only $8,000. So our expected cash flow becomes

.5 x $12,000 + .5 x $8,000 = $10,000

There could be more possibilities to consider than boom or bust; however, the important part of our expanded formula for PV is really the denominator, which calls for risk adjustment. Here we bring in a variable which measures the degree of sensitivity of our project (or our investment) to other economic variables—i.e., a measurement of the degree of risk. It is known as Beta, or **B**, and we can calculate it. A high **B** (housing, for example) indicates greater sensitivity to economic change and therefore higher risk. A low **B** (public utilities, for example) means the opposite. The S&P 500, which is the broadest portfolio of common stocks, has a **B** of 1, so anything else could be more or less than 1. To the extent that **B** is greater than 1, the investor expects to be compensated for risk, and this he calls his risk premium.

An example of calculated risk, with reference to three different kinds of investments, over the period 1926-1981, is as follows:

Asset Class	**Average Return to Asset 1926-1981**	**Degree of Risk**
Common Stocks	11.4%	**High**
Corporate Bonds	3.7%	**Moderate**
Treasury Bills	3.1%	**Low**

If we were to risk to invest in a project with risk on the order of **B** = 1, then its risk premium would be 11.4% - 3.1% = 8.3%, and its risk-adjusted discount rate would be

7% (= risk-free rate) + 8.3% = 15.3%

If we now calculate the PV using our expanded definition (under conditions of risk and uncertainty) for a project which is slightly below average in risk, with a **B** of .8, using the other assumptions noted above, we get

$$PV = \frac{.5 \times \$12{,}000 + .5 \times \$8{,}000}{1 + .07 + .8 \times .083} = \$8{,}800$$

If the cost of the project was $9,000, and its NPV is only $8,800, it would not be undertaken. The cost must be less than $8,800 to make the NPV positive, before we will have a going project.

What are the implications for labor in this analysis? The only impact that labor can have would be (1) on expected cash flow (an example would be a plant expansion project which might require a negotiated wage concession to make); (2) on the **B** or risk sensitivity of a project (for example, with labor sharing the risk through an ESOP); or (3) on the cost of the project (for example, with labor agreeing to outsourcing, which reduces the cost).

How far can labor press management? Only to the point of zero NPV for any conceivable project or investment of any kind.

HOW CAN LABOR DEAL WITH THE DISCOUNT RATE?

Clair Brown, Professor of Economics, U.C. (and Associate Director of the Institute of Industrial Relations) took vigorous exception to this 15.3% expectation. "His calculations are right, but he's wrong, from labor's point of view," she said, "when he argues that labor must accept that 15.3% break point for investment decision making." Labor instead must stand up and protest that kind of profit expectation, which is unheard of elsewhere in the world. "The long-run, real rate of return of capital in Japan is in the 3% range; in Germany it's in the 5% range. It is one of our chief problems that the expectation in the U.S. has been in the 12-20% range. There is no reason for that. It means we are underinvesting, and the problem lies with capital and not with labor."

The 15.3% expectation, according to Professor Brown, is chiefly a product of social norms, which have been highly structured by the Reagan Administration, especially in its early PATCO action (which put labor under siege, and showed management how to do it). Labor must also care about the national economy and about national politics. Its role on the shop floor and in negotiating the agreement is not enough. Too much of what labor can do in these roles is predetermined by the rate of unemployment, the rate of inflation, the budget deficit, and the world trade deficit—all of which are determined by government policies. There is no such thing as a "natural free market." The government must always regulate the economy—for example, by protecting private property, passing tax laws, and establishing the money and banking systems. The government and society make the basic rules for participating in the economy. Currently, we have tax and other regulations that make it profitable to merge or to raid or to leverage or to pay greenmail—so that these paper operations become more profitable than investing in new plants and operations that would create new jobs. The change in rules we are experiencing is "re-regulation," not "deregulation," and it's directly against labor's interests and in capital's interests.

Professor Brown urged that, "As labor leaders you must know how to calculate expected return, and you should know why capital argues that they need at least a 15.3% return, because if you blindly accept it, next you'll find that the rate has gone to 18%, and then you'll have nothing to come back with except, 'boy, you're really greedy pigs this year, aren't you?' while your people are still losing their jobs."

"Labor did not create these problems. Labor must use every tool it has to change the government in power, which is committed to shifting even more power and income from working people to the upper classes—and to the professionals who help them maintain power."

In response to questions, Professor Brown sharpened the difference between her view and that of Professor Ronn. "We haven't always been a 15.3% minimum return society," she said. "If this seminar had been held in 1973, you would have heard about a 3% basic rate of return, plus maybe 2-3% additional for risk, plus the rate of inflation. A discounted rate of return of 15.3% is astonishing and outrageous. It is not a mandate from heaven; it is heavily influenced by the current social norm and regulations, and these can be influenced and changed."

The seminar discussion resolved the issue of an "acceptable" rate of return in a different way. In the words of one Teamster official: "I want to know that these guys are calculating these 15.3% rates, and I want to hear it directly from them. And I want to know that they teach this kind of numbers game to the students, who soon will be the investors and the managers. How the social scientists analyze it is valuable, but it is absolutely valuable to us to have these people from the other side come here to tell us how they are going to screw the workers and the unions and a lot of others as well. That's what we need to know, from them."

MERGERS, ACQUISITIONS AND DIVESTITURES

The lead-off seminar speaker on this topic was Stephen Kealhofer, Visiting Professor of Finance at U.C. Berkeley. Professor Kealhofer described the general types of mergers (vertical, horizontal, and conglomerate) and the specific type which has become most common now: acquisition of stock by friendly or unfriendly tenders (offers to stockbrokers to sell to an acquirer), as regulated by the Williams Act of 1969.

The various defenses now utilized to fight acquisition attempts are summarized in the chart following this page.

Mergers have occurred in the past in waves (1900; 1920s; 1967-69; 1981-87), in periods of very high stock prices. The current wave owes much of its force to the shift to a global economy (more competition from abroad), greater availability of easier credit (past requirements, for example, prohibited the development of "junk bonds"), and the relaxed or non-existent regulatory environment. The Reagan Administration has been able to interpret and do what it pleases about the loose anti-trust requirements of Sec. 7 of the Clayton Act. It has only observed the increasing wave of merger and acquisition activity, and has blocked almost nothing.

The traditional economic rationale for mergers and acquisitions is based on greater economy of scale, or efficiency of operation, or better deployment of the firm's resources (Lucky Stores getting rid of Gemco), or on removing or disciplining inefficient managers. However, there are significant tax considerations involved as well, and these are important in social policy terms. Because of tax liabilities, there is greater incentive now to use debt (to be able to

HOSTILE TAKEOVER GLOSSARY

Poison Pills:	Booby traps set up to make a hostile takeover attempt less profitable, and therefore less likely to occur.
Shark Repellants:	Changes in corporate charters designed to make it more difficult to acquire the corporation.
White Knights:	Third parties acceptable to the target firm as alternate acquirers.
Restructuring:	Taking actions the acquirer planned to take, like increasing leverage. A white knight is also likely to restructure.
Golden Parachutes:	Large cash payments to top executives, usually made as hush money to keep them out of the picture.
Greenmail:	Buying off raiders by a substantial premium for their stocks.

write off interest payments against taxable income) than to issue stock. Also, if a firm is underleveraged (not using enough debt), someone may be poised to use debt in a takeover attempt.

Prior to 1979, firms resisted getting too highly leveraged, because managers would lose out if defaults occurred. But since then, credit markets have permitted easier borrowing, use of debt has increased, and leverage has been exploited. When a corporation has little or no debt, it may even need to "leverage up" to keep from becoming a takeover target. We've also seen more leveraged buyouts in recent years (Safeway is an example), where the acquirer borrows substantial amounts to purchase the target firm's shares, and ends up selling off assets to service the higher level of debt. Finally, we've seen substantial increases in tender premiums in recent years. In the 1960s, if a stock was at 100, a takeover bid would be at 110 or 120. Since 1981, the premium involved has gone up to an average of 80% over the initial market price; so a tender for a stock at 100 would now typically be 180. It is difficult to see that so much additional value is being created in the takeover to justify such a premium.

THE VIEW FROM THE STOCKMARKET

Professor Kealhofer reviewed the conclusions of an exhaustive study (by Mikkelson-Ruback, University of Chicago) tracing out the stock market reactions that followed from 175 out of a total of 470 13(D) filings. These filings are required by law, whenever someone obtains a 5% interest in a public corporation. In the 175 cases, the original filing was not associated with any takeover that was then going on, and the transaction involved in the filing was completed in some fashion. So the 13(D) filing was the initial event, after which the following should occur:

Intermediate Events	Outcomes
Acquirer makes tender	Takeover by Acquirer
Third Party makes tender	Takeover by Third Party
Acquirer buys more stock	Acquirer sells shares (no takeover occurs)
Target Company resists	Target Company repurchases stock ("greenmail" situation)

This is a fairly complete listing of what could happen after the initial filings. What emerges from a summary of the stock market reactions in these 175 cases is first, that the target firm got most of the positive effects, with average returns to stockholders of about 20% in the whole process. Secondly, the worst thing the acquirer can do is actually go through with the takeover. There is some positive increase in shareholder values if the takeover occurs, but there is a greater increase if the target firm pays greenmail to buy off the acquirer, or if the acquirer sells off the shares to someone else (another potential acquirer, or a White Knight).

None of the analysis reviewed by Professor Kealhofer included any references to the impact of takeover/merger/buyout activity on workers, on jobs, on suppliers, on consumers, or on communities affected—only the impact on stockholders (and incidentally, on top executives and corporate managers). The question was therefore raised whether the social consequences justified hearings and possible legislation to review the standards and criteria and rules under which all this frenzied and often chaotic economic activity is taking place.

Professor Kealhofer relied on the "long-term" view, to which economists so frequently retreat: takeovers and mergers may have short term social costs (associated particularly with tax code politics), but there is no consensus on what new standards or criteria or rules should be established; further, the takeover bidders have their own resources at stake, and are committed to find better long term uses of the assets of the targeted firms, which will finally lead to more income and more jobs for everyone concerned. "I don't want to get on the spot of defending Ivan Boesky," he said. "And I'm not advocating greed. We should be concerned about the social benefits of these actions. But on the other hand, just because we may say that a person is motivated by greed doesn't mean that the effect of his actions is going to be bad for us."

A number of seminar participants took serious issue with Professor Kealhofer's position. Harry Polland, Economist (Beeson, Tayer, Silbert, San Francisco), summarized what appeared to be the consensus: it is not a matter only of greed or criminality; instead there is predatory activity involved, that has nothing to do with economic efficiency. Avis, which has been sold five times in the past three years, is a familiar example for Teamster employees. People are playing a real estate game with business interests in the U.S., in contrast to countries like Japan, where industries look to the future and are concerned with improvements in the productive mechanism. That's a better model. Here, the model is one of financial wizards moving in and out of companies, interested only in temporary gains for the people they represent. "The takeover process that has developed in our country in recent years is doing great economic harm to our system and is creating a group of employers who are not more efficient, and who don't even know the business enterprise they are entering into, but are simply playing short-term profit games."

CASE STUDY OF LUCKY STORES

The basic difference in view which emerged in discussion of Professor Kealhofer's analysis was not resolved in the ensuing case study of the attempt by Asher Edelman to take over Lucky Stores (between September 17, 1986 and February 23, 1987). The analysis was presented by Therese Hensen, an MBA candidate in the Graduate School of Business at U.C. Berkeley, who was instrumental in organizing and arranging the entire seminar series.

At the time of Edelman's raid, Lucky had 1,500 food stores (including 600 supermarkets) and 68,000 employees. Lucky also owned Gemco, Kragen Auto Parts, Checker Auto Parts, Hancock Fabric Stores, and Yellow Front General Merchandise Stores. In responding to the takover threat, Lucky restructured its entire operation, first by selling Gemco, with the loss of 14,000 jobs (4,000 of them in the Bay Area, where terminated employees were represented primarily by the Teamsters and UFCW). Most Gemco stores were purchased by Dayton-Hudson Corp. which closed them for six months, thus avoiding union recognition and permitting them to re-open as non-union operations.

Lucky's restructuring to "protect" itself from Edelman's takeover bid also required the sale of its 378 Kragen-Checker stores, and the sale of its Yellow Front General Merchandise Stores, and the spin-off of its Hancock Fabric Stores (to Lucky shareholders). Ms. Hensen discussed in detail her model analysis of the Lucky takeover chronology—including discussion of her sources for the data which she compiled in an "integrated ratio analysis" of Lucky, and her explanation of the stock market reactions to Edelman's challenge and Lucky's response. She concluded that Lucky would have had to sell Gemco, raid or no raid. Using $560 million of income from the "restructuring" sale of its assets to buy back shares from stockholders, Lucky's stocks came back to trade at about $30 a share (it was $26 before Edelman's raid). So the shareholders gained, and Lucky ended up with fewer assets and much more debt (its leverage ratio went from 20 to 30). Thus Lucky is no longer an "underleveraged" potential target for another raid.

1985 RATIOS UTILIZED IN THE LUCKY STORES CASE STUDY

Ratio / Calculation	1985 S&P Food Chain[1]	1985 Lucky Stores[2]
Current Ratio (Current Assets + Current Liabilities)	1.2	1.2
Quick Ratio (Current Assets - Inventory ÷ Current Liabilities)	0.3	0.16
Debt to Total Assets (Total Debt + Total Assets)	26.0%	20.4%
Times Interest Earned (Earnings Before Income Taxes + Interest)	4.00	5.59
Inventory Turnover (Sales + Inventory)	12.2	11.83
Assets Utilization (Sales + Total Assets)	4.1	4.86
Profit Margin (Sales - Cost of Goods - Expenses + Sales)	3.73%	3.02%
Return on Assets (Earnings After Taxes + Interest + Total Assets)	7.85%	6.15%
Return on Equity (Earnings After Taxes + Common Shareholders/Equity)	15.0%	13.6%

(1) Standard and Poors Analysts' Handbook, 1985
(2) Lucky Stores Annual Report for year ended February 2, 1986

THE VIEW FROM JAPAN

Pressures from the stock market are not felt in the same way in Japan, where there are no hostile takeovers and restructuring reactions, according to the next seminar speaker, Michael Gerlach, Professor of Business Administration at U.C. Berkeley. The Japanese economy has had the lowest unemployment rate of any industrialized country in the past decade, and has the highest savings rate, making it now the world's leading creditor nation. Japan is also the chief funding source for the world's largest debtor nation, which is now the United States.

The Japanese economy directs competitive pressures in a very different manner: while we cut staff and close plants and terminate employees and trim costs, Japan puts the emphasis on keeping employees and finding new work for them by creating new markets. Japanese companies have closer relations with banks and a more positive relationship with government. They have a greater commitment to stabilized (if not full) employment. Working relations between labor and management are closer; labor has given management greater production control in exchange for greater employment security. It is true that this exchange prevails mainly in larger industries. It is also true that there is a company union tradition, but there are also national unions—of teachers and railway employees—and there is a non-negotiating federated group bigger than the AFL-CIO, which has active socialist ties.

The U.S. trade deficit with Japan will not end soon, and there is little the Japanese government can do about it, because it is not related to their government policies. Tensions in our relations will continue, but in the long run, we need each other. The most likely solution to the trade imbalance is that Japan will replace its exports to us by buying and operating production facilities here. Thus, in the future, and especially in California, a lot more Americans will be working for Japanese companies.

It is not clear yet how well this will work out—there is conflicting evidence. At NUMMI in Fremont, the autoworkers have jobs and good benefits, but do they pay a price with harder work in order to maintain the high Japanese standards for quality of output? Japanese workers make this kind of trade-off; American workers may not be willing to make it. Also, American managers have different kinds of pressures and incentives, which result in responses to workers that are very different than in Japan. There is some concern there that our management practices might poison theirs, when they begin to own more plants and produce more goods here.

HOW CAN UNIONS PROTECT THEIR MEMBERS?

How can organized labor protect its members from the increasing impact of these unregulated raiding/merging/restructuring activities? Some ideas and possibilities were explored by speakers and participants during the seminar series.

George Strauss, Director of the Institute of Industrial Relations at U.C. Berkeley, argued that anything affecting the company's profitability is now the business of the union, which must demand continuous information on what is going on, as a contractual right. The banks hedge their loans to the company with contract provisions about the use of profits and assets; the union can make similar arrangements, particularly when concessions are involved. Unions should tighten job security provisions (which can be privileged claims against company assets even in bankruptcy cases), and establish more joint labor-management committees for all kinds of purposes (including quality of work life programs; not all of them just manipulate the workers). Finally, there must be more careful consideration of profit sharing and stock ownership (often possible in concession situations), participation on the Board of Directors, and the final option of taking over and running the company. Above all, it is not possible any longer to wait and react to what management does; T. Boone Pickens will then be on the scene. "Experiment and be imaginative. Put on the running shoes. Play a new ball game. The old one doesn't work for you anymore."

Harry Polland, the chief organizer of this seminar series, summed up at the request of Chuck Mack (President, Teamsters Joint Council 7). He noted a serious problem with those who believe we shouldn't stop or regulate excessive takeover activity. American industry has to learn to balance some human values with all this competition and incentive theory. Worker morale is very low in this country, but it takes high morale to get high productivity.

Labor must learn to speak up on these matters. The workers we represent want to participate in the survival and the success of the enterprise.

Secondly, we have to adopt more effective and constructive positions which are sensitive to what the company is doing and where it is going. We cannot relegate the collective bargaining process to a 60-day period at the end of the contract. We have to commit to increased productivity and we have to audit continuously and we have to participate in labor-management committees—and on the Board of Directors, as Strauss indicated. We even have to revise our own jurisdictional lines, like those between drivers and warehousemen.

Third, we have to relate to the macro-economic policy issues, like trade relations and monetary and fiscal policy and exchange rates. We can't rate the politicians any longer on the exclusive basis of their labor relations voting records.

EXPAND THE COLLECTIVE BARGAINING HORIZON

Most important, in our relations with management we have to expand our horizons and broaden our view of what the relationship is all about. It's about more than processing a grievance, or winning an arbitration, and more is involved now than just negotiating a new contract. The basic nature of the collective bargaining process itself has changed. In our past approach to profit sharing, for example, we have usually just rejected plans put forth by management; now we have to approach this subject on a bilateral basis, and help to structure the plan. And we have to audit, continuously, not just the plan, but the company's operations. Professor Lev indicated the wealth of statistical data and information that is available, and the Lucky case study showed the kind of analysis we should be making of the companies we deal with. In the pension area, where the savings of working people make up 45% of all the investments that are publicly traded, we have to find a way to influence the anti-union attitudes of those who use our money. We need to play a role as shareholders, and get involved in their meetings. And we need to learn how to deal with the banks. Neilson Freight was just closed down by Barclays Bank, even before the contract negotiators got to any question of a wage concession. There was no input to the bank's decision from the workers whose jobs were lost.

SOME LEGAL CONSIDERATIONS

Duane Beeson (Attorney, Beeson, Tayer, Silbert, San Francisco) urged labor representatives to negotiate a solid successors and assigns clause, committing the employer to make any sale only on condition that the jobs and the contract go with it. The courts have acknowledged the right of the union to sue an employer who violates a careful successors and assigns clause. But beware, because the language of many existing clauses is inadequate. The courts have also permitted the union to sue a buyer who knew of the existence of a valid clause—for interfering with the contractual relationship between the union and the seller. Through Joint Council 7, model clauses have been distributed on successors and assigns, severance pay, job retraining, and extended health and welfare coverage.

Secondly, employers in this era of concession bargaining have been coming back to the union to ask for new negotiations even in the middle of a contract term, opening new doors for you to say "show us," "explain your problem," "tell us how you plan to run the company in the future," because we want to be participants in this. We can get our foot in this door.

Third, we should be demanding legislative hearings. Some fierce in-fighting is going on between a few highly paid managers and the market raiders and opportunists, and millions are made on these deals, and millions of employees get hurt in the process. We are on the defensive, and so we must build some momentum by pushing out our views to others. In the long run, the only effective protection may be that which comes from legislated regulation and control of takeovers and mergers and acquisitions.

SOME SEMINAR POINTS OF VIEW

In the presentation of the Lucky case study, seminar participants agreed that the numbers (in the integrated ratio analysis) give some signals about the company's vulnerability, which can help the union protect its members even when there is no takeover attempt. However, there was also suspicion of the tendency of academics to over-quantify and to neglect what can't be expressed in numbers—like ideologies, personality conflicts, prejudice, ego trips of executives and managers, and careful analysis by management of strengths and weaknesses of the unions involved.

There was also healthy distrust of the economic models. "Our experience is that once the model is in place, someone can decide what the outcome should be and go back and manipulate the numbers to get there. So the model ends up turned inside out. We wonder what value it has."

The seminar was organized to present to a labor audience what the business school professors teach their students. One participant responded: "We're very much concerned here that the MBAs are taught how to make money, and not how to create jobs. Hell, we're greedy too. We want the best for our members. But what we hear you saying is that you teach people how to get rid of $14/hour jobs, and pick up some of the slack with $5/hour jobs. We're concerned with what is being taught in our colleges, because it sounds to us like you teach how to go out there and make yours—even if you have to screw everyone else in the process."

Another participant was critical of the exclusive business school focus on the interest of stockholders, neglecting any interests of employees or the society itself. "All of us here have much greater problems with what is going on than any one of you has addressed. We think that the standards and the criteria for mergers and takeovers have all but disappeared. No one is taking account of the consequences to employees and to consumers and to the community and to the economy in general. When do we get on with some hearings and the possibility of new legislation and new rules?"

SOME EDITORIAL COMMENT

Seminar participants were impressed not only with the sophistication of the financial data that managers and investors and business school students utilize, but also with the extent to which they appear to be immersed in the numbers they live with. The wealth of detail about corporate earnings and costs and profitability and debt presents a striking contrast to a worker or his union representative: there simply are no comparable data sources and calculations of the costs to workers of job losses, and the costs to consumers and communities and the society at large of economic changes resulting from private investment decisions. The national economy appears to function only with reference to shareholders and their interests.

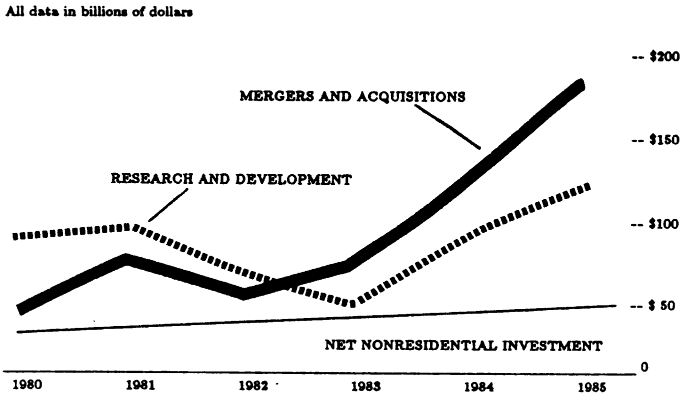
Some participants were surprised to learn of the extent to which debt now fuels merger and acquisition activities. Professor Brown indicated how the Reagan years have restructured our social norms with respect to the roles of labor and capital. But Reagan's willingness to fund huge military expenditures with debt has given the same lead to the corporate raiders who replace equity with debt in their funding of mergers and acquisitions. Only a few years ago, it was a fundamental tenet of conservative ideology to avoid this plunge into debt, which was regarded as the illegitimate offspring of the profligate spending of liberals. The accumulation of enormous debt loads, at real interest rates that are high compared to other industrialized countries, now drags down the ability of American enterprise to compete.

Participants raised other issues which are just beginning to be raised by national authorities and critics, some of whom now believe that American industry has been distracted by the new game of mergers and acquisitions. Some of the nation's brightest management talent is engaged in takeover activities and empire-building. Some of the nation's best students become MBAs or lawyers and eventually, professional moneymakers. Their attraction is the money game, in which profits are made not by engineering innovations and manufacturing and selling goods, but by risk arbitrage and by speculating on the rise and fall of the dollar against other currencies. This is not productive enterprise.

Data reported by the *New York Times* indicates that the value of mergers and acquisitions reached an all-time high of $82.6 billion in 1982 ("The Hidden Costs of Failed Mergers," *N.Y.Times*, June 24, 1987). New records have been set every year since then: $122.2 billion in 1984; $179.6 billion in 1985; and $190 billion in 1986. All told 75 of the 100 largest mergers in our history have occurred since 1981. "Thus, two decades of managerial energies devoted to playing the merger game are, at the same time, two decades during which management has been diverted from the critically important job of building new plants, bringing out new products, investing in new production techniques and creating jobs. The billions spent on shuffling paper ownership shares are, at the same time, billions not spent on productivity-enhancing investments. The following table illustrates the point dramatically. Note that in 1985, spending on mergers exceeded combined expenditures for R&D and net new investment."

The hostile takeover raid has been the engine driving this activity, relying on easy credit arrangements, and paying out enormous fees to risk arbitragers, some of whom have gone to jail for fraud, while others have reported incomes from fees as high as $86 million in the single year of 1986. In the corporate restructuring which has resulted from hostile raids, from defenses against them, and from leveraged buyouts in response to them, thousands of jobs have been eliminated, and thousands more have been dislocated and downgraded, as employers have sought to meet unprecedented new debt loads. Some long term pension and health care "commitments" to workers and retired workers have disappeared. While many have faith in their "invisible hand" that will always direct the free marketplace to benevolent ends, it has yet to be shown that any significant part of this frenzied economic activity leads to

WHAT U.S. INDUSTRY HAS SPENT ON:



Source: W.T. Grimm & Company, Commerce Department greater efficiency. But contrary evidence piles up daily in mounting trade imbalances, which have changed the nation's status from creditor to debtor in the brief span of the Reagan years, and have called into question the competitive ability of American enterprise.

Jim Hightower, Texas Commissioner of Agriculture argues that "Last year there were 4,022 mergers, leveraged buyouts and takeovers in this country. They soaked up $190 billion in capital. In the last three years, 9,000 companies at a cost of nearly half a trillion dollars. For what? Not for new plants, products or jobs but for paper shuffling—for lawyers, accountants, brokers, bankers, and big investors—hundreds of millions of dollars paid in nonproductive fees to achieve nonproductive ends." (*N.Y. Times*, 6/21/87)

Hightower goes on to point out that the investment syndicate of Kohlberg, Kravis and Robert "paid itself $60 million in fees to handle its own takeover of Safeway" in a $4.2 billion leveraged buyout scheme. KK&R paid its lawyers $10 million, its consultants another $10 million and the printer of the takeover documents made $3 million. How did the employees fare?

"Nearly 1,000 of the 3,000 Safeway stores are expected to be closed or sold to pay for the deal, affecting over 30,000 employees. Already, 8,600 Safeway workers in north Texas have been laid off." (*N.Y. Times*, 6/23/87)

Recently, Safeway sold 172 of its stores to Vons for $325 million in cash and 30% of Vons stock. *L.A. Times* labor editor Harry Bernstein says that "[t]he only victims of the deal will be those workers who get laid off in a consolidation and consumers who may have to pay higher prices because the acquisition will reduce supermarket competition." Bernstein points out that much smaller mergers were judged monopolistic during the Eisenhower years, but the Reagan administration has a "mergers-are-not-all-that-bad" attitude that makes any interference with the Safeway-Vons deal by the Federal Trade Commission unlikely. (*L.A. Times*, 12/18/87)

Chairman of Sony Corporation Akio Morita writes, "A nation's economy is only as strong as its manufacturing base, and this base is chipped away by every mindless merger and by every decision to shift production to a newly developed country only to save on labor .... America must return to fundamentals, to making things of real value. A business organization's real asset is its people—their good will, their enthusiasm, and their creativity. But how can you expect your people to be motivated to work when they are traded like merchandise? ... The world's economy depends on the dollar; the strength of the dollar, in turn, depends on the vitality of American industry. The United States must get back to business." (*San Francisco Chronicle*, June 15, 1987).

The issue of the role of ethics in the business school curriculum is now subject to lively debate. Lester Thurow, Dean of the Sloan School of Management at MIT, writing on this subject in the *New York Times* (June 14, 1987), notes that today's finance classes teach that the sole goal of business managers should be to maximize the net worth of shareholders. Managers follow this principle because doing so maximizes their personal net worth. But if these are the only goals of firms and individuals, "it is but a short jump to maximize such monetary variables with means that are illegal or unethical. To create ethical business behavior, we must place higher value on goals other than personal or shareholder net worth."

Should the business schools then teach the doctrine that one should sacrifice self-interest for the collective good, Thurow asks? "Sacrificing self-interest for the common good is not going to be advocated by business schools or accepted by our students unless a majority of Americans also support the premise. In the end, business ethics is merely a reflection of American ethics." (*N.Y. Times*, 7/14/87)

The national debate on these issues is far from over but if Hightower, Morita and Thurow and a legion of other businessmen, public officials and academics are correct, we in the U.S.A. must act quickly. We must effect some very basic changes, we must return this nation to a path of producing valued goods well and valuing good workers—or we will wish we had.

Appendix 1

Financial Information from Employers

1. Documents submitted to banks for the purpose of obtaining a loan. These should include projected balance sheets and income statements.
2. Schedule of total compensation to officers, managers, directors and/or owners.
3. List of autos owned or leased by the company.
4. Expense reports submitted by officers, managers, directors and/or owners.
5. Information on pension and/or retirement, plans from which union members are excluded.
6. List of prerequisites such as club memberships, etc. provided by the company to its executives.
7. List of buildings and land owned or leased, their market value or lease information.
8. Organizational chart of all non-union employees.
9. Other companies owned in part or whole by any company affiliates or officials.
10. Financial statements for three years prior as well as tax returns and current financial statements.
11. Depreciation schedules for all depreciable assets as well as current market values for these assets.

12. Corporate federal income tax returns for last three years.
13. Employment contracts, stock options, life insurance policies, executive pensions, golden parachutes and loans for officers, managers, directors and/or owners.
14. Analysis of working capital for the last three years.
15. Identification of any extraordinary, unusual or non-recurring costs occurring in the last three years and current year.
16. Management reports/analyses submitted to top management or corporate heads on the facility and its performance during the last quarter and last two years.
17. Average employment, broken down between bargaining unit and non-bargaining unit, for each of past three years and projected for current year.
18. Future outlook—operating plans, forecasts, projections and specific company programs to improve its financial situation.

In addition, multi-plant companies:

19. Cost and price information and other relevant information on intracompany transfers of products and services.

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SEMINAR IN BUSINESS ECONOMICS AND CORPORATE FINANCE FOR LABOR

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**International Brotherhood of Teamsters
Joint Council No. 7
and the Center for Labor Research and Education
University of California at Berkeley**

There will be four sessions, each Friday from April 24 through May 15. Each session will begin at 9:00 a.m. and last until about noon each day. The sessions will be held at the Teamster Hall, 70 Hegenberger Road in Oakland.

April 24

Introduction	Chuck Mack, President, Teamsters Joint Council 7 Marty Morgenstern, Labor Center Chair
The Emergence of Competition in the U.S. Economy	Robert Harris, Professor, School of Business
Power and Control in Corporate America	Susan Foote, Professor, School of Business
New Directions in Collective Bargaining	George Strauss, Director, IIR

May 1

Financial Statement Analysis	Baruch Lev, Professor, School of Business
Analysis of Strategic Investment Decisions	Ehud Ronn, Professor, School of Business
Why All This Matters	Clair Brown, Professor, Economics Department

May 8

Mergers, Acquisitions and Divestitures	Stephen Kealhofer, Professor, School of Business
A Case Study: Lucky Stores	Stephen Kealhofer and Therese Henson, MBA Candidate

May 15

International Competition and U.S. Competitiveness	Michael Gerlach, Professor, School of Business
Labor's Response to the New Business Environment	Duane Beeson, Attorney Harry Polland, Economist
Discussion	Chuck Mack