

THE GLOBALIST

Commencement 2000

Myths of the Past to be Considered Today

by Richard M. Rosenberg • Chairman and Chief Executive Officer (Retired), Bank of America NT&SA

Dear Friends:

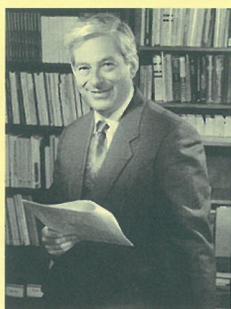
On May 24, Brandeis celebrated its 48th Commencement and GSIEF its 6th. It was a festive day, with Archbishop Desmond Tutu delivering a moving plea for freedom at the main graduation ceremony. GSIEF awarded 72 degrees, including the Lemberg MA and the first MBA/International and Master of Science in Finance degrees.

Those who remember the first Lemberg graduation, with nine graduates and home-made hors d'oeuvres on the Sachar roof (one could still walk on it in those days), would have been amazed to see the School's ceremony in the Sachar auditorium, filled to overflowing with proud parents and relatives from every corner of the world. The photographs hopefully capture a little of this special day.

The School's Commencement Address was delivered by Richard Rosenberg, former Chairman and Chief Executive Officer of Bank of America. It was an excellent address, focusing on the extraordinary changes of our economy, and commending humility to all who'd dare forecast it. We reprint it fully below.

With congratulations to the new graduates and best summer wishes to all.

Peter Petri
Dean and
Carl J. Shapiro
Professor of
International
Finance



Thank you, Dean Petri, and good morning everyone. It is an honor to be back at Brandeis today. I am especially pleased to address those of you whose names are on the advanced degrees from the Graduate School of International Economics and Finance; those who supported you in that effort, namely your families and friends; and, of course, those who provided the knowledge, guidance, and wisdom prerequisite for this event, namely the Brandeis faculty and staff.

I intend today to speak of nine myths or truisms that were absolutely accepted as facts at graduations similar to this one, as short a time as two decades ago.

With the benefit of time, we have come to see that these so-called truisms have become discredited, and are almost amusing when one considers that these myths were completely accepted by outstanding economists, business leaders and financiers.

Unfortunately, many domestic and international financial actions, and many business policies were formulated on the basis of these myths. It is not my desire to point out how wrong the world of finance and business was 10, 15 or 20 years ago for the sake of demonstrating how smart we are today. Rather, I will discuss these truisms and their implications to, hopefully, alert you to the new truisms to which you have been exposed, and how today's irrevocable or indisputable facts may become tomorrows discredited truisms.

Myth #1: Sovereign Nations Don't Go Bankrupt

As a career banker, this myth really resonates with me. It is popularly credited to Walter Wriston, while he headed Citibank and its international lending during the 1970s and 80s. This was a time of great optimism and international expansion, when major banks and multilateral agencies syndicated loans of billions of dollars to lesser-developed countries, particularly in Latin America, to theoretically help them finance infrastructure, facto-



Left to right: Dean Peter Petri, Board of Overseers Chair Charles Housen, and Commencement Speaker Richard Rosenberg.

ries, and housing. There was no credit concern, because loans were backed by the full faith and credit of the governments involved.

The reality was that the Latin American governments reneged on their loan payment obligations, throwing their loans into default, and forcing their lenders to restructure, write down, or write off the loans. Citibank, Bank of America, Barclays, The Industrial Bank of Japan and most other big money-center banks lost billions of dollars, taking major cuts in share prices and the erosion of public confidence because their capital had been wiped out by loan losses.

The world's financial structure was crumbling because of a truism that had been repeated over and over again—sovereign nations don't go bankrupt. As a result of that lesson which was discredited, we hope, banks today are in much better shape than they were going into the Latin American debt crisis of the 1980s. They have much larger capitalization, larger loan-loss reserves, tougher adequacy rules, more diversified earnings streams, and much more sophisticated risk management.

The larger question that still arises from that discredited myth lies in the question of whether troubled nations should be forced to repay their debts regardless of their circumstances and, if they do not repay them, who takes the loss—the banks that assumed the risks or the governments that want economic stability. The economics of international lending are being questioned by individuals, who argue that monies being spent on debt

market. But more important, cable television came on the scene and fragmented the mass audiences that the networks had provided. Cable competition transformed over-the-air networks from cash cows plump with advertising dollars into low-margin businesses. And cable became the most profitable entertainment business of the 90's.

To see what happens when a myth or truism is shattered and all of its implications, think of the following: Today, General Electric owns NBC, Viacom owns CBS, and Disney owns ABC. And, even with people watching more TV than ever—seven hours and 24 minutes a day in the average household—the three networks together have only a 45 percent market share.

Looking into the future, the networks' greatest competition is not each other. They are facing an onslaught of new competitors, all driven by digital technology.

All these warring parties want to grab a piece of the \$60 billion a year in advertising revenues generated by the television industry each year. Their focus is personalization—viewers will watch what they want, when they want, on whatever device they want, and also be able to create and distribute their own content. People will watch Internet video interchangeably with traditional TV.

A sideline to this battle, but a new battle in which huge amounts of capital are being invested, is whether we will use traditional telephone companies around the world to carry our telephone messages, or will we use the cable MODEM combined with fiber optics to be our telephone company. In fact, I could have created another myth or truism from this statement: "We will always use telephone companies to make telephone calls." But, instead, let's turn to Myth 6.

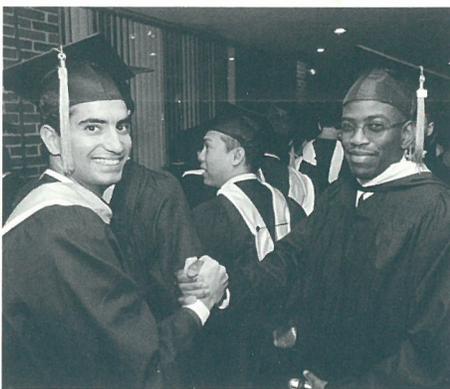
Myth #6: The World Will Always Wear Levi Jeans

When my kids were your age, they wore Levis jeans. Their friends wore Levis. The Rolling Stones wore Levis. The whole world wore Levis—or wanted to. Levis were cool. They were actually used as currency in some developing economies as a medium of exchange. Levi was one of the world's most successful brands.

Flushed with success, the company went semiprivate in 1985. Levi's stock climbed more than 100-fold. It went totally private in 1996, placing its entire future in the hands of four family members. Driven by a social conscience and a community minded management, it became a politically correct organization that just happened to be in the garment business. Fundamentally, it did not change its principal

product line, strain its distribution system, or revamp successfully its image over time. One of its major distributors, The Gap, switched to its own brand, and distribution of something that had once been a currency became a not so profitable commodity.

Since 1990, the once and seemingly forever-cool Levi Strauss & Company has lost half its market share to hipper brands (excuse the pun). Intent on showing that a company driven by social values could outperform one driven by profits, Levis management lost touch with the Company's main goal: To sell as many jeans or other apparel as possible.



Levi's current situation is that, despite a major re-engineering, the Company's market value has shrunk from \$14 billion to about \$8 billion since it went private. But no one is writing Levi's obituary. No other apparel manufacturer comes close to it in brand recognition, sales, or cash flow. The Company appointed a new CEO last fall, the first non-family member to head the company. It has refocused its mission and is fighting hard for survival and success.

What are the implications of the Levi Strauss myth for those of you who will have to evaluate similar situations in your careers? Levi is a private company so there is much we do not know. Perhaps, it's a story of what can happen when very well-intentioned managers run a private company and do not have to answer to public investors and security analysts. Perhaps, it's a tale of mistaking a social mission for a manufacturing plan. Perhaps, it's a lesson about ignoring changing markets at your peril. And, perhaps, it's only a great lesson in the fact that kids don't wear the same jeans that their parents did.

Myth #7: Prescription Pharmaceuticals Will Never Do Direct-to-Consumer Advertising

Historically, prescription drug makers promoted their products exclusively to health-care profes-

sionals. Patients rarely, if ever, knew the name of a drug they were prescribed, and certainly never knew enough about a new drug to ask a doctor for it. The fear was that people would use medicines improperly and be harmed—an attitude that persisted for some 400 years.

To some extent, worldwide drug policies reflected some of the anachronisms of this way of thinking. If distribution and introduction of a new drug was always going to be a laborious process, drug prices would need to reflect, not only the enormous cost of development, but the tremendous costs of introducing drugs when the drugs could not use the accepted methods of mass introduction—consumer advertising.

Perhaps coincident to the rise of consumers demanding more information, Federal Drug Administration rules regarding advertising slowly loosened. In 1990, 10 medicines were advertised directly to consumers—with voluminous information about possible side effects. In 1997, 87 medicines were advertised directly, as the FDA relaxed its guidelines for television and radio advertising. Today, you can't open a magazine or watch a TV program, without being bombarded by drug company ads. The best-selling drugs in America are advertised everywhere, by former presidential candidates and super models. The industry spent \$1.4 billion for prescription drug advertising in 1999, and will spend an estimated \$2 billion this year.

Many sell at the \$1 billion-plus level. For example, Monsanto's new arthritis drug, Celebrex did \$1.5 billion in sales in its first year, even breaking Viagra's first year record of \$700 million. Advertising is the miracle drug for miracle prescription sales. Many people believe it has been a win-win-win situation: People have become more involved with their health care, doctors have developed better communication with their patients, and drug companies have become the darlings of Wall Street.

Once again a truism or myth is demolished with significant implications for consumers, companies, governments and their economic advisors in every nation in the world, since drug pricing is a political issue as well as a health issue.

Myth #8: Low Unemployment Leads to Inflation

How many of you took Economics 101? How many of you learned there that low unemployment absolutely leads to inflation, because consequent rising wages push up prices. I learned that, too. But Economics 2001 is teaching us that low unemployment can peacefully coexist with low inflation. In fact, our current situation

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in the U.S. is that we are in the 10th year of economic expansion, the longest expansion in recorded U.S. history. It is not only the longest; but also the highest, in terms of sustained growth in real GDP; the lowest, in terms of unemployment; and, most critically, the mildest, in terms of inflation as measured by the Consumer Price Index.

In the course of the last few years, your faculty has developed a variety of theories to help Alan Greenspan question the truism—once learned—that low unemployment leads to inflation. These theories included the fact that contraction of Asian economies led to goods being imported into the U.S. at lower prices, which increased competition in domestic markets. Energy prices bottomed out. Uncertainties associated with economic crises in Asia and Latin America prompted foreign investors to seek the dollar as a safe haven. The result was an appreciation of the dollar, an inflow of funds, and a decline in U.S. interest rates—all of which helped support business investment and growth.

But, clearly, the most important reason being advanced in the last two years is that inflation, in spite of low unemployment, has remained under control because productivity growth has accelerated to more than 2 percent—an unprecedented rate. This factor has helped to explain how the U.S. economy has been able to grow with negligible inflation over the last two years.

My forecast is that productivity will accelerate, because of the hundreds of billions of dollars firms have invested in computers, data processing, networks, telecommunications, and other equipment. Because companies and employees are working smarter. Because they're managing their supply chains in real time. Because companies are empowering their employees to produce more goods and better services, more efficiently. My real concern is that many economic policy makers are unable to let go of the myth they once learned—low-unemployment automatically

leads to inflation. They cannot let go because that myth has been around so long that they must create policies that perpetuate it.

Myth #9: Location, Location, Location

Whether in London, Paris, Tokyo or New York, location was a critical component of success in determining real estate values. It used to be that where a business put its bricks and mortar—it's real estate—largely determined its sales.

Location also played a major role in decision factors for office construction. But Myth 9 is being demolished faster than any of us can imagine all because of the Internet—a concept that really did not exist for commerce just 10 years ago. But, today, does anyone in Waltham care if Amazon is located in Seattle when you want the convenience of buying a book quickly? Do I care in San Francisco, that as a director of the San Francisco Symphony, I like to read the reviews of the Boston Symphony in the Boston Globe but I can't buy The Globe at my local newsstand? Of course not. I read the Globe on the Internet. Real Estate, with all of its implications for wealth creation, public policy issues from zoning, to urban sprawl, to highway construction, taxation, to fund causes in which many of you are interested, is becoming a different entity and will have to be redefined. The myth of location, location, location may no longer mean Fifth Avenue or Tremont Street but may mean www.AOL.com. Think about the meaning of that statement for the world of real estate finance and urban economics.

The Internet has changed the golden rule of real estate. Cyberspace has no boundaries. The new world currently being created online is bounded not by geography, but by technology. Having a Silicon Valley address is nice, but ultimately it doesn't matter where you do Net business.

Conclusion

So what do we make of all this? I started out by saying that my purpose was not to discredit myths to show how smart we have become, but to challenge all of us about the myths and truisms that we now currently accept, just as earlier generations accepted that Sears Roebuck was always going to be the dominant retailer and that low unemployment always quickly leads to higher inflation.

All of you are leaving Brandeis with certain "irrefutable" facts on which you are going to build careers that will involve finance, economics, international policy and other important areas. I encourage you to ask yourself, in the years ahead "are the derivative theories that you have mastered always going to be true? Is the bond pricing model, which has been developed and refined during your education here, always going to be valid in the face of changes that may include new demographics or new commodities?"

I hope that you agree, of course not, but that also every day you will challenge your own truisms in the light of a world that is continually and rapidly turning irrefutable facts into discredited myths.

With that one request, challenge or admonition, let me say thank you for allowing me to share these thoughts with you today.

