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Unique Viewpoints from Industry Leaders

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William Tauscher

Chief Executive Officer and Chairman of the Board, Blackhawk Network

***Editor's Note:** In this issue, **martin**wolf interviews William Tauscher Chief Executive Officer and Chairman of the Board, Blackhawk Network. William has served as Chief Executive Officer since August 2010, as a member of the Board since August 2007 and as Chairman of the Board since August 2009. Mr. Tauscher has served on the board of directors of Safeway since May 1998, and currently serves on the executive committee of the board of directors of Safeway. Since 1986, he has been a managing member of the Tauscher Group, which invests and assists in the management of enterprises involved with home products, transportation, telecommunications and real estate. From 2004 to August 2010, he served as the Chief Executive Officer, and continues to serve as the Chairman of the board of directors, of Vertical Communications, Inc., a communications technology company.*

MW: Markets seem to be mostly flat YTD, coming off a strong 2013. Where do you see the markets going for the second half of 2014?

The market appears to be driven—at least over the last period of time this year—by the Fed and its Quantitative Easing program. This, rather than earnings, has been responsible for an increased market multiple. I believe the market has been pulling back because there's a general belief and recognition that the Fed has signaled that it will stop doing the Quantitative Easing.

The crazy thing about this for me is that it's not clear that any of this is related to fundamental market conditions. While the Fed has introduced massive amounts of money into the system, the velocity of that money has slowed way down and it's clear we're not seeing the usual effects of what happens when the Fed injects money in the system. Of course, the other thing they are doing is suppressing interest rates.

It's not clear to me that we're seeing more money at work, other than the effects of the suppressed interest rates. In general, the Fed can do three things—make banks more liquid, make money go do work and make interest rates cost less. They've certainly made the banks healthy, but that's never been difficult for the federal government and it's not clear that the economy is better. We're in such new uncharted land when it comes to trying to understand monetary and fiscal policy, and there's such a huge debate going on with economists, that there's no consensus on what's going on or what's next.

What about M&A deal volume? Is that affected by this uncertainty?

M&A deals are clearly driven by two things right now. First, the cost of money is very low, so M&A can be largely fueled by debt (which will always lead to a higher ROI calculation than using alternate funding). Additionally, money is available for the leveraged buyout market. We've got the financial buyers empowered by low interest rates and available funds from the bank to do reasonably sized buyouts. I don't think the uncertainty is causing anyone to hesitate.

Let's talk about you. What was it like selling mainframes?

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It was in some ways the most fascinating part of my career. I was in my early 20's—I was an Operations Research major with a Computer Science minor, and I went to work for IBM, which was just making its transition from batch computer systems to online computer systems. Those were the days where the 360, which had made IBM but was still a batch processing system, was transitioning to the 370, where things were for the first time appearing on screens of computer terminals and being processed on a real-time basis.

Up until that time, all the entry was offline and at night you would make all the updates—but you began to be able to think about reengineering processes to be more efficient. People could look at files real-time, and talk to customers about them real-time on the phone—or you could perform real-time inventory management. There was a long list of those types of advancements when I was at IBM, and since I focused on the retail and distribution industry, which was logistically focused and therefore very interested in these developments, the high-level executives and clients I worked with always wanted to talk about this. The result was that I got a large amount of exposure to this transition, which was every bit as relevant as the transition to the more recent transitions to the internet or later to mobile.

“The likes of Computerland and its contemporaries as big entities went away as people began to buy their PCs directly from the manufacturers”

When did you go to from selling mainframes to becoming a leader in the PC industry?

Basically, when I was at IBM I bought one of my customers, a small distributor in Wichita, KS. At that company, we used recent technology to automate or expedite processes and create handheld and online solutions for our customers. In fact, the systems that we used for pharmaceutical inventory and pricing management were so compelling that Walmart and Kmart opened their own pharmacies powered by our systems. The company grew from $40 million to $4.5 billion, but the real driver of this growth was the technology we used to transform our business into a solutions business for our customers.

So I exited that business, and after a couple of different projects I then led a group that bought Computerland, which was the original granddaddy of PC retail distribution. Before I bought it, it was the king of the PC world—but that shifted as manufacturers began to take control back through direct sales beginning in the late 80’s.

In the early 90’s, after the acquisition, we realized that the small store PC retail model was no longer working—so we encouraged our franchisees to change into a B2B model, which is when Marty and I worked together. We then bought back almost every franchisee in the NFL cities, and in a 2 year period we changed those businesses to sales and services offices, firing 2,000 people from the acquisitions and replacing them with 1,000 people in corporate doing their functions. Over the next 5 or 6 years, we added 8,000 Services people and created the largest sales and services organization to sell PCs and PC networks in corporate America at its time. We then sold the remaining Computerland stores to Merisel to fund the process.

What happened to Computerland? What would it look like if it were around today?

There are some fledgling Computerlands in secondary markets, but most people in the computer business now sell various types of solutions – either in house or through providers like IBM. The likes of Computerland and its contemporaries as big entities went away as people began to buy their PCs directly from the manufacturers. What are left are lots of small computer dealers, but they also serve as services providers for small and medium businesses—an industry that is currently flourishing by providing new emerging services such as cloud services. But the model that Computerland had ended for two reasons. First, Dell came along and taught the world that buying directly from the manufacturer was efficient. Next, services became the new key focus of the large computer companies such as IBM's success at transitioning into a services provider.

So where do channel companies fit in in this age of direct sales and services?

Big box stores are selling personal computers or outfitting home offices. Medium-sized businesses are buying directly from Dell or CDW, and often performing their own services needs in-house. But for all those small and medium businesses that don't have those capabilities, that is where the smaller channel services and solutions providers fit in.

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How does the current decline of the PC affect the channel? Are they going to be able to adapt?

I think it's all about adjusting their business model. I operate on a giant screen at home, but when I travel I carry a tablet and a smartphone. When I'm at work, I want a big screen and a full keyboard—but the minute I travel or I want to do something personal I bring out my mobile. Mobile solutions are growing very fast and becoming very effective, but now fewer and fewer people are carrying a laptop with them when they travel. Ultimately, the discrete nature by which we think of things is changing. The change needs to extend to support this model.

You've interacted with all the big names in tech—which company has changed the most throughout your time in the industry?

In the 90's, we were IBM, Compaq, HP, and Microsoft's biggest customers. We worked with the guy who ran IBM's PC division, Compaq got swallowed up by HP but we knew its staff who went over to HP, and Microsoft was then run by Gates and Ballmer. Apple went into disarray in the 90's.

The company that changed the most was Apple. Now it has gone back to its roots and has many compelling devices, but when I knew them they were really trying to be a business company. They were led by John Sculley and were trying to compete in business. They were active in education, but they

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weren't winning in the personal space and struggled in the business space.

IBM has changed a bunch in that they completely exited the business. IBM was the original founding granddaddy along with Computerland in the PC business. The first two places they exclusively put PCs were Sears and Computerland—but now they're out of the PC and Server business after selling both to Lenovo. What they have kept as part of their whole global services unit is a large unit to maintain desktops and networks.

If you look at Compaq, you have to say it changed a lot—it's gone!

HP is a sad story. It was solid as a rock back in the 90's, going from almost no share in the PC business to taking the leadership away from Dell—but they've had quite a difficult past six years.

I guess the answer is that they've all changed a lot, Microsoft, which was then still Gates and Ballmer, probably changed the least.

With new CEO Satya Nadella, and his mobile-first, cloud-first focus, is Microsoft making the necessary changes?

I think in one sense, Microsoft is a well-run, mature company with spectacular financials that has been able to maintain its incredible hold on the operating system business with PCs and its Office franchise. That said, other than Xbox, they have yet to really move into a new market that could lead them into the future and provide a real growth engine for them in any technology category.

I believe they're desperately trying to address this and have made progress, but they face significant challenges. They launched the whole competition with Yahoo!, trying to buy it, but they lost the search game to Google, they're behind Amazon on cloud and they're behind Google and Apple on mobile.

Let's talk about Blackhawk Network. How does a prepaid card network survive this digital transition?

This was a company birthed out of Safeway where people had the idea to sell other companies' gift cards at Safeway—and the business has shifted to where gift cards are not bought in individual stores but instead are sold in huge destination racks in grocery stores worldwide. Blackhawk has flourished, operating in 21 countries, 185,000 distribution points, 400 distribution retailers and 600 different content partners. The company is now public and is doing really well.

The question that everyone asks is "Is digital distribution going to do to your business what it did to Blockbuster?" The answer is no, and for multiple reasons.

First, over the last 3 years we have been preparing a series of digital services to offer all of our content to digital distributors, ranging from startups to giants like Amazon, eBay and Staples.

Second, there's the issue of digital wallets—and we have contracts with the big industry players there, too: PayPal, Google, and Amazon.

Finally, the latest trend is mobile and online banking.—and we've signed with three of the five major banks in this country and are working on the other two.

"The digital payment transition in this country is significantly behind projections."

And we're also working with major retailers. Safeway has developed a "Just for U" system where you engage Safeway on mobile and online, and they show you the deals that are relevant to you (interesting fact: there's 45,000 items in a grocery store but you and I only buy 250 of them). So they're thinking about how they morph into wallets, and they're thinking about selling various deals, and we've contracted with major retailers to help provide the necessary digital services. Our role isn't different—we've just moved from physical distribution to online distribution.

But the digital payment transition in this country is significantly behind projections —and the reason for this is that we have a redemption problem. If you walk into any retailer, and you have a PayPal wallet or Google wallet, you can't use it to pay for anything. And NFC—which was going to own the mobile payment scene years ago— hasn't gone anywhere largely because Apple decided not to include it. And retailers haven't done anything because they don't know what to put in.

Everybody's speculating on what Apple's going to do, and they officially won't tell most people. But those who follow the industry believe that this year, Apple is going to introduce a mobile payment strategy with NFC. Will have to wait and see but it will move things.