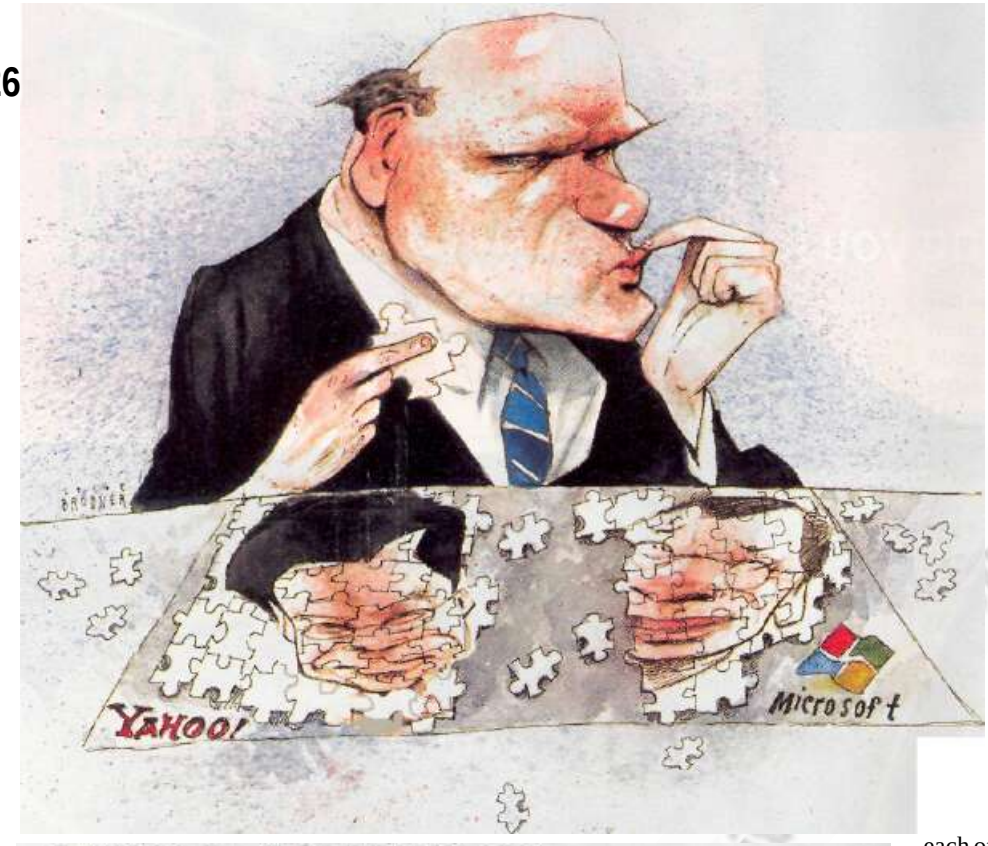

WILL YAHOO! FEEL THE LOVE?

Steve Ballmer's $45 billion marriage proposal is fraught with risk. But Microsoft can't let Google go on unchecked

By Jay Greene

With the hefty premium included in its $44.6 billion bid for Yahoo!, Microsoft looks well on its way to persuading shareholders in the Internet company to support its unsolicited offer. Yahoo employees, however, will be another matter. Not only has Microsoft been a frequent rival, but many Yahoo staffers view it as a lumbering giant that doesn't understand the Internet. "I see culture clash," says Norm Fjeldheim, chief information officer at wireless chipmaker Qualcomm. "If I was Google, I'd be thrilled. I can steal alot of the top talent out of Yahoo."

Microsoft CEO Steve Ballmer has an astonishingly difficult task in front of him. To make his historic bid for Yahoo pay off, Ballmer will have to overcome a series of high hurdles, from winning the approval of regulators, who have warred with Microsoft in the past, to retaining key talent in the wake of an unwelcome takeover. He'll need to sort through scads of overlapping businesses, shutting down some units and laying off staff. All the while, he and other top executives will have to make sure that the nitty-gritty of making the merger work doesn't distract them from keeping Microsoft's other businesses on track and watching out for the Next Big Thing. "It's a mess," says analyst Charlene Li of the market research firm Forrester Research.

Yahoo staffers' wariness of Microsoft could turn a complex and challenging merger into a talent exodus

The challenge is made all the more difficult because Microsoft and Yahoo would merge as two struggling rivals,' trying to catch up in the online advertising business to an increasingly powerful Google. That, some experts say, could be an indication of troubles ahead. "Virtually all the deals from Hell are done by companies that are collapsing into each other's arms like a defeated prizefighter," says Robert F. Bruner, dean of the Darden Graduate School of Business Administration at the University of Virginia and author *of Deals fromHell,* a book that examines failed mergers.

"THE SINGLE BIGGEST THREAT"

The history of tech megadeals is littered with unfulfilled promise. AOL's $164 billion acquisition of Time Warner is only the most notorious. There's also Lucent-Alcatel, Sprint-Nextel, Excite-@Home, and many more. Tech deals are particularly prone to failure because change comes so fast in the sector. Any distraction from a problematic deal, and you're left in the dust.

Of course, Ballmer knows the history and the challenges ahead. But Microsoft has few alternatives. Google is racing ahead in online advertising, and the surging ad business threatens the very foundation of Microsoft's empire. Computing is increasingly moving to the Web, challenging the relevance of Microsoft's core products, the Windows operating system and Office productivity software. "Google is the single biggest threat Microsoft has ever had," says David B. Yoffie, a Harvard Business School professor.

Ballmer argues that Microsoft, with

Yahoo, can get the sort of scale in Web surfers and online advertisers it needs to compete with Google. The same goes for capital spending. Microsoft could boost the returns on the money it invests in computer server farms, for example, if its online audience more than doubles. "The ability to do more, thafs fantastic " Ballmer said in an interview with *BusinessWeek*.

What's more, the company is hoping to bring together Yahoo's research and development staff, who've done innovative work in online advertising auction theory and data-mining, with its own online lab. Microsoft expects to reap $1 billion in operating efficiencies by combining the 14,000-person Yahoo with the 80,000-employee Microsoft.

DILEMMAS, DILEMMAS

Looks great on paper. The reality, though, may be something else entirely. Start with efforts to meld or eliminate overlapping businesses. There are dozens of them, everything from news Web sites and Net portais to e-mail, instant messaging services, and online advertising technology. To achieve the projected cost savings, Microsoft will have to choose which businesses survive and which ones don't.

Ballmer says: "Yahoo, the brand, will live." But eventually he'll have to decide between Yahoo Mail and Microsoft's Hotmail, Yahoo Finance and MSN's finance site, and others. Inevitably, products will be jettisoned, managers will lose clout, and people will lose jobs. "They've reaíly bitten off quite a bit," says Kevin Lee, executive chairman of Didit, a search marketing company that helps companies place ads on Google, Yahoo, and Microsoft Web sites.

One thorny call will concern Microsoft's adCenter and Yahoo's Project Panamá, both technologies designed to help advertisers finely target online marketing. In a combined company, there's no reason for both to survive. And if you ask Tarek Najm, a distinguished engineer at Microsoft and adCenter's general manager, what Panamá technology he'd like in his product, he's blunt. There isn't any. "We're the leaders in technology," Najm says. "Ours is better."

Of course, getting to that *$1* billion figure means cutting bodies, lots of them. "The cost structure of these companies is predominantly people," says Charles Di Bona, an analyst with Sanford C. Bernstein & Co. Who goes? It's impossible to know. But it won't just be lower-level staff. There's no reason to have two bosses for e-mail, instant messaging, and Web portais. Ballmer may have to chose between respected managers such as Brad Garlinghouse, the senior vice-president who runs those businesses at Yahoo, and Steve Berkowitz, the Microsoft sénior vice-president with similar duties.

That sort of uncertainty can crush morale, something Yahoo has already been struggling with as its business has floundered. Some key employees have left in the past year, including sales boss Wenda Harris Millard, marketing chief Cammie Dunaway, and Yahoo Entertainment leader Vince Broady. Such defections are likely to mount if Microsoft takes over, even among the Yahoo engineers Microsoft badly needs to keep in order to compete with Google. "I just can't imagine most Yahoo employees wanting to stay on" says one former executive who left íast year.

Much of Yahoo's appeal to employees has been its place in the Valley firmament as a Net icon. Being absorbed into Microsoft strips that away. "People at Yahoo have a little bit of that natural Silicon Valley hatred of Microsoft," says a former Yahoo vice-president who left last year. "Yahoo has always considered itself a bit of an upstart."

Microsoft may have little choice in bidding for Yahoo. If it wins, it'll have little room for error. BW

-With Catherine Holahan, Robert D. Hof, and Steve Hamm

LINKS

Yang's Search
Can Yahoo CEO Jerry Yang keep the company he helped found out of Microsoft's grasp? His chances are slim. But in "Yahoo: Time For Bold Moves?" at BusinessWeek.com, Robert D. Hof examines the possibilities.

THE MESSY MICROHOO! MASH-UP

Even if Microsoft persuades Yahoo! to accept its unsolicited takeover bid, plenty of challenges will remain. A sampling:

OVERLAPPING BUSINESSES:
Microsoft and Yahoo have dozens of similar services, from e-mail and instant messaging to shopping sites and portals yahoo.com and msn.com. Many must be folded to reap the savings Microsoft wants, but that could flatten morale.

RETAINING TALENT:
Yahoo has already seen an exodus of employees, including some top talent. If the company is acquired, business units are closed, and decision-making shifts to Microsoft in Redmond, Wash., the departures could accelerate.

EXECUTIVE DISTRACTION:
Microsoft is going after Yahoo to erase Google's edge in online ads. Yet as the brass at the merging companies focus on the deal, Google will continue to raise its game. And Microhoo! will spend less energy on the Next Big Thing.

REGULATORY APPROVAL:
The U.S. Justice Dept. has to sign off on the deal, and it almost certainly will. But it could drag out the process and make Microsoft sweat, given the giant's antitrust history. European regulators will be tougher.

TROUBLE WITH BIG TECH DEALS:
The track record for big tech tie-ups is terrible. AOL's marriage to Time Warner is only the most notorious. Star-crossed deals tend to involve companies that team up to gain strength—sort of like Microsoft and Yahoo in online ads.

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