

Expanding Without Managing

By JEFFREY SONNENFELD

The New York Times

June 12, 2002

(PFD File)

Looking at the group of troubled corporate leaders — Dennis Kozlowski of Tyco, Ken Lay of Enron, Bernie Ebbers of WorldCom, Gary Winnick of Global Crossing and John Rigas of Adelphia — it is easy to conclude that flaws in board governance or shady accounting practices are behind their problems. This diagnosis overlooks the commonality in the approach of these corporate executives: All of them are "serial acquirers" of other companies. Proud of his leadership model, Mr. Kozlowski once even offered a "C.E.O. Academy" to help new chief executives follow his path.

These executives saw their jobs first and foremost as expanding corporate holdings, rather than managing their companies to produce better products and services. And because their focus was on immediate financial results, they also tended to see regulators as adversaries and accounting rules as inconvenient barriers to fulfilling their schemes.

It is not surprising that opaque financial reports are a common denominator with these chief executives. Nor is it surprising that those reports withered under scrutiny. Tyco, for example, moved its headquarters to Bermuda as a tax dodge, though it operated out of Exeter, N.H. While Mr. Kozlowski pushed his stock publicly, he and his finance chief made more than half a billion dollars in profits by selling stock the company granted them. When analysts pushed for answers on how Tyco accounted for its acquisitions, questions about asset manipulation were met with vague responses.

Mesmerizing Wall Street with a dazzling number of deals makes an absence of long-term management vision easy to hide. Virtually every strategic corporate pronouncement from Tyco was reversed in short order — from a flip-flop over breaking up the firm to flip-flops over whether a major business unit, CIT, a financial services firm, would be sold to an investment bank or sold to the public.

In another example, Mr. Ebbers of WorldCom cared more about snaring new companies and less about making all his acquisitions work together.

These serial acquirers did not build businesses around core competencies but were scavengers for good deals, a strategy that rarely pays off in the long run. (A study done for The Wall Street Journal by Thomson Financial found that in the current weak economy the stocks of the top 50 acquirers have fallen three times as much as the Dow Jones industrial average.)

Tyco, originally a government-supported laser research lab, became a purchasing platform for Mr. Kozlowski. In three years, Tyco acquired 700 companies, creating a pileup of businesses that includes valve makers, health care product makers, security system services, medical device and diaper makers, electronics and telecommunications equipment manufacturers, and businesses involved in financial services and office leasing. This huge portfolio does not reinforce common distribution channels or share technologies. Yet "Deal-a-Day Dennis," as Mr. Kozlowski was proud to be known, was celebrated for Tyco's 20 percent annual growth rate — until the last six months, in which the stock has fallen by 81 percent, losing over \$80 billion of value.

The flawed strategic logic of these serial acquirers repeats the failures of their predecessors from the 1970's. Shaky corporate shells like I.T.T. under Harold Geneen, Gulf and Western under Charles Bluhdorn and American Can, headed by Gerald Tsai, were broken up as distressed properties in the 1980's. I.T.T., a phone company, had become a base for hotels, bakeries and industrial equipment. Gulf and Western, an auto parts seller, became a shell for buying sugar

refineries, steel mills and film studios. American Can, an old-line packaging company, moved into retail, stocks and insurance.

The weakness in both the new serial acquirers and the failed acquirers of earlier decades is that managers did not understand the businesses they got into. They assumed that they could allocate the financial resources better than existing external financial markets could.

The academic research on diversified firms is unambiguous. They generally do not beat the market. The executives could not possibly remain knowledgeable about the changing technological and market requirements for such disparate businesses. It has been reported that Gary Winnick of Global Crossing, for example, so little understood his telecom businesses that he relied on a Salomon Smith Barney telecom analyst, Jack Grubman, to guide financial and strategic moves.

The serial acquirers were successful briefly in that the very complexity of their businesses made it hard to hold them immediately accountable. No single financial analyst can track this sort of dizzying array of companies and industries. Rapid growth without clearly defined enterprises makes it hard to judge the performance of these chief executives by conventional yardsticks. Rather than having to demonstrate skill in creating new products, providing better services or motivating employees, these executives are usually judged by investors and analysts only by the swelling size of their empires.

The lack of accountability also translates into a lack of successors. Few executives of this type are interested in building enterprises that could in time be led by others, so they generally don't nurture successors, and the boards of these companies are rarely independent enough to insist that they do. For many, there is also difficulty drawing the line between corporate decisions and their private interests. At Adelphia, for example, John Rigas transferred control of corporate assets to his family, and family entities borrowed billions of dollars from the company.

Perhaps because they go unchallenged, executives of this kind tend to believe that leadership is an intrinsic, unearned quality. New survey data from the Yale School of Management and the Gallup Organization found that out of 130 prominent chief executives surveyed, 26 percent believe that "great leaders are born and not made." Who are these leaders anointed with greatness at birth? They are the serial acquirers. Those who believe that great leaders are born have tended to invest less in their existing businesses through expanding factories, developing new products and the like, and were far more likely to prefer growth through acquisitions (some of them are considering making more than 20 acquisitions in the coming year). Those who believed that great leadership is developed through experience were less likely to be serial acquirers.

Executives who build their businesses primarily on acquisitions are perhaps most susceptible to another pitfall: They tend to fly solo. Their near total control in setting strategic plans for their companies makes it difficult for subordinates or the board to critique the direction of the company. And yet, acquirers generally lack a strategic logic that can survive market changes; as a result their empires of hype can be undone very swiftly by market discipline. None of this is really new. The fall of the most recent corporate acquirers provides spectacular reminders of lessons we've seen decade after decade.