



Chapter 1

Adaptability

Corporations Can Change

The forces of globalization have substantially accelerated convergence towards the publicly held corporate form. The availability of information – instantaneous, free, and universal – has brought the reality of change to everyone everywhere.

Yet all businesses, once successful, develop an aversion to change. This fact is abundantly clear in the story of Stone & Webster, recounted in Chapter 5 of this book. As this appalling case shows, it is so hard to achieve sustainable profitability that managers have an overwhelming temptation to lock in place all the rules – including the rules that govern their pension funds. This is why the large corporations are, if the truth be known, so very much in favor of complicated regulatory structures. As entrenched players, they know the rules; new entrants have a steep learning curve to climb if they are going to compete.

When corporations want to change, they can do so very effectively. But *change must be led by someone who is willing to accommodate societal concerns*. Is it the “board of directors?” Is it the “philosopher king” CEO? In my view and experience, the answer is no. The answer, instead, lies in corporate shareholders. It is difficult to imagine any constituent having the independence, the motivation, the knowledge and the power of these investors, especially today with their new global reach.

It is this capacity to respond to change that distinguishes the publicly owned corporation from other business organizational forms. The first corporations, including notably the East India Company, were created by government to serve a particular public objective. They were instruments of the



state. This tradition lingers in many countries, most notably in post-World War II Japan. The difficulty lies in the inability of the state, or – for that matter, anyone – to know enough in order to proscribe a continually healthy and profitable course for an enterprise. Could the most elite Japanese or French civil servant have anticipated so violent a necessary change and have proscribed such an effective response as Microsoft's in 1995, when Bill Gates bet on the Internet?

Again and again this unique energy of the private corporation is evidenced through experience. With all their flaws, corporations are better than the alternative: state-owned enterprises. Why? Because corporations, if owned by shareholders, are highly adaptive. State-owned corporations run without market pressures are far less adaptive. The best they can do is phase out when the public no longer needs them.

How very different from the typical state-run company is the splendid example of Westinghouse Corporation, which has used its relatively high level of freedom, energy, and resources to maximize shareholder value, converting from a diversified technology firm with \$11 stock to a television and radio company with \$45 stock – and changing its name twice in the process. What explains the change? The engine was a set of managers and importantly, owners, committed to optimizing shareholder value.

We deliberately selected a company involved in communications technology. Technology advances emanate directly from an environment of freedom. The liberation ratio = freedom + genius/constraints. When the liberation ratio declines, pressures build to create new institutions. Technology provides a phenomenon new in the planet's experience to this time: Information can be available to everyone, everywhere, at the same time and free. CBS has been an exemplary part of this change – and all because its leader understood and shared the goals of his company's owners.

The WX/CBS/Viacom story

WX, as it appeared on the New York Stock Exchange ticker, was an institution – cited for excellence since its founding in 1886. In that year, George Westinghouse developed the technology that found practical uses for alternating current, successfully competing against the advocates of direct current – among them his contemporary, Thomas Edison.

His company has since achieved an enviable list of firsts: the first tungsten lamp, the first commercial radio station, the first television camera, the first atomic engine for the Nautilus submarine, and the camera that broadcast man's first steps on the moon. In 1900 George Westinghouse introduced the slogan, "The Name of Westinghouse is a guarantee." Today we say, "You can be sure ... if it is Westinghouse." However you say it, Westinghouse has been known for innovation, for quality, and for technology designed to improve the welfare of mankind. The Westinghouse Science Honors Institute (for promising high school students) is still one of the most respected programs in a culture keen to the possibilities of technology.

Let us look more closely at the history of Westinghouse to see the important role played by investors in changing the company over time. While the company has been one of the most prestigious in the land (one of the Dow Jones 30) for most of the twentieth century, it has not been free from problems. History records that George Westinghouse lost control of his company in a financial panic in 1907. Along with its long-time rival – The General Electric Company – Westinghouse was convicted of a price-fixing felony in the so-called "electric company conspiracy" of the late 1950s. In the 1960s, the company virtually went bankrupt on account of promises to purchase uranium at a fixed price in a market that fell precipitously. The courts were persuaded to extend the ancient doctrine of "force majeure" in order – one suspects – to save a great corporation.

The comfortable prosperity of companies like Westinghouse – coddled by oligopoly and US world dominion following victory in war – became sorely threatened in the 1970s with the abandonment of the gold standard and the reality of foreign competition in domestic markets. The great General Electric was driven out of computers, driven out of making television sets, and driven out of nuclear power generation. Westinghouse diversified with a vengeance into activities spread across the commercial spectrum, from low-income housing to resort development in 135 divisions with marginal profitability and no organizing theme.

Its belated entry into the finance field in the late 1980s was a disaster, the extent of which was amplified by appalling board misjudgments and incompetent top management. In 1987 Westinghouse Credit Corporation accounted for 16 percent of the entire corporate profit with a return on equity above 20 percent. An incentive compensation scheme that rewarded increments to return on equity without any consideration of debt led to the situation described by Peter Nulty in *Fortune* magazine as "shoveling the

loans out the door with the speed and abandon of a go-go S&L into high-risk, high-return investments,”¹ such as shopping centers, junk bonds, and leveraged buyout (LBO) financing. Because short-term earnings increased and the public failed to notice the build-up of debt, WX stock actually went up in 1989.

The last Westinghouse CEO to be a national figure was Douglas Danforth. When he retired, the board was unable to agree on a successor. Directors split 5–5 between longtime staff person John Marous, age 63, and the younger Paul Lego, with a career as an operating executive. No Solomon emerged to resolve this deadlock, so they divided the baby: Marous was to be CEO for two years and Lego was committed as his successor. Marous was in charge of the Credit Corporation; Lego oversaw the rest. By the time Lego took over in 1990, long-term debt had escalated to \$5.2 billion, the company had an operating loss of \$844 million, and \$3.5 billion of WX’s assets were classified for “restructuring.”² By the close of 1991, fully 67.3 percent of WX’s assets (\$6.52 billion) were considered bad. *Business Week* commented that only the fall 1991 negotiation of a new line of credit kept Westinghouse from filing in bankruptcy.³ I made note in my journal of a meeting during this troubled era.

“A meeting with Paul Lego on October 22, 1992, was almost surreal. He was literally the only executive present on the top floor of the Westinghouse building in downtown Pittsburgh. We had a spaghetti luncheon, prepared by his closest colleagues in the company, Tony and Eileen Massaro, in the empty executive dining room. The formal meeting started with (I clocked it) a 25 minute unprompted monologue in the style of the Rime of the Ancient Mariner. Each verse of the lengthy rhyme ended with the refrain ‘It ain’t my fault.’ Paul was at the same time genuinely in love with Westinghouse, bursting with pride to be its head, furious about his colleagues’ ineptness – ‘They took my cash flow and put it into that bottomless pit,’ and unconscious as to the imminence of corporate death.”

In late October, Lego had to issue a statement saying the company was not contemplating a bankruptcy filing. In November, the company announced that it was getting out of the financial services business and would henceforth concentrate on its historic leadership positions in transport, temperature control and broadcasting markets, as well as on three technology-based businesses: electronic systems, environmental systems and power

systems. As I noted in my journal, “This isn’t the end of it. Somewhere in that big company, there is a small company trying to get out.”⁴

In December, WX adopted a whole range of governance amendments in a belated effort to appeal to institutional shareholders.

In January, Lego departed.

On April 28, 1993, I spoke at the annual meeting in Minneapolis, citing an editorial I had published simultaneously in the *Wall Street Journal*:

“[Westinghouse] is a company all but ruined by mismanagement and neglect. The mismanagement was the fault of the chief executive officers; the neglect was the fault of the board. The CEO resigned after four months; the directors are still there. That is the problem ... Unfortunately [under American law] shareholders can’t ‘fire’ the board; the law permits only a symbolic withholding of approval. In withholding my approval, I am casting a vote of no confidence.”

On July 1, Michael H. Jordan, a consultant with McKinsey, was named the new chairman and CEO of Westinghouse, the first from outside the company in 64 years. Jordan indicated early on that he was going to do what had to be done and very sensibly declined to talk with anyone for six months. His “coming out party” was held before a packed crowd in the big ballroom of Donald Trump’s flagship hotel, The Grand Hyatt Hotel on 42nd Street in Manhattan on January 11, 1994. The speech from this calm Yale/Princeton alumnus gave the candor that one expects from a hustle-hardened consultant. His message: “No quick solutions, no easy answers, patience, better execution, and maybe we can get the results that GE gets from comparable businesses.”

More journal entries follow:

“Undated (April 1995) – Torrential rain on the windows of Michael Jordan’s hotel room in Orlando, Florida, provided atmosphere for two hours of intricate chasing after possibilities for WX. How much time will the market give him to change the company culture? He thinks that tightening up will produce substantially improved earnings, but he doesn’t sound confident that it will be enough. It boils down to the old Maine joke – ‘There is no way to get there from here.’ The core businesses don’t have the scope or the margins to carry a major enterprise. The only asset with value appeal is broadcasting. Nobody can believe the

company's accounts – too many changes. Michael won't quit his outside boards, but concedes that his own is mediocre.

“September 12, 1995 – Pittsburgh headquarters – after 15 months, WX is still trying to get a handle on the problems and develop new opportunities. Power generation business is dead, so the firm is pursuing niche markets – long shots like nuclear power in China – with Jordan's personal time. You can count the improvements, but there does not appear enough progress to change the basically negative momentum. New directors are being sought – but Jordan will not cut down his own outside commitments – he listens well and describes suggestions as ‘interesting.’ Finally, I ask – ‘interesting means yes, interesting means no?’ He doesn't miss a beat – ‘Interesting means I am not going to be bullied.’ Only one discordant note – an utterly random ‘I don't need this job.’ This is an energy that will work out its own solution. Will the 1994 results confirm the present direction?”

Jordan had induced Fred Reynolds, a personable and insightful financial maven, with whom he had worked at Pepsi Cola, to join WX as CFO. Together, Reynolds and Jordan reviewed the portfolio of businesses and found that they were not as badly run as originally feared. Their ability to understand the interrelationship between the cash flow and the liabilities of the disparate entities and to articulate it with confidence to lenders and investors provided the element of credibility that a decade of incompetence had eroded.

Plainly, Jordan's intent at the time of his first annual report was to save the Westinghouse franchise – sell off what had to go in order to pay down debts, improve operations, and restore financial discipline and systemic coherence (over one hundred different accounting systems) to headquarters. Transformation could be neither large nor quick enough to attract capital competitively.

A pattern began to emerge. Westinghouse divisions had not kept up with worldwide developments and either were not large enough to form the core of a continuing enterprise – power generation business, for example – or were dominant in an anecdotal market – refrigerated transportation. Again and again, the conclusion was forced that the only business susceptible of being favorably valued in the marketplace was broadcasting. Traditionalists would continue to advise that broadcasting be sold and the proceeds used to free up the industrial units that were the traditional soul of the enterprise. Jordan and Reynolds, the outsiders, came rather quickly to a contrary con-

clusion – they should use broadcasting as the base on which to build a modern communications empire.

Such a decision is the genius of the corporate mode. The corporate institution exists in order to create long-term value for its owners. There is no “bill of rights” guaranteeing right to life for particular industrial units or right to location for particular communities or right to employment of specific individuals. The corporate energy is the search for competitive investment of capital. This undiluted focus accounts for the worldwide dominance of the corporate form over partnerships, co-operatives, mutual enterprises, and government-owned or dominated companies. The deployment of financial and personnel resources in the focused pursuit of an identifiable objective results in creation of values that ultimately enrich all constituencies – what Jordan’s old firm McKinsey & Company calls the “virtuous circle of shareholder value.”⁵

On August 1, 1995, WX announced the acquisition of CBS for \$5.4 billion. The market had expected this, and WX stock rose barely ten percent. Where is the money coming from – J P Morgan, where else, and – down the line – from the continuing disposition of industrial businesses. The price appeared “full,” but only because the market had savagely written down the management of the selling Tisches.

“Westinghouse was still recuperating from a string of massive losses, and banks were clamoring for debt repayment. Cash flow was stretched thin. Fronting costs on expensive power-generating projects overseas drained a large and growing chunk of working capital ‘Westinghouse could barely buy lunch, much less CBS,’ says a securities analyst who recommends the stock today.”⁶

“To work, it would require that everything fall neatly into place; Westinghouse must get financing to do the deal, it must sell off assets at a good enough price to pay down all or most of that new debt, and it must in the end turn out to be good at the broadcast game. It’s asking a lot, but if it does work, what a change. Instead of a crummy bunch of low-margin businesses, you have a hot, high margin company with room to grow.”⁷

This announcement coalesced all of the fear and suspicion of traditional Westinghouse – employees and deserted community. Had Michael Jordan ever moved to Pittsburgh? Did he own a house there? One Westinghouse employee stood up during a meeting after the announcement and accused Mr. Jordan’s team of “leaving for New York on a luxury liner and leaving

the rest of us behind on a leaky barge.”⁸ Westinghouse’s decade-long failure to keep up with the worldwide competitive trends compelled the conclusion that the businesses being sold are more valuable to other enterprises than to a US company increasingly focused on broadcasting. Reynolds got fine prices for the businesses:

- 1994 – Distribution and Controls to Eaton – \$1.1 billion
- 1995 – Real Estate Development
- 1996 – Knoll group to Warburg Pincus – \$565 million
- 1996 – Defense Electronics to Northrup Grumman – \$3 billion
- 1997 – Thermo King to Ingersoll Rand – \$2.56 billion
- 1998 – Power Generation to Siemens – \$1.53 billion

All of these units are performing well in their new incarnations. Jobs have been added, not lost. The same suppliers and employees are for the most part grinding, polishing, and welding for the same customers just as they ever did. But there are new owners now, and more profits for them, who have paid handsomely for the opportunity.

Meanwhile, Westinghouse was making substantial acquisitions in the communications area. It acquired the leading independent radio operator, Infinity Broadcasting, for \$4.9 billion, and announced the acquisition of two major cable TV stations, The Nashville Network and Country Music Television. And in the same year – 1997 – it announced that CBS would be “spun off” into a separate company from the surviving Westinghouse industrial companies. In fact, this never worked out as the dispositions continued and viability of the remaining assets became doubtful.

Jordan announced that as of December 1, 1997, Westinghouse would become a media firm known only as CBS Corporation. What was left of the industrial assets were to be sold in pieces. Headquarters will move to New York City, the stock ticker WX and the 111-year-old name Westinghouse would vanish from the face of the earth. On March 22, 1999, the new Westinghouse Electric Company, a combination of three enterprises in the nuclear and environmental fields, was born as the subsidiary of Morrison Knudsen Corporation and British Nuclear Fuel Laboratories.

Progress at CBS was not immediate. In acquiring Infinity, the new venture also acquired its largest shareholder and a legendary media value enhancer – Mel Karmazin. Karmazin successfully became part and then leader of the enterprise, beating out first CBS’s Peter Lund to become chief execu-

tive of CBS's television station group, and then Michael Jordan himself at the end of 1998 to become CEO of CBS, itself. An energetic and optimistic man, Karmazin in 1999 merged CBS into Viacom and became CEO in waiting for the mantle to pass from the 77-year-old Sumner Redstone, who owns an even larger stake in the combined enterprise than he does and who shows Armand Hammer-like tenacity in holding onto life and his job.

In May 2000, despite considerable public opposition, the merger became legally effective and George Westinghouse's legacy became part of the Redstone–Karmazin empire.

Michael Jordan's five years with Westinghouse provide unique insight into the character of capitalism at the end of the twentieth century. As one observer wrote, "He's very capable, but he's not a charismatic-type figure. He's got a game plan and strategy and tries to carry it out, but I would describe it as more leading by doing: this is what I am doing – come and follow me."⁹ His education at the principal meritocratic East Coast institutions provided comfort in dealing with financial institutions and engineering expertise to inform his judgments in weighing values at a traditional technology company like Westinghouse.

The McKinsey legacy

The ubiquity of McKinsey & Co. has been widely observed. It becomes clear in hindsight that the legendary Marvin Bower, past managing director of the consulting firm, was able to communicate insight into the process of value adding that has made so many of his alumni into successful CEOs in world class companies. Between Pepsico (where he did not become CEO) and the investment firm of Clayton, Dubilier & Rice, Jordan had the opportunity to meet this generation's business leaders, to become a director of several companies, and to earn significant amounts of money long before deciding to take on the ultimate challenge of "turning around" Westinghouse (in the style of his former McKinsey colleagues Lou Gerstner at IBM and Phil Purcell at Dean Witter, now Morgan Stanley). While he was not conspicuously undercompensated for his time at Westinghouse, it is probable that Jordan has not in recent decades otherwise worked so hard and so long for so little.

What emerges is the human incarnation of capitalist energy – a corporate leader convinced that resources must be committed in the direction of earn-

ing the best competitive return, possessed of superior analytic skills, not pressed by time or personal need, willing to reverse direction in the face of evidence, and willing to be abused personally for not pleasing all of the people all of the time. And crowning this portrait was Jordan's willingness to leave – without public rancor – a position of power that he was entitled to keep indefinitely.

Michael Jordan manifested the strategies necessary to enhance ownership value and was endlessly patient and purposeful in taking the chances necessary to achieve his goal. This corporate leader found an enterprise firmly anchored in the past and barely out of the clutches of bankruptcy. Patiently but surely, he tested several solutions, and ended up with one that changed the ownership and management of virtually all of the assets he inherited. In the process, he created highly competitive value for the company's investors. He did so with the active support of investors whose investments spanned the globe. This is the nature of the publicly held corporation – US style – at the end of the twentieth century. (See Fig. 1.1.)

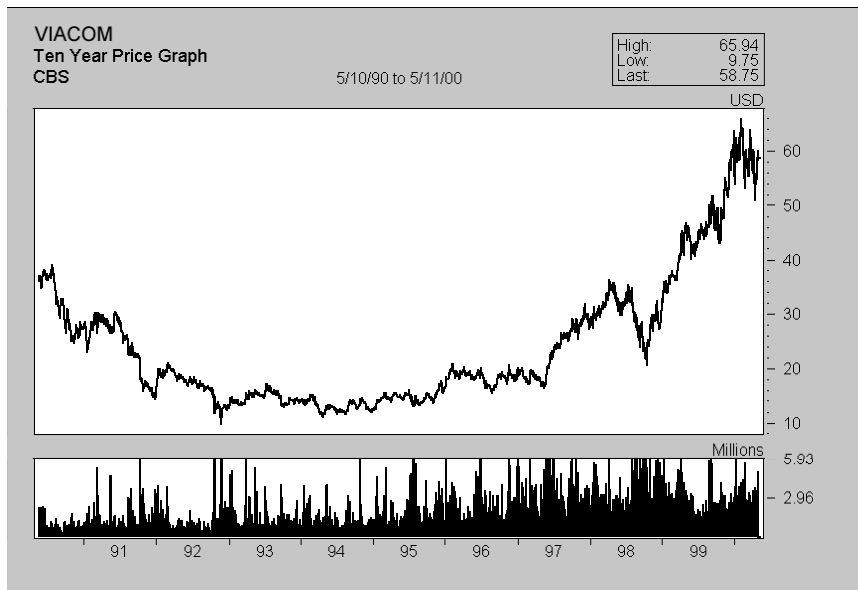


Fig. 1.1 Viacom Corp. – ten-year price graph.

Endnotes

- 1 Peter Nulty, *Fortune*, November 4, 1991, pp. 93–99.
- 2 Westinghouse, *Annual Report*, 1990, pp. 2, 21–24.
- 3 *Business Week*, March 8, 1993, p. 69, as cited in James P. Hawley & Andrew T. Williams, *The Westinghouse Corporation and Institutional Activism* (a research proposal), October 4, 1994.
- 4 Nell Minow, “Westinghouse Decides to Retrench, but CEO Remains under Fire,” *Wall Street Journal*, November 24, 1992, p. A5.
- 5 *McKinsey Quarterly* 1997, 2, pp. 156–167.
- 6 S.L. Mintz, “Why Westinghouse Thinks Buying CBS will Solve its Operational Woes,” *CFO*, April 1996, p. 29.
- 7 Jay Palmer, “Strategy Switch? Westinghouse’s Sudden Interest in CBS May Reflect Radical Plan in the Making,” *Barron’s*, July 24, 1995, p. 12, quoting author.
- 8 Timothy Aeppel, “How Westinghouse’s Famous Name Simply Faded Away – Media-Struck CEO Didn’t Follow Through on Promise to Keep Industrial Lines,” *Wall Street Journal*, November 20, 1997, p. B6.
- 9 Lisa Green, “Jordan’s Strategy Faces Major Test,” *USA Today*, August 2, 1995, p. 3B.