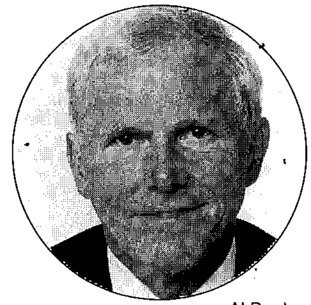
Al Dunlap and the Shareholder Revolution


Al Dunlap

By Richard Miniter

Scott Paper was a household name whose stock price was in the basement. The *Fortune* 500 conglomerate lost some $277 million in 1993 alone. Money managers threw up their hands. Executives pointed fingers.

Spread across the globe, Scott's divisions warred with one another like medieval princes. A bloated corporate staff spent more than $30 million per year on consultants, and millions more on cars, jets, club memberships, and other corporate perks—while splashing the company ledgers with red ink. Like Soviet commissars, factory managers knew exactly how many tons of paper they produced each year, but muttered "I'll have to get back to you" when asked how much money Scott made per ton. In surveys, customers called Scott's products "antiquated" and "boring." In short, aging plants lost money making goods of uneven quality that were haphazardly marketed to shoppers who considered them poor substitutes for the competition's products. Scott Paper was about to fall.

On his first visit to Scott's sprawling corporate headquarters near Philadelphia, Al Dunlap ran his hand along its marble-lined walls. It was a palace built for a declining empire. It had to go. Dunlap sold it for some $39 million and moved the corporate headquarters to Boca Raton, where Scott saved another $6 million per year in maintenance and climate-control costs. "In my experience, the success of a company is inversely proportional to the size and opulence of the headquarters," he explained.

Selling the palace was just the beginning. Dunlap knew Scott needed "shock therapy" and that administering it wasn't going to make him popular.

Within two years, Dunlap all but eliminated Scott's more than $2.5 billion debt. The stock price zoomed up some 200 percent over the same period. The value of the company, as measured by the total value of outstanding shares, grew from $2.5 billion in 1993 to $9 billion in 1995—one of the most dramatic turnarounds in commercial history. Once Scott was profitable and valuable, Dunlap sold it to Kimberly-Clark, thereby creating the second largest consumer products company in the United States. Scott, the ailing giant, was revived and merged to form a world-class competitor that would add jobs and profits in the coming years.

How did Dunlap do it? He brought focus and energy to the executive suite, cut costs, and trimmed overhead by firing some 71 percent of the corporate headquarters staff. He set out to cut corporate bloat with his characteristically direct manner. One day, Dunlap told the 11-member executive committee that ran Scott's, "I don't want the status quo." What followed, as described in Dunlap's new book *Mean Business,* was a typical example of Dunlap's confrontational management style. "I asked them to introduce themselves and explain their duties. One thing immediately caught my attention. There was no chief executive officer in attendance. The chief administrator, an engineer by training, said he handled financial details," Dunlap writes. "How absurd!" He soon disbanded the committee. Two members saw their responsibilities grow. The rest quit, transferred, or were let go.

Dunlap scrapped more than just the executive committee that debated while Scott's stock plunged. He also eliminated about 70 percent of upper-management jobs. Though most of the cuts were at the top of the organizational chart, few excess jobs (at any level) were spared as Dunlap trimmed more than 11,200 jobs from the payroll for a total reduction of 35 percent. Another 6,000 jobs were transferred to the payrolls of other companies when Dunlap sold non-core businesses, such as the coated paper division S.D. Warren and a Mobile, Alabama power plant. The 20,000 remaining jobs were secure in a reinvigorated company that began to grow for the first time in seven years, Dunlap contends.

The details of Dunlap's turnaround of Scott Paper are being repeated at Sunbeam and other big blue-chip companies as shareholders wake America's sleeping corporate giants and give them a simple choice: change or die.

In this way, a dramatic, if unheralded, shareholder revolution is slowly changing the way American business works. Turnaround specialists like Dunlap and an array of fund managers are forcing entrenched corporate management to pay more attention to shareholders. This could signal a break with what political scientist James Burnham called "the managerial revolution," in which professional managers, beginning in the 1930s, gradually took control from shareholders. Shareholders and their representatives on the boards of directors gradually ceded power to management, which demanded increasingly large salaries and lavish treatment while suffering little when the stock price sank. Chief executives and board members didn't act like owners because fewer and fewer of them *were* owners. Boards surrendered their judgment and relied on elaborate dog-and-pony shows staged by management. Interlocking sets of corporate directors led to an unwritten rule: judge not another company's performance lest your own company's performance be judged.

These new leaders claimed to be "scientific managers," but they gradually came to ignore the fundamentals of business. In the 1960s, overconfident CEOs bought other firms far from their core business and built massive conglomerates. The resulting behemoths had gross revenues larger than many developing countries, but they were operating too many businesses at a sub-par level. Few conglomerates were consistently profitable. Some, like RCA, were nearly killed by the acquisitions and later lost their independence as some other firm acquired them. Many are now being broken up by men like Dunlap.

"There was this theory, in the 1960s, that you had to conglomerize because as one business would go down, another business would go up and offset the cycle," Dunlap writes, "The flaw in that thinking is that shareholders are quite able to diversify on their own, thank you. Management doesn't have to do that for them."

Dunlap's management philosophy boils down to this: "The most important person in any company is the shareholder." By focusing on one goal—"make money for the owners"—Dunlap has succeeded in a series of turn-arounds at Lily-Tulip, Crown-Zellerbach, Australian National Industries, and others. His methods sometimes make enemies with executives and the press, but shareholders generally cheer.

Writing under the headline "Does Al Dunlap mean business or is he just plain mean?" Thomas Petzinger, Jr., a *Wall Street Journal* columnist, neatly summarizes the standard complaints against Dunlap and his fellow shareholder revolutionaries. The most popular criticism is that Dunlap likes to oust people from their jobs. Petzinger carps, "Just ask the casualties at Scott and elsewhere, people he brags in his book about dismissing with such rejoinders as 'get rid of her' and 'You two stay; the rest of you are fired.'" Other critics write about the laid-off workers as if Dunlap gunned them down.

Well, Dunlap rejoins, ailing companies frequently "restructure"—a euphemism for laying off workers—but these efforts rarely succeed because key executives fail to make hard choices. Instead, the constant mini-fixes drive out productive employees while keeping the indecisive and the demoralized. This kind of restructuring is all pain, no gain. Before Dunlap came aboard, Scott had had three restructurings in four years. "I only restructure once," Dunlap proudly points out. What's more, he sets a strict deadline (usually less than one year) when all cuts are made. After that, employees do not have to live in fear of an endless parade of job cuts and transfers. In the long run the tough-love approach is kinder, Dunlap argues.

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"Dunlap's hasty personnel judgments may be valid when the objective is a quick bump to the stock price. But building a great company demands managing people individually, marshaling the knowledge they accumulated yesterday in the service of tomorrow's markets," Petzinger complains. Dunlap's response is less elegant but more direct. If these individuals have such valuable ideas, why didn't they use them to boost the stock price?

Some opponents blame Dunlap for taking a company's problems out on the most vulnerable. Actually, though, Dunlap tends to cut from the top down. His first action is generally to release layers of executives and sell their toys.

Dunlap does not support today's fashionable idea that executives should manage a company for a wide array of "stakeholders," who are said to include not just the shareholders and employees, but also the host community, suppliers, consumers—anyone the company touches in any way. Dunlap, by contrast, ends all corporate donations at his companies. When a woman at Scott asked Dunlap if the company could restart a philanthropy program, he replied, "If you want to give on your own, that is your business and I encourage you to do it. But this company is here to make a buck. The stockholders and the board have not empowered me to give away the company's money. My job is to make sure you have a secure future, and the best way for you to have a secure future is to have a healthy company." Dunlap says he strongly supports individual donations to charity. And in leaving millions of dollars to West Point, his alma mater, in his will he seems to practice what he preaches.

Another frequent charge is that Dunlap leaves companies weaker. "Of the eight troubled outfits he claims to have rescued, six are gone—kaput, finished—sold off, split up, or otherwise wiped out as independent entities," Petzinger writes, but this is misleading. All eight of the firms Dunlap rescued are alive today. Six were sold because Dunlap made them *worth* buying.

A final criticism is that Dunlap is shortsighted. Yet under him, Scott expanded operations (including building new plants) in China, India, and Brazil, tapping into the world's fastest growing consumer markets. These investments will take years to pay off, but will leave the company with a solid brand name and customer base in these dynamic markets. If he hadn't made those investments, the balance sheet would have looked stronger in the short run, but not in the long run. Since expectations of future earnings boost stock prices, it seems that Dunlap's relentless emphasis on boosting the share price has benefited the long-run interests of companies exactly as economists would have predicted.

Dunlap's no-nonsense tour through today's business practices is bracing—and the sign of things to come. As more and more people invest their pensions and paychecks in mutual funds, the pressure on executives to keep the stock price high will intensify. Power will continue to shift from managers to shareholders, from the country estates to the suburbs.

"Chainsaw Al" the press calls Dunlap. Given his record in saving companies and the people who own stock in them, a more enlightened sobriquet might be, "public servant."

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Relax Regulations to Clean Up Urban Blight

By Sen. Spencer Abraham

Crime, poverty, and general disarray aren't the only obstacles that face anyone hoping to rehabilitate our blighted urban centers. Too often, government rules make it almost impossible to rejuvenate inner cities. Inflexible regulations, the threat of lawsuits, and high costs keep acre after acre of dilapidated buildings untouched—marring the landscape, killing commerce, and driving new business and growth off to the green fields outside cities.

Government environmental policies have proven especially counterproductive. A large proportion of our cities' abandoned properties are environmentally contaminated. And new companies refuse to take over these properties for fear of environmental suits from government and/or private parties. As a result, contamination and joblessness go unaddressed. A survey of Toledo, Ohio, businesses found that environmental worries affected 62 percent of the area's commercial and industrial real estate transactions—almost always hindering job creation and economic development.

Similarly, plans for a $3 million lumber treatment plant in Hammond, Indiana, were abandoned when low levels of contamination were found at the proposed site. The developer concluded that uncertain costs and potential liabilities outweighed the site's benefits—so the city of Hammond lost construction jobs, 75 full-time lumber plant jobs, and any reasonable prospect that a developer would assume the risk of developing property anywhere on the 20-acre site.

In Flint, Michigan, the former site of Thrall Oil Company also sits vacant. Local officials say the property is excellent for manufacturing. Unfortunately, because the Michigan Department of Environmental Quality has labeled it "contaminated," developers cannot be found.

For decades, social engineers in Washington have tried to revitalize distressed areas like these, but the blight remains. Too often, various urban renewal and welfare programs have only made things worse by spawning dependency on government help. Environmental laws intended to force clean-up of contaminated sites have only scared away investors fearful of potentially unlimited liability, including liability for contamination the investors did not cause or even know about.

Federal and state environmental rules have created as many as 30,000 "brownfields" today—urban commercial sites that are essentially undevelopable for environmental reasons. Although not serious threats to public health or safety, legal rules make these properties too financially risky for investment and job creation, creating permanently abandoned blights on the urban landscape. Even investors willing to shoulder the liability are not allowed to write off the cost of cleaning up a brownfield. Instead these costs must be spread over a number of years.

Sen. Joseph Lieberman (D-Conn.) and I have proposed targeting tax benefits at brownfields in economically distressed areas. We would allow investors to "expense" their clean-up costs immediately, which would have three positive effects. First, by encouraging redevelopment of abandoned sites, these tax incentives will foster economic growth in distressed communities across the country, providing economic opportunity rather than dependence on government.

Second, these tax incentives will significantly improve our ability to clean up contaminated sites. Existing clean-up laws have proved remarkably unsuccessful. With 30,000 brownfields nationwide, we need to start cleaning them now, and we need voluntary private investment to get the job done. Third, this solution, unlike past governmental ones, uses the private sector to reclaim contaminated land and reinvigorate distressed communities. Sen. Lieberman and I have intentionally linked our brownfield provisions to currently designated "enterprise zones"—economically distressed areas the federal government has targeted for special tax and regulatory incentives. In my state of Michigan alone, Flint, Muskegon-Muskegon Heights, Lake County, and Detroit all have been designated enterprise zones. Existing incentives to spur investment and job creation include tax breaks for small businesses, as well as crucial relief for local entrepreneurs from some of the most outlandish federal rules and mandates. By encouraging private investment, rather than trying to buy or force cooperation with government mandates, we can free up private capital and initiative to do the job of revitalizing hard-pressed areas.

These tax incentives would mean foregoing only $1 to $2 billion in federal revenues—an amount easily made up by eliminating wasteful programs such as corporate welfare in the Commerce Department, whose costly efforts to fight urban blight have yielded little. In exchange we will get reinvigorated and re-purified urban land into productive use. With government out of the way and the right incentives in place, good jobs and a clean environment can go together, to everyone's benefit.

Sen. Spencer Abraham (R-Mich.) is a member of the Senate Commerce Committee.