Unbeholden to Wall Street, privately held companies can behave more responsibly

the FREEST ENTERPRISE

One of the forgotten tragedies of World War II was a precipitous decline in the quality of candy. With government rationing of sugar, cocoa, and other key ingredients, many candy firms used cheap substitutes, and made windfall profits. But the people who walked into Fannie May shops in Chicago got the real thing: pure delectable candy. The company's owners decided that instead of adulterating their product they would simply sell less of it and make less money.

It was not the first, or the last, time Fannie May Candy Shops, Inc. skipped a chance to get fat. The company has, for example, always stayed away from making candy for others to sell under different brand names. "We have no idea what they might be doing with the product once it's out the door," Richard Peritz, the firm's president, told *The Chicago Tribune*. A longstanding refusal to use preservatives meant Fannie May could expand only slowly to ensure delivery of fresh merchandise weekly to company-owned shops. "We're not desperate to do business at any cost," says Peritz.

Fannie May can operate this way because it is privately owned and thus free of the pressures to pursue profits that the stock market imposes on companies whose shares trade publicly. Most private business owners, of course, do not purposely avoid profit opportunities. But the fact that they can is an underappreciated freedom. Private business owners are also freer to pursue worthwhile ventures aggressively, even if it means large short-term sacrifices. Most important, they can spend every penny of company profits as they see fit: on higher wages and benefits, on philanthropy, on research for new and better products and services, or on new equipment that is more efficient, safer to work with, and easier on the environment.

This is no small privilege, considering their impact on the country. One hundred and seventy-five of the Fortune 500 companies are family owned or controlled; privately owned firms of 100 or more employees make up one-fifth of the U.S. economy. While corporate reformers talk about shareholder democracy, management accountability, and other issues involving publicly traded companies, privately held companies are in the best position to create models of capitalism at its best.

Betraying the faith

Taking a company public can be unavoidable if a firm needs capital to expand and cannot secure it any other way. But the usual motivation for going public is the self-interest of the owner. Turning a fixed investment like a company into liquid assets by selling some or all of it, then reinvesting the assets in diversified portfolios, has always been the way to secure a life of leisured wealth.

The prospect of wealth, however, can be outweighed by the loss of control. "When you go public and sell the majority of the firm, you've essentially made the marketplace your partner," says Columbia University law professor John Coffee. "It's a very finicky partner." Decisions concerning ethics or the future health of the company can upset Wall Street and drive a company's stock price down. And there's nothing like a low stock price to put the manager who wants to do the right thing on the defensive. His proposals—whether they are to reduce the plant's pollution emissions, use sturdier materials in the product,

Paul Glastris is an editor of The Washington Monthly. *Alex Friend provided research for this article.*

by paul glastris

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or increase worker salaries—can be voted down or his own position at the firm terminated by a board of directors made skittish by worried investors. The ultimate threat to his job, a corporate takeover, becomes likely when a stock's price dips below the value of the firm's assets.

Wall Street isn't stupid; a share price is as good a measure as any of a firm's long-term prospects. The financial markets will reward a company for a long-term investment, like R&D spending, by bidding up its share price, assuming such spending doesn't cut into short-term earnings. But that's where the problem is. There are innumerable occasions when a firm should sacrifice earnings now—even if it means some red ink—for future payoffs.

That's where private companies have the advantage, if they choose to use it. Without shareholder demands on company earnings, the owner-manager can spend those earnings on what's best for the firm and its customers and employees. Why should a public company executive risk his job by plowing money into new plants and equipment to make products that may or may not sell as well as those made in Japan, when he can sell existing plants, buy an insurance company, and give his stockholders all-but-guaranteed returns? This is one reason privately held companies often thrive in industries public companies have abandoned. Perhaps the brightest spot in America's otherwise dismal machine tool industry, for instance, is the privately held Ingersoll Milling Machine Co. of Rockford, Illinois, one of the most prosperous and technologically up-to-date machine tool manufacturers in the world.

A public corporation manager has more than his job on the line when making decisions on the crucial trade-offs between his company, his conscience, and his shareholders. A manager who fails to convince shareholders that he acted to enhance the long-term value of their investments can be sued for "waste and dissipation" of a firm's assets. The "business judgment" rule in corporate case law gives managers and directors great leeway in deciding how the interests of the shareholders are served. But the fear of such lawsuits quietly fences in the range of the public company manager's options. One could make a good case, for instance, that AT&T would best serve itself and the nation by slashing its dividends and devoting the money to R&D. But "if AT&T did that," says Georgetown University law professor Donald Schwartz, "it would be a betrayal of faith to the millions of investors who have historically depended on those dividends. The money managers, out of fiduciary duty to those investors, could sue, and I think they'd win."

Taking a gamble

"About ten years ago I did a survey of business owners who have taken their firms public," recalls Amar Bose, a professor of engineering at the Massachusets Institute of Technology, who also owns and runs the Bose Corporation, manufacturer of high fidelity equipment. "One of the things I found that was common to each and every one was the almost unimaginable time they spent—sometimes 25 to 30 percent of their day—maintaining the image of the company."

When the owner-manager goes public, he becomes as much PR man and politician as entreprenuer. There is suddenly a vast constituency of interested parties—directors, securities analysts, institutional investors, members of the trade and business press—to whom he must justify his decisions, for whom he must constantly be putting the best face on quarterly earnings reports. Not playing to this audience means risking a dip in the company's share price, which managers rightly fear. All those Archer Daniels Midland ads on television aren't meant to get Joe Sixpack to rush out and buy grain; ADM sells only by the bargeload. The ads serve only to keep the company's stock price buoyant by promoting ADM's success in the agricultural products business. You will not see ads for Cargill, ADM's privately held

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competitor.

Keeping share prices up by fielding the questions of analysts, investors, and business newsmen was not Amar Bose's idea of fun. "I for one am not prepared to spend 25 percent of my time doing PR. I'd rather do research," he says. Those who have never been entreprenuers or worked for them may not understand, but a major reason many people start businesses is to do the kind of work they like. For Bose, and for the star MIT students he brought into the company with him, doing cutting-edge, scientific research of high fidelity technology, then incorporating the findings into state-of-the-art equipment, was at least as big an attraction as the money to be made. The passion for research paid off in critically acclaimed equipment. For teenage audiophiles in the seventies, having enough disposable income to afford Bose speakers was an incentive to grow up.

Despite the success, Bose has good reason to believe his firm would not have survived as a research-oriented organization had its shares traded publicly. In 1979, Bose began sinking money into developing a line of American-built car stereos for General Motors to offer as optional equipment. It was a big gamble. He had no contract from GM, nor had GM ever offered such a non-cosmetic option on its cars. It was also bad timing; the recession that hit months later decimated sales at Bose and throughout the industry.

Managers at almost any publicly traded company would have cut the project to boost earnings. Bose kept millions in R&D money flowing. In 1982, Bose Corporation went into the red for the first time in its history. This led a bank that had been providing the firm with credit to pull its financing. Had the company been publicly traded, Bose told *INC.* magazine, "I certainly would have lost my job." Today, Bose car stereos, which GM now offers as optional equipment, make up more than 20 percent of Bose Corporation sales.

Textile tenderness

The dream of running a wonderful company that makes top-notch products and is a pleasure to work for is apparently not behind the latest trend in corporate "privatization": the leveraged buy-out (LBO), in which managers borrow money to buy the outstanding shares of the companies they work for, using the company itself as collateral. Most managers who engage in these buy-outs eventually plan to take their companies public again, at huge profits to themselves. They justify their windfalls by saying they are being rewarded for making the tough decisions, which usually involve plant closings and massive layoffs. A good many of these closings are necessary to save the companies involved. But these managers are usually far too busy dreaming about the seven-figure "rewards" they're going to get to put much effort into easing the suffering of the employees who are affected by their "tough decisions."

The case of Levi Strauss & Co.—the world's largest garment manufacturer—is an instructive exception. In 1971 Robert Hass, CEO and great-great-grandnephew of the famous blue jean maker, took the family-owned company public. As long as sales grew, which they did throughout the seventies, Wall Street was happy, and Hass, who, with his family, had kept 40 percent of the stock, retained general control over company policy.

Keeping control was important to Hass; he had a reputation to protect. Levi Strauss had long been singled out as a model of corporate responsibility. When the 1906 San Francisco earthquake destroyed Levi's plant, as well as much of the city, the company took out newspaper ads to let its employees know their paychecks were coming. Levi racially integrated its plants long before the law forced other manufacturers to do so. Levi employees—85 percent of whom are women—have historically received pay, benefits, and profit sharing far above the industry average. And

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it has a record of corporate philanthropy that should put other firms to shame, devoting 2.3 percent of its pretax earnings to charities and employee-run community volunteer programs—triple the corporate average.

But in 1984, sales dropped 8 percent, the company's share price followed, and the specter of a takeover loomed. The company would have to close plants to survive. In order, said Haas, not to lose the company's "important values and traditions" and to make difficult decisions without worrying about Wall Street's reaction, the family borrowed $1.7 billion to buy its shares back. To pay off the debt, Hass sold off companies Levi had acquired while it was public.

Now fully in charge, Hass went about the dirty business of "downsizing" a company that had too much capacity to survive, with a consideration for affected workers that is rare in corporate America, especially in the textile industry. Workers got three months' advance notice (a relatively rare phenomenon) that their plants would be closing, priority in hiring at other Levi Strauss plants, and financial help in moving if they chose to take the new jobs. Seventy-five hundred couldn't or wouldn't move; most were women working at plants in small or midsized southern towns. For these employees, Levi Strauss provided up to a year's extended medical benefits as well as intensive job retraining and outplacement services. What's more, the company kept up its philanthropic commitments. Today, the Hass family could tender their shares for a huge profit. Few if any analysts, however, think they will.

Levi Strauss is an exceptional company. It's safe to presume that most private business owners wouldn't choose to go the extra mile in this way. Indeed, plenty of other private businesses use their freedom for socially irresponsible ends. Because the Securities and Exchange Commission doesn't require them to disclose financial data as publicly traded companies must, private businesses find dodging the tax man a lot easier. But if private companies can be worse than public companies, they also have the freedom to be better—and kinder.

It is the freedom to be exceptional that makes running a private company appealing. Public corporation executives often convince their directors and shareholders of the PR value of giving small percentages of their earnings to good causes like charities. They could never get away—to take an extreme example—with giving all the company's profits to charity, as actor Paul Newman has done with his salad dressing company. Family-run newspapers that spend a large portion of their earnings on expensive foreign bureaus and teams of investigative reporters, or that forgo revenue by not accepting cigarette ads, may be less profitable than papers owned by publicly traded conglomerates that don't make such sacrifices to quality or ethics. But they are assets to America and sources of pride to their owners.

Putting concerns like product quality above profits doesn't have to mean forfeiting prosperity. Being sheltered from the stock market's discipline certainly hasn't turned Fannie May into a charity case—though it is very nearly a civic institution to sweet tooths in Chicago. The firm is in fact thriving; it is the midwest's largest candy chain, with 215 shops in 11 states and the District of Columbia. "Fannie May is a very successful regional company," remarks Lisbeth Echeandia, publisher of *Confectioner*. "They have a down-home, all-American image and very loyal customers. Their prices are extremely reasonable. In terms of product and positioning in the market, I'd say they're excellent."

The prospect of selling the company is now its biggest temptation. "I can't count the number of times people we know and aquisitions brokers call about selling," says Peritz. The firm's answer, says vice president of sales Jack Barber, is always the same: "Absolutely not. There is neither the intention, nor the desire to take the company public. You lose too much control." ■

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Sam Donaldson's style is more than just entertaining

PUSHINESS WE CAN RESPECT

by Jody Powell

Let's get this out up front: I like Sam Donaldson. More to the point, I even liked the guy when we were hurling insults and accusations at each other in the White House briefing room some years back. Unlike some of his colleagues, he always came straight at you. If he had a story he knew you'd hate—and he often did—he'd make sure you got a chance to have your say. And when you talked to Donaldson about a story, you were dealing with the man who makes the decision. No ninny in New York was going to call in at the last minute to tell him how to cover the White House.

Well, now there is a Donaldson book*, and it comes right at you, too. It's vintage Sam. He says he rejected the idea of hiring a ghostwriter, and it's clear that he's telling the truth. Read a few paragraphs aloud and your eyebrows begin to arch upwards in that inimitable Donaldson style. It's him alright.

The Donaldson ego is there, too. Toward the beginning of his chapter on television news reporting he unabashedly observes: "Call me a braggart, call me arrogant. People at ABC (and elsewhere) have called me worse. But when you need the job done on deadline, you'll call me."

Still, there is more than the usual ration of self-deprecating stories and admissions of error. The latter are rare enough in Washington books of any description and particularly scarce in those by journalists.

Hold On, Mr. President! does not claim to be a scholarly dissertation on the last quarter century of Washington journalism, and it's not. Mostly it is a collection of stories, anecdotes, and observations. At that level it is the best such collection to come along in quite a while. In at least two areas, however, his book has serious things to say about business immediately at hand.

The first has to do with the nature of a reporter's job, particularly at the White House. Appropriately, his first chapter is entitled "Challenging Presidents." What he has to say is hardly new, and it might not have seemed terribly important three months ago. Now, with most journalists pumping out lame defenses for their six-year failure to challenge much of anything about the present administration, Donaldson's dogged approach deserves more than casual consideration.

Most of the journalists now squirming in the wake of the Iran scandal wouldn't be caught dead shouting a question at a president from behind a saw-horse. Some even turn up their noses at presidential press conferences. All are now using presidential answers to Donaldson questions to explain belatedly to the public what this administration is really like.

Who asked the question on Martin Luther King that produced evidence of profound presidential ambivalence over whether King was a "communist sympathizer?" What about the one that elicited the sweeping condemnation of the Soviet Union at Mr. Reagan's first press conference? Or the one that produced the first statement from the president, or any other administration official, that the goal of American policy was to "remove" the Sandinista government of Nicaragua? You guessed it, and the list goes on and on.

Donaldson says his job is to challenge

Jody Powell, press secretary in the Carter White House, is a syndicated columnist and a commentator for ABC News.

**Hold On, Mr. President!* Sam Donaldson. *Random House, $17.95. To be published at the end of March.*

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