

# The Case for Takeovers

By Carl C. Icahn

**T**HE TAKEOVER BOOM IS A TREATMENT for a disease that is destroying American productivity: gross and widespread incompetent management. Takeovers are part of a free-market response, working to unseat corporate bureaucracies, control runaway costs and make America competitive again.

A most interesting, yet often ignored, fact about takeovers is that in all bids for control—hostile or friendly—a price much higher than current market value is paid for the company. This is generally referred to as a “premium for control.” But, generally, what the acquirer is really saying when he or she pays this premium is that the company is actually worth more if the ability to remove top management exists.

In almost every takeover, the purchaser has been able to make the assets of the company more profitable and productive than the previous, entrenched management could. The corollary is that current management is not doing the proper job.

Top management in this country is mediocre, yet we do very little about it. Corporate executives are judged by their peers not on how profitable their departments are, but on how many people report to them. The chief executive officer's compensation is often based on the size of the company rather than on the company's profitability.

With a number of notable exceptions, American C.E.O.'s, while not the best and the brightest, are politically astute and possess finely honed survival instincts, which may explain why they generally select seconds-in-command who are not quite as bright as they are; smarter ones would constitute a threat. When the C.E.O. retires, however, that second-in-command takes the reins. We clearly have an anti-Darwinian principle working in our executive suite: the survival of the unfittest. At the same time, companies are burdened by layers of vice presidents who not only don't produce, but are often counterproductive.

We have, therefore, created a corporate welfare state.

The astounding and tragic thing is that nothing of significance is being done to correct the problem. We give lip service to “corporate democracy” and “accountability” but in reality they don't exist.

After World War II, we were unquestionably the greatest power in the world. We were the only country left with great productive machinery and a willing and healthy work force. Today, we are fast becoming a second-rate power with huge budget and trade deficits. Were the incompetent, inbred managements of many of our major corporations replaced by strong and capable leadership, we might still be able to save our economy from decline.

I've had some opportunities to test my thesis. In 1983, I took a major position in ACF Industries, a Fortune 500 company in the railcar manufacturing and leasing industry. Although I knew nothing about the railcar business when I took over, I have been able to increase the earnings of the basic operating company to \$35 million from \$4.5 million.

In 1986, I took control of T.W.A., which was on the brink of bankruptcy, having lost about \$200 million in the previous year. I managed to eliminate more than \$300 million a year in waste and bureaucracy; an additional \$200 million a year in savings was provided by union concessions. I accomplished this without sacrificing revenue, and, in fact, improved the quality of service. Today, far from being in the red, we are setting earnings records; net earnings for 1988 were about \$300 million.

Critics of takeovers say that we bust up companies. If this means that we sell off divisions that don't fit in with the main business and whose assets can be used more productively at another company, I proudly plead guilty. More of that is exactly what America needs to compete.

Another criticism is that “raiders” put people out of work. On a percentage basis, I have put far fewer people out of work at ACF and T.W.A. than have A.T.&T. and G.M. or, for that matter, other Fortune 500 companies in their restructurings. The difference is that I and other “raiders” usually eliminate the people who are most

responsible for the mess—the “Top Brass.”

In the last 20 years, Japan's total average percentage change in the rate of manufacturing productivity (as measured by output per hour) has been more than four times greater than America's. I believe that a major reason for this discrepancy is our lack of managerial talent and the strangling bureaucracy that exists in most of corporate America.

The productive engine of our country will simply not be able to support the war babies, who will begin to retire in the first part of the next century. Today, there are 3.4 workers per Social Security beneficiary. The ratio of workers per beneficiary may fall early in the next century to under 2, and shortly thereafter to just over 1. If we fail to make managements accountable and corporations more productive, the result will be economic chaos and rampant inflation.

A criticism often heard against trying to make poor management more accountable is that insistence on better performance might force management to concentrate on short-term goals rather than on research and long-term planning. This criticism is nonsense. It is analogous to saying, “Don't reprimand your 16-year-old for getting poor grades in high school because he or she may punish you by not planning for college.” Moreover, if this were true, we would have witnessed intensive takeover activity in research-driven industries, such as pharmaceuticals, aerospace and high technology. That has not happened. Instead, the stocks of these companies are generally given a high value by analysts, which discourages takeover bids.

Most of the approximately 2,000 takeovers and leveraged buyouts since 1981 have been characterized by a redeployment of assets to create greater competitive and economic gains. The fact is that this decade has seen the highest business investment, as a proportion of gross national product, since World War II and has, in addition, brought greater research and development spending than we saw in the 1970's. The real problem is not that we are failing to do enough research and long-term planning, but that we are not productive enough to compete in world markets.

Since true corporate elections are a rarity, by far the most effective way to remove ineffective management

and enhance productivity is through a takeover and/or a leveraged buyout.

The reason there is so much capital available for L.B.O.'s and takeovers is that tremendous amounts of capital are dammed up in pension funds. These funds must generate a certain return in order to support future retirees. Therefore, pension managers lend money for L.B.O.'s. The fund is taking most of the risk with little of the reward and admittedly, in some L.B.O.'s today there is too much debt and too much risk.

It would be far better for the economy if pension funds invested directly in a takeover rather than merely being lenders. This way, the pension plans would stand to profit much more from the success of the takeover, taking for themselves some of the huge profits now reaped by L.B.O. fund managers. Additionally, with pension funds as equity investors, much of the problem of debt overburdening now appearing in certain L.B.O.'s would disappear.

Perhaps more importantly, if pension plans were willing to invest in hostile takeovers, the mere knowledge of this fact would cause many managements to become more interested in enhancing shareholder value and by so doing, make their companies more productive.

**A** SIMPLE WAY TO HELP CLEAR THE way for true accountability would involve passing a law to provide that, should a merger offer for any and all the stock of a company be made by a credible purchaser, the company would have to allow the shareholders to vote on the offer, and management would have to abide by the vote. Of course, during the time preceding the vote, managements would be permitted to campaign against the offer and/or find a higher offer. This would do away with unnecessary shark repellants, litigation and like deterrents, and open the way for responsible bids.

The assets of our country are mired in the quicksand of waste. If we do nothing to redeem our corporations, future historians will marvel at why, when we could have so easily. However, it is still not too late, and takeovers are an essential part of the solution. ■