Merger Mania Revisited

A Survey of Recent Articles

If you were looking for fighting words during the 1980s, "mergers and acquisitions" would do nicely. This phrase could make the hair on a corporate titan's head stand on end and touch off ideological brawls among people worried about the future of the U.S. economy. Some said the decade's extraordinary number of corporate mergers, takeovers, and leveraged buyouts was destroying the U.S. economy. Others insisted that these activities were a healthy development.

In the cool light of history, it appears that the optimists may have been "more right" than the pessimists. In a special issue of *Business History Review* (Spring 1994), Harvard's Alfred D. Chandler, Jr., the dean of American business historians, puts the decade's events in longer-term perspective. Their roots go back to the 1960s, when U.S. corporations facing rising competition from domestic and overseas rivals began diversifying into other, frequently unrelated areas of business. There were some 6,000 mergers and acquisitions in 1969 alone. The trend toward conglomeration produced corporate indigestion, as headquarters personnel lost touch with their varied and far-flung operations. The financial restructuring that reached its crescendo in the 1980s actually got under way during the 1970s, as big businesses began to shed divisions they had unwisely acquired.

But the problems of American business were bigger than a few unwise acquisitions and by the 1970s they were becoming painfully apparent. In another article in the Spring 1994 issue, Carliss Y. Baldwin and Kim B. Clark, both of Harvard's Graduate School of Business Administration, argue that the usual explanations for declining competiveness—the high cost of capital and the short time horizons of U.S. business executives—are too simplistic. They report that in a 1993 study of 432 large companies, economist Michael Jensen found that about one-quarter of them *over*invested during the 1980s. General Motors spent $67 billion on new plant and equipment but saw its market share drop from 45 percent to 35 percent.

The real problem, Baldwin and Clark believe, is more prosaic: the capital-budgeting and financial-planning techniques that big business increasingly adopted after World War II. These methods gave managers a way to estimate returns from investments in tangible items but made it difficult to evaluate spending on what the authors call "organizational capabilities": things such as skills, procedures, and information systems that improve the speed or quality of production. Adhering strictly to conventional methods, for example, it would be hard to justify costly investments in gathering customer feedback, reorganizing management, and redesigning products to improve quality. Quality is hard to quantify.

A backlash against those methods was already beginning in corporate circles as the merger-and-acquisitions movement gathered speed in the early 1980s. Both the backlash and the movement were propelled by ever-increasing competition, not only from foreign firms but within U.S. industry.

Chandler finds that financial restructuring varied a great deal during the period, depending upon the type of industry. In what he calls the "low-tech" industries (e.g., food, drink, and tobacco), there were a lot of mergers and takeovers, and many were highly publicized. Well-known companies such as General Foods, Nabisco, and Beatrice Foods were absorbed into other corporations. Most of these changes, Chandler suggests, were needed responses to the overdiversification of the recent past; in the end, the competitive strength of the low-tech sector was little affected.

In America's "high-tech" industries, such as chemicals, electronics, and aerospace, there were a number of high-profile mergers and acquisitions, but "managers, not financial intermediaries, proposed the moves and carried them out." Unlike the controversial "transaction oriented" deals masterminded by investment bankers and corporate raiders gunning for quick profits, these deals were normally made

by managers taking the long view. They bought and sold companies chiefly in the interest of reshaping "product portfolios." Consider chemicals (including pharmaceuticals), a $210 billion industry in 1987, as compared with the $127 billion auto industry. Reshaped by mergers and acquisitions and reinvigorated by heavy research-and-development (R&D) outlays, the U.S. chemical industry held its own against foreign competitors. Between 1987 and '91, exports rose from $25 billion to $44 billion.

"Stable-tech" industries, ranging from fabricated metals (e.g., cans) to farm equipment, suffered the most during the decade. The high-tech industries were able to respond to rising competition by boosting R&D spending to develop new products and markets. Stable-tech companies that were able to find similar opportunities generally managed to fend off unwanted suitors: oil companies moved into petrochemicals; companies such as 3M and Corning Glass moved into fields such as fiber optics. But other industries, such as steel, aluminum, and nonelectrical machinery, were battered by the merger-and-takeover wave. Corporate raiders such as Asher Edelman and Samuel Heyman contributed to the chaos, says Chandler, but corporate managers pursuing long-term goals were again the chief players. The problem was that in the superheated markets of the 1980s, investment banking houses and other financial intermediaries collected huge fees, costing industries hundreds of millions of dollars and forcing reductions in R&D and capital investment.

In a third *Business History Review* article, Berkeley economist Bronwyn H. Hall reaches similar conclusions with regard to firms that went through leveraged buyouts (in which so-called junk bonds or other forms of debt were used to take a company private) or big increases in debt loads. The action, she says, was focused in the stable-tech sector. Overall, she suggests, such a freewheeling "market for corporate control" has a salutary effect on business.

In all three sectors, Chandler concludes, the past few decades have taught business the dangers of unplanned growth. The stable-tech industries learned the hardest way. But "the United States is not going the way of the United Kingdom in terms of long-term competitive strength," he writes. Late-19th-century Britain failed "to make the long-term investments in production, distribution, and above all in management essential to compete globally. . . . Today American companies remain powerful competitors in the most dynamic and transforming industries of the late 20th century."

The Ugly Truth About 'Lookism'

"Beauty and the Labor Market" by Daniel S. Hamermesh and Jeff E. Biddle, in *The American Economic Review* (Dec. 1994), American Economic Assoc., 2014 Broadway, Ste. 305, Nashville, Tenn. 37203.

Now there is proof: women do face discrimination in the workplace on the basis of their looks. Economists Hamermesh and Biddle, of the University of Texas, Austin, and Michigan State University, respectively, have the evidence to prove it. But there is a surprise: men face even greater discrimination.

In three extensive surveys (two done in the United States in 1971 and 1977, and one in Canada in 1981), interviewers not only obtained the usual labor-market and demographic information but also rated their respondents' physical appearance, from homely to drop-dead good-looking.

Hamermesh and Biddle's analysis shows that, other things (such as education, health, and marital status) being equal, the five percent of women judged homely or quite plain earn about five percent less than those with "average" looks. The unlovely male, however, pays a penalty of about *nine* percent. At the other end of the scale, good-looking or beautiful women earn about four percent more than ordinary-looking ones. Men who are "10s" (or thereabouts) get an earnings bonus of five percent.