Discussion of:

Managing with Style: The Effect of Managers on Firm Policies

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"Chainsaw Al" Dunlap

Al Dunlap was a turnaround artist, who rescued a series of companies (American Can, Lily Tulip, Crown Zellerbach, Scott Paper)

> In each of the companies he had "rescued" ... Dunlap had started by decrying the waste and inefficiency of previous management. Then he had brought in C. Donald Burnett, a senior partner at Coopers & Lybrand, to work out the details of the vast payroll cuts and plant closings that were Dunlap's signature.

Dunlap was hired as the CEO of Sunbeam in July, 1996:

> The day after Sunbeam announced that it had snared the self-styled turnaround artist and downsizing champion as its CEO, the company's shares soared nearly 60%, to $18.63, as one analyst after another urged investors to load up on the stock. After all, at Scott Paper Co., Dunlap's last CEO assignment, he had driven up shares by 225% in 18 months, increasing the company's market value by $6.3 billion.

Dunlap said (on his hiring at Sunbeam):

> I take on the corporations that are in the worst possible shape. I go in when no one else wants the job. And I rescue and save the corporation. That's my job. That's what I'm there for. There are other executives who run a corporation year in and year out, and they do a very nice job. But it's not necessarily what I do.

Dunlap's Sunbeam Tenure

As he had done previously, Dunlap brought in a team from Coopers & Lybrand, headed by senior partner C. Donald Burnett, and proceeded to cut dramatically:

> [Coopers & Lybrand's] restructuring plan, approved by the board on Nov. 12, 1996 ... called for the elimination of half of the company's 6,000 employees and 87% of its products. [They went from twenty-six factories to eight] According to Sunbeam managers, it also resulted in near-total chaos.

However, some argued that Sunbeam's situation was not as dire as other firms', but Dunlap cut anyway:

> ... many managers believed that [C & L partner] Burnett's job was not to figure out how much to cut but simply to find enough bodies to meet Dunlap's preset goals. Once, when the Coopers team came back with estimates of layoffs that didn't meet Dunlap's expectations, Sunbeam managers heard the CEO quip that Burnett was "getting weak-kneed in his old age."

Some of the cuts certainly appear, at least *ex-post*, to have been unwise:

> Coopers also urged Sunbeam to fire its computer staff and outsource the entire information processing function. Dunlap axed technicians making $35,000 a year who quickly discovered they were worth $125,000 a year elsewhere. To replace them ... Dunlap had to hire contract workers at far higher rates, some of whom were people he had just let go.

The Aftermath

- Reported earnings growth was good for several years.
- In response to the apparent success of Dunlap's cutting, the stock hit a peak of $53/share.
- It was later turned out that much of this earnings came from questionable accounting practices.
- Dunlap was fired in 1998.
- Sunbeam filed for Chapter 11 in February 2001.
- Its shares now trade (OTC) at $\approx \$0.06$/share.

What Happened at Sunbeam?

Did Dunlap evaluate the situation at Sunbeam, decide on an optimal strategy, and implement it?

- Had he been hired to run Microsoft, would he done something entirely different?
- Did he have a full toolbox, or was he just a hammer?

Did the board of Sunbeam hire optimally?

- Did they hire Dunlap thinking that he was an all-around "good manager," who would determine and implement an optimal policy?
  - Did he?
- Alternatively, it could be that the board knew that all Dunlap could do was slash, but they knew this and they hired him precisely for this job.
  - Many of Dunlap's interview statements suggest that this was his belief.
- Or, did the board hire him without understanding his limitations?

This Paper's Results:

The main result in this paper is that there are manager-specific effects:

- That is, λ_{CEO}, λ_{CFO} and $\lambda_{\mathsf{Others}}$ are not zero in:

  $$y_{it} = \alpha_t + \gamma_i + \boldsymbol{\beta} \cdot \mathbf{X}_{it} + \lambda_{CEO} + \lambda_{CFO} + \lambda_{\mathsf{Others}} + \epsilon_{i,t}$$

  where $y_{i,t}$ are sets of corporate policy variables describing the firms':

  1. Investment
  2. Financing Decisions
  3. Organizational Strategy

Since we know that $\mathbf{X}_{it}$ is not a perfect set of controls, this result is not that surprising:

- If we failed to reject the null hypothesis (that there were no manager fixed effects) what would this mean?:
  - Managers are perfect substitutes.
  - Boards select managers randomly.
  - Boards need not worry about the "fit" of the top management hires.

Thus, it's reassuring nice to see this null hypothesis rejected, but what other (more controversial) hypotheses could we test with these data?

What Hypotheses Explain the Manager-Specific Effects?

Several possible theories explain this result:

1. Managers inherently do some things better than others:
   - These things (*e.g.*, restructuring) are associated with certain policy variables.
   - Boards pick the best manager for the job.
2. Boards *think* experience matters (and maybe it does):
   - Managers are probably brought in to do things they have done well in the past.
   - This doesn't mean that the managers don't act optimally.
   - It doesn't mean that the boards don't act optimally.
3. Do managers follow (inappropriate) *ad-hoc* rules?
   - If something worked in the past for a manager, the manager will tend to do it again, whether it is appropriate or not:

How can we discriminate between these with the data used here?

Testing these Theories:

- It would useful to know if the firms characteristics, and changes in these characteristics (the $\mathbf{X}_{it}$'s) can forecast what type of manager is hired:
  - For example, do firms in trouble hire turnaround artists?
  - This might help to answer the question of the extent to which boards pick managers whose (perceived) skills are what the firm needs.
- It would also be useful to know how much manager's actions change when they move from one firm to another with different needs.
  - Does their behavior change based on the apparent needs of the firms?
  - This would help to answer the question of the extent to which managers just follow *ad-hoc* rules, without regard to their applicability.
- How does the market react to:
  1. The "fit" of the manager chosen?
  2. When management deviates towards their "modal" behavior (and away from what is forecast to be necessary for the firm) how does the market react?

  - One potential problem with this last exercise is that the market reaction to hires depends on the new manager's ability to extract rents.

Other Issues:

What Explains a Firm's Policies?

- The first paragraph of the paper says that its hard to explain corporate financing and investment policies:

  > A persistent result [in the corporate finance literature] is the enormous (and largely unexplained) heterogeneity in practices across firms.

  – How much extra help is the manager specific variable?

  – Is the manager specific

Manager/Firm (shareholder) Bargaining?

- Authors find variation in the ROA managers generate – and find that Higher ROA is associated with a higher residual compensation.
  - Could the authors bring in equity performance here?
  - How much of the rents do the managers capture?
  - Does this happen when the manager fit is correct?

What Causes Style?

- Relation between observables (age, CEO tenure & MBA) and policy variables are interesting.
  - Other variables?
- Authors find that ROAs for new MBA'd CEOs increase by about 1%
  - Do these CEO's capture these rents?
  - Can we identify what is it that these CEO's are doing to drive up ROA?