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Author(s): George P. Baker

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Beatrice: A Study in the Creation and Destruction of Value

GEORGE P. BAKER*

ABSTRACT

This paper chronicles the history of the Beatrice company from its founding in 1891 as a small creamery, through its growth by acquisition into a diversified consumer and industrial products firm, and its subsequent leveraged buyout and sell-off. The paper analyzes the value consequences the firm's acquisition and divestiture policies, its organizational strategy, and its governance. The analysis sheds light on a number of issues in organization theory, strategy, and corporate finance, including the sources of value in diversifying acquisitions, the cost of over-centralization and weak corporate governance, and the mechanisms of value creation in the market for corporate control.

ON SATURDAY, AUGUST 3, 1985, James Dutt was forced to resign as Chief Executive Officer (CEO) of Beatrice Companies by the board of directors and members of his own management team. The following Monday, the firm's market value jumped by more than 6%—a single day value increase of almost \$200 million. Within days, takeover rumors were surfacing. On October 17, Kohlberg, Kravis, and Roberts (KKR) announced a bid for the company that would culminate the largest leveraged buyout (LBO) in history. Less than five years after the LBO, the 100-year-old company, which had been hailed in *Dunn's Review* ten years earlier as one of the five best-managed companies in America, ceased to exist as an independent organization. Its pieces were sold in a dozen major divestitures ending with the sale of the leftovers to ConAgra in June of 1990.

This paper follows the 100-year history of Beatrice¹ from its founding as a local creamery, through its LBO and ultimate disassembly in the largest

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¹Over its 100-year history, the company has had five names. It began as Beatrice Creameries. In 1945 the company changed its name to Beatrice Foods. In 1983 the name was changed to Beatrice Companies. After the 1986 LBO, the company was named BCI Holdings, then in 1987 the name was changed to Beatrice Company. Throughout the paper, I refer to the company simply as Beatrice.

corporate sell-off in American history. The history of Beatrice is, in many ways, the history of American business during the twentieth century. Begun as a small single-business partnership in rural Nebraska, it grew by acquisition, first in its own industry, then in related industries, and then across numerous industries, into one of the largest and most diversified firms in the country. Widely admired as one of America's best run companies in the early 1970s, the firm struggled with problems of strategic direction and internal governance in the late 1970s, which resulted in tremendous value loss. In large part because of this value destruction, Beatrice was caught up in the financial restructuring mechanisms of the 1980s and was taken over in a LBO in 1986 that led to the sale of all the assets of the firm within four years. Along the way, Beatrice participated in more than 400 acquisitions and 90 divestitures, it acquired a conglomerate (Esmark), spawned a hostile take-over vehicle (E-II Holdings), and sold more than 40 units in divisional LBOs.

This paper attempts to explain the sources of value creation and reasons for value loss identified in Figure 1. The company's acquisition and divestiture activities are a large part of this value creation process. Figures 2 and 3 provide information about Beatrice's acquisitions and divestitures. Figure 2 shows the number of transactions made by Beatrice during this century, while Figure 3 gives a sense for the scale and timing of the largest of these transactions. In terms of numbers of transactions, the company was the most active acquiror in America from 1955–1979 and the most active divestor in America from 1979–1987 (Blair, Lane, and Schary (1991)). All of the companies bought between 1950 and 1979 were sold, either alone or packaged with other companies, in the 1980s. Yet Figure 1 suggests that the acquisitions of the 1950s, 1960s, and 1970s created substantial value for the shareholders of Beatrice, and that the divestitures and the LBO more than recaptured the value losses of the late 1970s and early 1980s. This raises the central puzzle in the Beatrice story: how could the acquisition of hundreds of companies create value, and then the subsequent divestitures of these same assets thirty years later also create value?

The history of Beatrice also raises a number of questions about capital markets, corporate strategy and governance, and organizational structures. How did the firm, which was operated as a highly decentralized holding company from the 1940s through the mid-1970s, add value to the firms it acquired? What brought on the decline in value between 1979 and 1981, and how did the internal and external control mechanisms respond to this value destruction? And finally, how did the LBO and the sell-off of Beatrice create so much value for both pre- and post-buyout investors?

Examination of Beatrice's history throughout the twentieth century provides insights whose relevance goes well beyond merely understanding the history of a single firm. For example, a close examination of Beatrice's transition from related to unrelated acquisitions, and the company's organizational structure and strategy for creating value through these acquisitions, sheds new light on the old controversy over the value of conglomerate-type

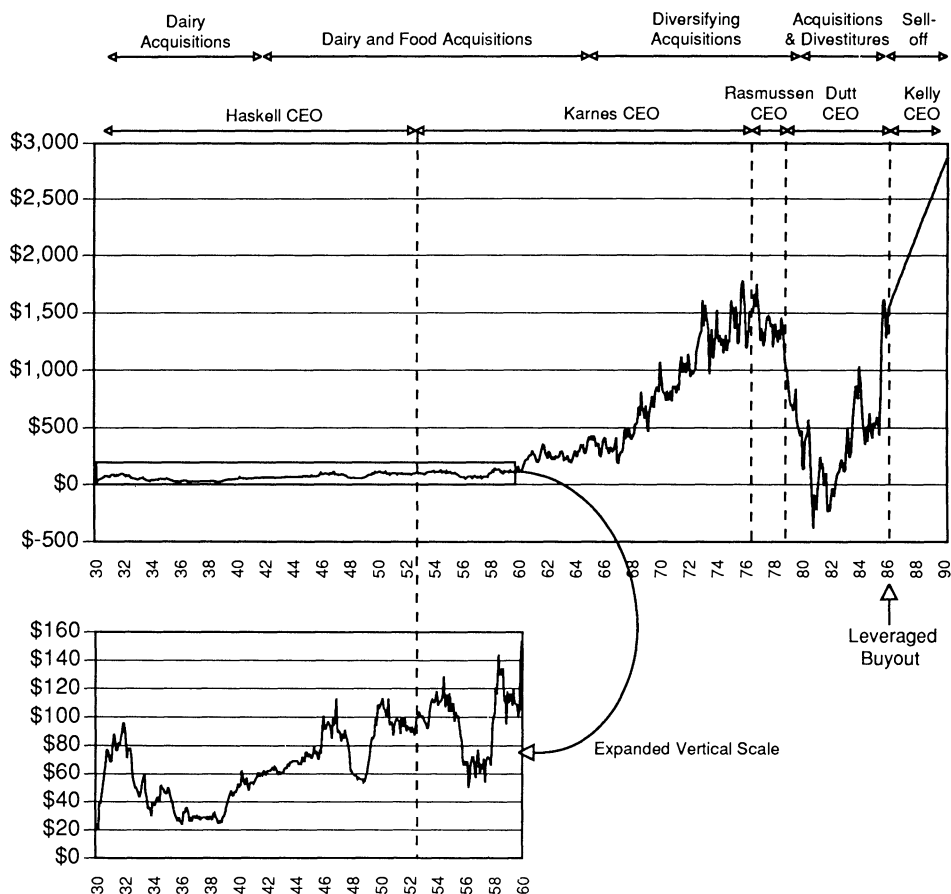


Figure 1. Cumulative abnormal dollar returns for Beatrice, 1930–1990. Cumulative abnormal dollars before the LBO are calculated by multiplying the abnormal return for a month by the market value of the firm at the end of the previous month, and then cumulating these dollar amounts. The abnormal return is calculated by subtracting the actual return from an expected return generated from CAPM. Beta's are estimated using a 60-month moving window. After the LBO, the total market adjusted value gain is calculated, and is simply plotted as a straight line increase in value. After the LBO, the asset beta from before the LBO is assumed, and is then adjusted for the declining leverage each year after the LBO.

mergers. (See Ravenscraft and Scherer (1987) for a review of this controversy.) More recently, many authors have characterized the capital markets activity of the 1980s as “deconglomeration.” (See Blair, Lane, and Schary (1991), Kaplan and Weisbach (1991), and Bhagat, Shleifer, and Vishny (1990).) They argue that the wave of divestitures, spin-offs, and LBO in the 1980s represent reversals of the conglomerate mergers of the 1960s and 1970s. Once again, a close study of the history of Beatrice provides a powerful lens through which to view this phenomenon. By examining in detail the economic

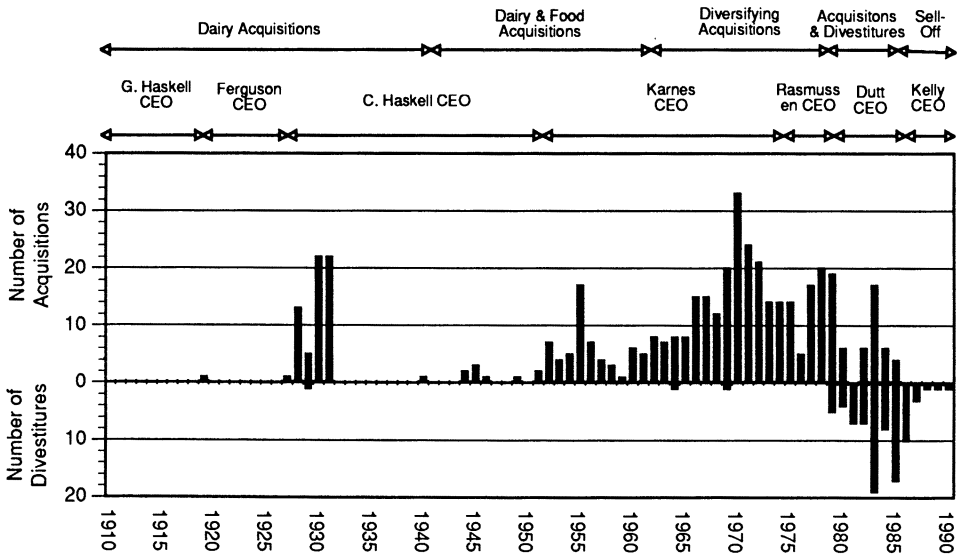


Figure 2. Number of acquisitions and divestitures by year, 1910–1990.

forces that let Beatrice be both an active acquiror in the 1950s through the 1970s, and an active divestor in the 1980s, hypotheses are generated about the process of value creation in organizations and markets that inform additional research on organizational forms, corporate governance, and capital markets.

The paper is organized chronologically, following the four major eras that punctuate the history of the company. Section I (1890–1939) discusses Beatrice's development from a local creamery to a national company and the sources of value in dairy acquisitions. Section II (1940–1976) examines Beatrice's diversification into foods and beyond and the sources of value in diversification. Section III (1977–1985) explores the changing strategic direction of the company and the destruction of value brought on by strategic muddle and the failure of governance. Section IV (1986–1990) covers the LBO and divestitures and probes the question: "value created or value recaptured?" Section V is conclusions.

I. 1890–1939: From a Local Creamery to a National Company

George Haskell founded the partnership of Haskell & Bosworth as a wholesale produce dealer in Beatrice, Nebraska in 1891. He operated as a middleman, collecting butter, eggs, and poultry from dispersed farmers and distributed the produce to retail outlets. After four years of only modest success, Haskell decided to enter the rapidly growing dairy processing industry, and leased the premises of the Beatrice Creamery Company. In 1897, Haskell & Bosworth incorporated as the Beatrice Creamery Company, with a total capitalization of \$100,000 (Beatrice (1930), Gazel (1990)).

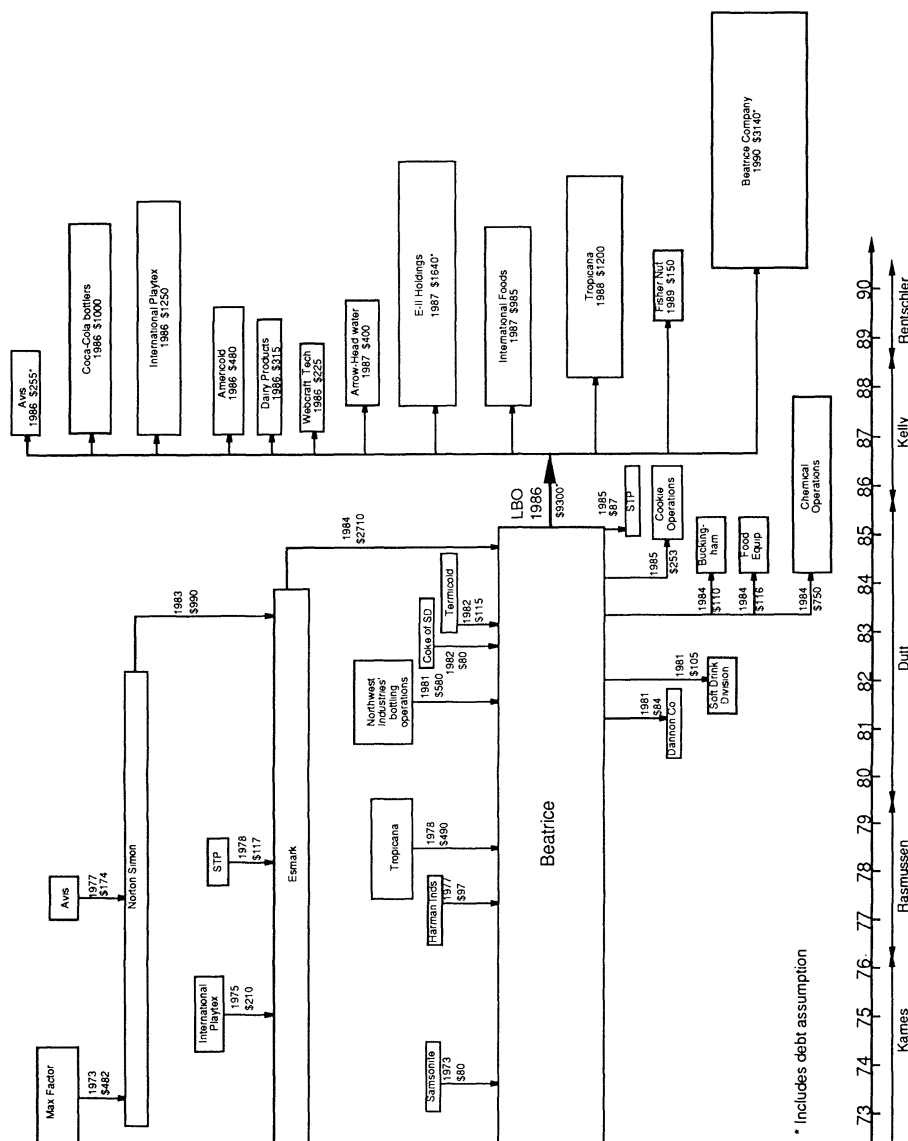


Figure 3. Large Beatrice-related acquisitions and divestitures. Figure displays all Beatrice-related transactions valued over \$80 million. Placement of arrowheads marks the announcement date of the transaction. Size of the box represents the size of the transaction.

In 1905, George Haskell engineered the acquisition of Continental Creamery Company of Topeka, Kansas. At the time, this was the largest consolidation in the history of the United States dairy industry; as such, it was a portent of events to come. Continental was one of the oldest extant dairies and had a strong regional brand called "Meadow Gold" dairy products. This brand was to become the cornerstone of Beatrice's dairy business. With this acquisition, Beatrice became the largest creamery in the world with an annual processing capacity of thirty-four million pounds of butter produced in six different plants.

Beatrice grew slowly until 1928 when Clinton Haskell, nephew of George Haskell, became president of Beatrice. Upon accepting the office of president, Clinton Haskell had three primary goals. The first was to expand the creamery, the second was to diversify into additional product lines (prior to 1928, Beatrice's business activity was principally limited to butter, cream, and eggs), and finally to extend the company's manufacturing facilities to the East Coast (*Fortune* (1936)). To achieve these objectives, Haskell launched an aggressive acquisition campaign in 1928 and largely accomplished the first two of his goals in the initial year of his presidency. On April 25, 1929, the New York Stock Exchange accepted Beatrice's application for listing, and the company reported plans to acquire seven additional dairies.

In the early 1930s, Beatrice continued its geographic expansion through acquisition. Few of the individual acquisitions in a geographic area gave the company a major market share in the territory into which it was expanding. Rather, the company bought smaller dairies, building market share in an area by selective acquisitions of smaller companies. This expansion program established Beatrice, along with Borden and National Dairy (later Kraft), as one of the big three dairy firms.

Beatrice, unlike National Dairy and Borden, generally discarded the brand names used by the companies it acquired. It packaged the bulk of its dairy products under the Meadow Gold brand name, which enabled Beatrice to advertise nationally. As early as 1931 Beatrice was running national Meadow Gold advertisements. The company regularly advertised its dairy products in such nationally circulating magazines as the *Saturday Evening Post*, *Ladies Home Journal*, and *Good Housekeeping*.

During the later years of the Depression, Beatrice participated in few acquisitions. One exception was the 1931 purchase of a minority stake in Chicago Cold Storage, a refrigerated warehousing concern, which operated as a subsidiary of Beatrice. The next significant acquisition did not occur until after the Depression. In 1938 Beatrice began to distribute frozen foods under the "Bird's Eye" label.

In order to manage its geographically dispersed company, Beatrice adopted a decentralized multidivisional corporation with a central office. Each processing plant Beatrice acquired was run as a complete operating unit that both processed and distributed its goods. The company's central office housed the president, vice president, treasurer, and secretary. It handled all financial and legal matters, research activities, advertisement, supervision of

quality control, and the formulation of general policies. Each of the field units was linked to the central office by seven district managers who monitored business at the plants. Plant managers reported directly to division managers who were located in the field. Uniform product quality was ensured by control laboratories located in each of the major processing plants. As early as 1942, Beatrice had intact eighteen committees that functioned to augment organizational cohesion and to facilitate the transfer of specific information up the organizational hierarchy.²

Sources of Value in Dairy Acquisitions

Beatrice grew and prospered during this period of dairy acquisitions. The company created value in several ways with its dairy acquisition program. One was the company's ability to achieve economies of scale through marketing its Meadow Gold brand in national magazines. These economies could only be captured efficiently if the company had broad geographic diversity.

There were also increasing economies of scale in production. The efficient plant size for a dairy production plant is limited by the cost of collecting the raw materials and distributing the final product. However, during this period, improved transportation and the invention of electrical refrigeration meant that the "milkshed" for a dairy plant could expand. This fact, combined with the growth of large cities and increasing mechanization of packaging, meant that the organization of the dairy industry was changing. (Mueller, Hamm, and Cook (1976)). What had once been a fundamentally fragmented industry, in which a large number of small integrated dairy companies processed and delivered milk to homes, became one in which large plants processed large volumes of dairy products and delivered them daily to local distribution centers from which home delivery trucks were dispatched. All three large dairy producers (Borden, National Dairy, and Beatrice) were making acquisition to take advantage of this change in the economics of the business (Mueller, Hamm, and Cook (1976)).

II. 1940–1976: Diversification into Foods and Beyond

The next significant step for Beatrice came on November 1, 1943, when the company acquired La Choy Food products of Archbold, Ohio. La Choy was a maker of Chinese speciality foods, and this was Beatrice's first nondairy-related acquisition. Symbolically, in the company's proxy statement filed for 1945, the board of directors recommended that the company change its name from Beatrice Creamery to Beatrice Foods Company, since "[the company] has long ceased to be just a creamery."

In the latter part of the 1940s, Beatrice continued its program of geographic expansion under the leadership of Clinton Haskell. When Haskell

² Beatrice's organizational form is described in the 1946 annual report.

died in 1952, William Karnes, a Northwestern Law School graduate and Executive Vice President for Beatrice under Haskell, became president. Karnes proved to be an even more ardent advocate of expansion through acquisitions than Clinton Haskell. In the three years following his election, Beatrice purchased twenty-six new dairy plants, including the acquisition of Creameries of America, the nation's seventh largest dairy company. This was Beatrice's largest merger to date: following this acquisition, Beatrice had book value of assets of \$66.7 million and produced and sold dairy products from coast to coast. Figure 4 shows Beatrice's assets from 1911–1988.

On January 3, 1955, Beatrice entered the confectionery business with the acquisition of the D. L. Clark Co., a national manufacturer of candy bars. Two years later, Beatrice purchased the Bond Pickle Co. and established a Grocery Products division that included its nondairy food operations. Beatrice also continued to expand its dairy operations. In 1961 the company expanded overseas with the construction of a condensed milk plant in Malaysia, and in September 1962 it purchased Cie Lacsoons, S. A., a Belgian dairy with annual sales of \$18 million.

Beatrice took the initial step toward unrelated diversification in 1964 when it acquired Bloomfield Industries, a maker of food service equipment for restaurants and hotels. Then, in June 1965, Karnes purchased Stahl Finish and Polyvinyl Chemicals, manufacturers of polymers, raw materials for polishes, and wood and metal coatings. These acquisitions marked Beatrice's

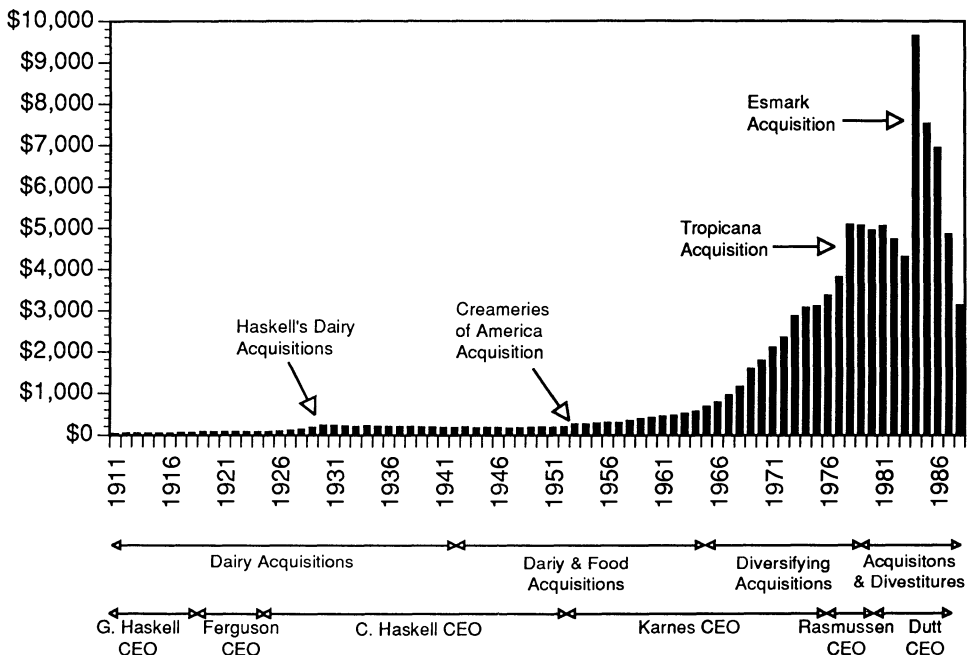


Figure 4. Book value of assets, 1911–1988. In thousands of 1982 dollars.

first move toward conglomeration; thereafter Beatrice's acquisitions were in a variety of disparate industries.

Beatrice's entry into nonfood product lines was driven in part by the actions of the Federal Trade Commission (FTC). In 1950 the government responded to the economy-wide merger and acquisitions wave with the enactment of the Celler-Kefauver Act. This act greatly strengthened Section 7 of the Clayton Act, the existing law on mergers. In 1956 the FTC issued a series of formal complaints against dairy mergers by large corporations from the period 1950–1956. One of these complaints was filed against Beatrice, challenging five of the company's more significant acquisitions from 1950 through 1955, including the Creameries of America merger. In 1964 a decision against Beatrice appeared imminent, and in April 1965 the FTC reached a verdict that required the company to divest \$35 million in prior dairy acquisitions (\$56.3 million in combined sales) and also placed a ten-year prohibition on future dairy mergers without FTC approval (Mueller, Hamm, and Cook (1976), FTC (1953)). After extended appeals, Beatrice and the FTC reached an agreement whereby Beatrice would divest certain plants amounting to \$27 million in sales, and refrain from further acquisitions in the liquid milk and dairy industries. In any case, Beatrice had made no such acquisition since 1961. The assets selected for disposition were sold to a single purchaser in January 1969 (Gazel (1990)).

The FTC's restriction on dairy mergers had a profound impact on Beatrice's decision to participate in conglomerate-type mergers, where the FTC placed few constraints. The expansion campaign launched in 1965 was aimed at companies in a variety of industries. By 1975, only 29% of Beatrice's \$1.83 billion in sales, and 21% in earnings, were attributable to the dairy industry. Twenty-eight percent of sales, and 44% of earnings were from outside the food business.

Under Karnes's direction, analysts at Beatrice studied and reported on the future of many industries to uncover areas for profitable acquisitions. For example, in 1967 Beatrice did a study of the "do-it-yourself market for home consumers" and determined it to be "a very rapid growth and potential profit industry" (FTC (1975)). Following this study, Beatrice acquired Melnor Industries in 1967, a maker of do-it-yourself gardening equipment. Between 1967 and 1969, Beatrice merged with seven additional home products companies. Beatrice followed a similar acquisitions pattern through Karnes's tenure. After analyzing an industry and orchestrating a first merger, it followed the beachhead with one or more subsequent acquisitions in the same area of business. Figure 5 shows this pattern of acquisitions. What is striking about this pattern is the extent to which Beatrice intensely acquired companies in particular industries for a limited period of time, then moved on to other industries. For example, the company acquired nine bakeries between 1963 and 1975, and nine recreational equipment companies between 1967 and 1973, but none during any other periods.

Karnes had four criteria that a potential target had to meet for takeover. First, the company had to be a viable and profitable concern in an industry

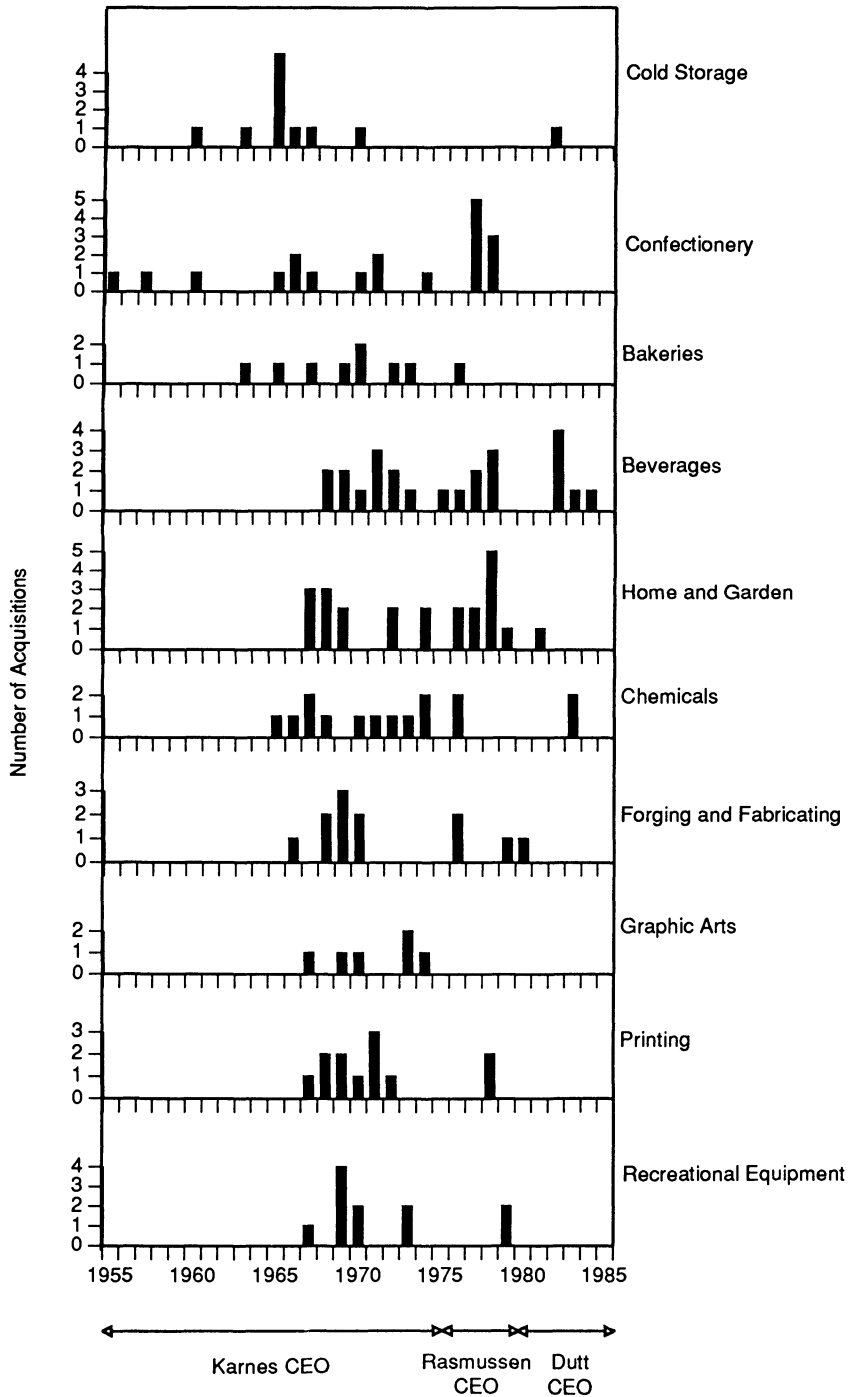


Figure 5. Patterns of industry entry for ten industries, 1955–1985.

growing faster than food. Second, the firm had to produce specialty products, not commodities. Third, only companies with competent managers that were willing to remain at Beatrice were acquired. Finally, Karnes preferred mergers which were small relative to the size of Beatrice. Figure 4 shows that this is true: with the single exception of Creameries of America, no acquisition before Tropicana increased the book value of assets by more than 9%. Beatrice would pinpoint the company it wished to pursue in an industry, and then carefully study the firm. The most important aspect to Beatrice was the quality of the company's incumbent managers (Gazel (1990)). The majority of the companies Beatrice purchased were family-run businesses, and Beatrice's commitment to and reputation for growing companies facilitated this type of merger. After Beatrice determined which company to pursue, Karnes would typically approach managers himself and would be personally involved in the negotiations (Gazel (1990)).

This strategy allowed Beatrice to function with the same organizational form that it had used to manage the dairy business: as a large holding company, with top executives focusing more on acquisitions than on operations as each merger brought with it a successful management team. Each Beatrice division had its own CEO. Headquarters delegated hiring, firing, and promotion decisions, determined pay scales, purchased raw materials, and advertised and promoted products to division managers. The central office, however, retained decision rights on capital expenditures and loans as well as determining inventory quotas for each subsidiary. The primary method of information flow from the divisions to the central office was monthly plant financial reports containing sales and profit data. Provided that financial results were satisfactory, headquarters did not get involved in the operations of the divisions (Gazel (1990)).

As part of this decentralized structure, Beatrice had established an incentive compensation system for division managers. Each manager received a base salary plus a bonus payment of around 2% of pretax profits. Many division managers were also given stock options; the first such program was introduced in 1957 and was then frequently expanded. The stock option plan grew to include all plant managers and, in some cases, even lower-level employees. In addition, managers were motivated by a strong internal promotion system: until 1980, every distinct and division manager in the company had been promoted from within Beatrice (Gazel (1990)).

Sources of Value in Diversification

During Karnes's tenure as president and CEO, Beatrice's sales grew from \$235 million in 1952 to \$5.6 billion in 1976. During this period, the total return to shareholders averaged more than 14% per year. By the time of Karnes's retirement, Beatrice was a multinational conglomerate, with divisions in 27 countries and many industrial categories.

The market reacted favorably, over several decades, to Karnes's acquisition strategy (see Figure 1). The sources of these value gains are different from

those associated with Clinton Haskell's geographic diversification of the dairy business. Neil Gazel (1990) argues in his book, *Beatrice from Buildup to Breakup*, that it was Beatrice's decentralized organizational structure, and Karnes's control over the allocation of funds, that produced Beatrice's superior performance. Indeed, the degree to which Karnes abstained from getting involved in the management of divisions seems remarkable. Beatrice did not try to integrate the operations of the companies it bought into those of the parent: the word "synergy" was never used in any of Karnes's annual letters to shareholders. Divisions bought as separate companies in the 1950s and 1960s were later sold *intact* to separate buyers in the 1980s. Even a company with clear opportunities for synergistic integration, such as the Sexton food distribution business, was sold, 14 years after its acquisition, as a stand-alone company.

It is interesting to note how similar the pattern and logic of Karnes's diversification across industries was to Haskell's strategy of geographic diversification. First, the pattern of moving into an industry with an acquisition, then following with more acquisitions in the same industry is very similar to the strategy of buying a small dairy in one area, then buying more in the same area. The organizational capabilities which enabled Beatrice to expand geographically—the ability to evaluate acquisition candidates within an area or industry, the ability to evaluate management teams, and a decentralized control system—were almost as well suited to industrial diversification as they had been to geographic expansion.

In addition, this expansion strategy allowed the company to take advantage of a very valuable source of information about potential targets: the knowledge and opinions of the managers of previously acquired companies. In many instances, Karnes took advantage of the contacts with and information about other companies that his managers possessed. Subjective information about the quality of the management team, or specifics like the fact that the founder of a business wanted to retire and the children did not want to take over, gave Karnes a tremendous advantage when trying to acquire companies. In industry after industry, Beatrice used this source of information to guide his acquisitions. Karnes stated that Harry Stahl of Stahl Finish Company, Beatrice's first acquisition in the speciality chemicals industry, "lead us from one chemical company to another."³ According to Gazel (1990), Joe Metzger, cofounder of Dannon Yogurt (an early Beatrice acquisition), was instrumental in many of Beatrice's international food acquisitions.

Another important source of value which Beatrice tapped during this period was its ability to bring capital and professional management techniques to small private firms. Almost all of the acquisitions that Beatrice made during the tenure of William Karnes were of privately held, family-run firms. Not only did these firms have poor access to sources of capital, but they were also run in a relatively unsophisticated way, with few formal management systems. In the 1960s, formal management training was almost un-

³Private telephone conversation, May 8, 1991.

known.⁴ Beatrice, with its small staff made up predominantly of accountants, was able to provide an important service to these acquired companies by bringing modern management practices to these organizations and helping them expand and run their firms. Management education was an important component of what Beatrice provided to its company managers. Beatrice held regular meetings for the company presidents, at which management problems were discussed, and scholars from business schools lectured. The meetings would also involve smaller group sessions, in which the managers of companies in the same industry would gather to discuss common problems.⁵ By bringing such management education and systems to these small firms, Beatrice was able to make these firms substantially more valuable.

In addition, Beatrice made capital available to these small private firms, allowing them to expand in the booming economy of the 1950s and 1960s.⁶ The providers of capital at this time, especially commercial banks, were hesitant to lend money for expansion to small, unsophisticated management teams, especially since the banks had little expertise to allow them to realize the value of their collateral should the businesses fail.⁷ Beatrice, on the other hand, could "lend" the substantial cash flow being thrown off by the dairy business to these companies and effectively monitor the performance of their loans, provide management expertise, and even provide management replacements if the need should arise. In this way, Beatrice was able to create value for these companies and itself, with little integration of the operations of these divisions into the greater company.

III. 1977–1986: A Change in Direction

When he retired in 1976, William Karnes left in place what he thought was an adequate succession plan. William Mitchell, a lawyer and former Chief Financial Officer, was named Chairman and Chief Corporate Officer, while

⁴ In 1955–56 only 3200 Master of Business Administration degrees were granted in the United States. By 1974 this number had increased tenfold. By 1986 the number was 67,000.

⁵ Private conversation and correspondence with Neil Gazel, June 6, 1990 and June 17, 1991.

⁶ Beatrice acquired only five public companies during Karnes's tenure, all of which had significant family ownership.

⁷ During the late 1950s and 1960s, there was a persistent concern among both economists and politicians with the financial needs of small business. In 1958, the Federal Reserve Board produced a report for the Congressional Committees on Banking and Currency and the Select Committees on Small Business entitled "Financing Small Business." This report concludes that "the core of the small business financing problem seems to be in the manufacturing area The unsatisfied demands that appear to have the greatest economic justification are mostly those of new firms or concerns with new lines or processes. Such firms also need working capital, but their greatest need is for investment funds to finance plant and major equipment installations The smaller firms . . . typically specialize in one or a few lines, because it takes capital (and a lot of other things) to diversify. Their managerial practices are frequently poor, and their internal managerial structure deficient To the potential lender or investor, this often appears to be evidence of 'no demonstrated earning potential,' 'lack of experience and spotty performance,' or the increased risks inherent in specialization" (U.S. Board of Governors of the Federal Reserve System, 1958).

Wallace Rasmussen, an operating manager who came up through the food business, was named Chief Executive Officer. Rasmussen was 62 years old and was expected to operate as a caretaker until he retired and Mitchell took over the CEO's job. Within a year, however, conflict developed between Mitchell and Rasmussen about how the company should proceed. Mitchell felt that the company should concentrate on digesting the many acquisitions made under Karnes, while Rasmussen favored a continuation of the acquisition strategy. According to the *Wall Street Journal*, Mitchell was "outflanked and outmuscled" and was forced to resign within 15 months of assuming his position (Cox and Ingrassia (1979)). Mitchell was replaced by James Dutt, a 52-year-old operating manager with a career path similar to Rasmussen's. In the following months, Rasmussen sought to purge Mitchell's and Karnes's influence from the company and fired six executives loyal to Mitchell.

Rasmussen began a series of management and strategic changes which would affect the complexion of the company dramatically over the coming ten years. One change was the creation of five executive vice presidents to "supervise specific sections of our operations permitting us to concentrate on *corporate directions and goals*" (emphasis added).⁸ While Rasmussen continued to pay lip service to the company's decentralized operating strategy, he began a subtle move towards a more centralized management approach. One executive said that "people at the operating level are being told more by the people on high" (*Forbes* (1979)). Another former Beatrice executive told a story of how Rasmussen personally denied a request for a particular make of company car to the president of a recently acquired division because the car was too expensive for his rank in the company. Another change was a new emphasis on marketing. In his letter to shareholders for fiscal year 1977, Rasmussen stated:

We have taken a number of major steps to strengthen our marketing resources. Special marketing groups now report to each of the five executive vice presidents. These groups give us the flexibility to bolster the marketing activities of individual operating units and also to seek out and capitalize on totally new opportunities.

This is the first time that marketing was ever mentioned in the president's annual letter to the shareholders. Figure 6 shows that annual expenditures on marketing increased from \$54 million in 1974 to \$107 million in 1977, increasing from less than 1.3% to more than 1.7% of sales.

In 1978 Rasmussen demonstrated that he rejected Karnes's strategy of acquiring small, private companies. He acquired the publicly-traded Tropicana Products Inc. for \$490 million in cash and preferred stock. This price far exceeded the second highest bid, a merger proposal from Kellogg company valued at \$344 million. The Tropicana acquisition was over six times the size of the largest acquisition that Beatrice made under Karnes.

⁸1977 Beatrice Annual Report.

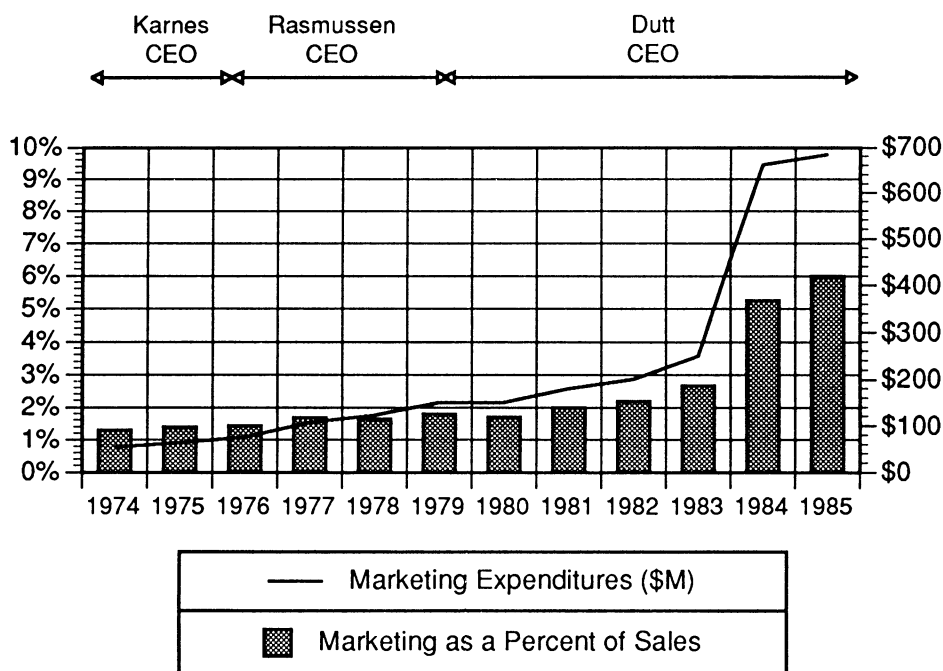


Figure 6. Marketing expenditures, 1974–1985.

In July of 1979 Rasmussen reached mandatory retirement age, and in March of that year, the board elected James Dutt to succeed him. Dutt's election was highly controversial. Beatrice's outside directors purportedly favored Richard Voell, deputy chairman, to succeed Rasmussen. However, Rasmussen persuaded all of the inside directors and two outside directors to vote for Dutt, creating an acrimonious rift between board members. Two outside directors as well as Voell resigned because of this incident (Colvin (1982)). It also prompted a lawsuit from King Shwayder, a Beatrice stockholder, alleging that Rasmussen had gone back on a promise to appoint a majority of outsiders to the board, and warning against insider domination of the Beatrice board. The suit came to nought, and a slate of directors favoring Dutt's appointment was voted in by the stockholders in June of 1979. By this time, Beatrice was a diversified consumer and industrial products company, with sales of over \$8 billion and 80,000 employees in nearly 90 countries.

In Dutt's first annual letter to shareholders, he committed to maintaining the three steadfast principles behind Beatrice's historical growth: diversification, decentralization, and balance.⁹ In the annual report he filed for fiscal year 1981, Dutt added that in the 1980s a commitment to growth necessitated an emphasis on brand marketing, asserting that "if you want to run

⁹Balance was interpreted to mean that Beatrice maintained both food and nonfood business and domestic and international operations.

successful businesses in the 80s, it will be absolutely necessary to have dynamic, innovative marketing." One of Dutt's first actions was to move company headquarters to 2 North LaSalle in Chicago, where Beatrice occupied a luxurious four-and-one-half-floor office. Previously, company headquarters had been housed in a frugal, one-and-one-half floor office several blocks to the south at 120 South LaSalle.

In the early 1980s Beatrice's competitors, including General Mills and Procter and Gamble, were consolidating operations and expanding their marketing, and early in his presidency Dutt decided to do the same (Shellenbarger (1983)). In accord with this goal, Dutt slated about fifty companies for divestiture. As Figure 2 shows, between 1979 and 1981, Beatrice divested fifteen divisions. In November 1981, however, Dutt returned to the historic growth strategy when he orchestrated the acquisition of the Coca Cola Bottling Division of Northwest Industries for \$580 million in cash. This price exceeded the book value of the Division's assets by over \$450 million and was 22 times current earnings. According to Colvin (1982), many Beatrice shareholders were infuriated by the Northwest acquisition. Analysts and institutional investors, looking at the company's low stock price and strong cash position, had been calling for a stock buy-back. Dutt disagreed, saying "You buy back your stock when you don't have a better use for your money." Table 1 shows the market's reaction to the announcement of the Northwest acquisition, as well as to Dutt's other acquisitions and divestitures. In the three-day interval around the announcement of the Northwest acquisition, Beatrice's stock price fell by a market-adjusted 7.1%, equal to \$136 million in equity value.

In 1982 Dutt announced the first of what were to be a continuing set of reorganizations of the company's businesses. He streamlined the firm's reported business segments, moving from ten segments to five, in order to "more accurately reflect our internal organization." This realignment of the firm's businesses was to become almost an annual event: the businesses were realigned again in 1984, then again in 1985.

At the 1983 annual meeting, Dutt announced a radical break with the past, abandoning the decentralized management philosophy that had served the company for ninety years. He stated,

In the past, our system of a number of small, regional profit centers worked well. But to be competitive and to grow in the future, we need broader product lines, with national marketing and advertising and with national distribution systems.... The result will be a much smaller number of free-standing and self-supporting businesses operating in the company's principal marketing areas. These new "businesses of Beatrice" will be larger, cohesive business units" (Gazel (1990)).

In addition, Dutt announced that Beatrice had embarked upon a new strategic direction centered around a "total commitment to marketing." According to the new plan, a program of internal growth was to surpass

acquisitions in its contribution to overall development. Dutt reorganized the company into six groups, which he argued would allow Beatrice to “achieve synergies among the operations, make quicker decisions, and build effective marketing strategies. At the same time, he launched the “We’re Beatrice” ad campaign designed to connect the Beatrice name with its many regional and national brands and thereby dramatically increase the company’s public exposure.¹⁰ Symbolically, the company once again proposed a name change, this time from Beatrice Foods to Beatrice Companies, to “recognize a clear departure from the past.”

As part of the 1983 reorganization, Dutt created several new corporate offices, including a corporate marketing department under senior vice president John McRobbie, and a corporate strategic planning vice president, William Reidy, brought in from Dart & Kraft. The marketing group was to focus on the corporate image campaign and on expanding regional brands to national distribution. Beatrice, like Nabisco and General Mills, would include its name and new logo on all consumer products. This move was designed to help boost the sales of less successful brands by associating them with Beatrice’s more well-known products. Reidy was to oversee the consolidation of the hundreds of Beatrice profit centers into 27 divisions, combining many small related units into larger ones. For instance, eight confectionery units were consolidated into a single profit center, two Mexican food companies were combined under the Rosarita brand, as were several of the cheese lines under the County Line brand (*Advertising Age* (1983), Collis (1991)). The number of advertising agencies that the firm used dropped from 100 to just seven.

The strategic and organizational changes which Dutt initiated were accompanied by poor financial performance. For thirty consecutive years, Beatrice had reported record sales and earnings for each quarter when compared to the same quarter of the previous year. This record was maintained until the first quarter of fiscal 1983, when the company reported a 34% plummet in net earnings and a 36% drop in earnings per share on annual sales of \$9.2 billion.

In May 1984 Dutt announced that he had orchestrated a \$2.7 billion takeover of Chicago-based Esmark, with 1983 sales of \$4.1 billion. Esmark, created in 1973 as a holding company intended to restructure Swift & Co., was headed by Donald Kelly. Esmark was formed to hold Swift’s four major lines of business: food, chemicals, energy, and financial services. Kelly became financial vice president of Esmark when it was organized in April 1977. In September 1973 he was made president and chief operating officer, and CEO in 1977. Kelly reshaped the company, operating it as an investment portfolio. He spun off Swift’s fresh meat packing business, and then began making conglomerate-type acquisitions and divestitures. Esmark bought and sold more than sixty companies before it was acquired by Beatrice

¹⁰The most notable use of this ad campaign was during the 1984 Olympics, when Beatrice spent \$30 million for commercials on ABC (Louis (1985)).

in 1984. Included among these were International Playtex, purchased for \$210 million in 1975, and Norton Simon, itself a conglomerate consisting of Avis and Hunt-Wesson foods, acquired for \$990 million in September 1983. As president of Esmark, Kelly gained a reputation on Wall Street as an expert dealmaker, able to negotiate premium prices on sales and bargains on acquisitions. He also was known for his ability to trim excess expenses and close down unprofitable operations. He was the "hatchet man" for the closing of 300 Swift facilities before spinning the unit off. As Frederick Rentschler, head of Beatrice's Hunt-Wesson business, said of him "Don . . . tries not to fall in love with any asset, because he must do what is necessary to protect investor interests" (Hodge (1988)). According to Diana Temple, a Solomon Brothers analyst, "There was no noted restructuring artist in the consumer field at that time. Kelly was among the first to take a coldhearted view of asset values" (Ipsen (1988)).

Three months prior to Beatrice's acquisition, Esmark had purchased 1.4 million Beatrice shares, equal to about 1.5% of the total shares outstanding. Around this time, rumors began about Beatrice as a potential takeover candidate. Beatrice later repurchased these shares at a premium.

Shortly after Esmark purchased the Beatrice shares, Kohlberg, Kravis & Roberts Company (KKR) organized a \$55-a-share (worth \$2.4 billion) LBO of Esmark, which Kelly and Esmark managers had accepted. Table I gives the history of interaction between KKR and Donald Kelly, which involves three separate LBO proposals and two instances of competitive bidding involving KKR and Kelly. Under the KKR-Esmark LBO, Kelly would remain Esmark's chairman and would institute the divestiture of numerous operations to meet the largest debt burden incurred in the transaction. However, Dutt topped the KKR bid with a \$56-a-share offer; after persuasion from Kelly, he

Table I
The Courtship of Donald Kelly and KKR

June 1983	KKR proposes a leveraged buyout of Norton Simon for \$925 million, or \$33 per share.
August 1983	Esmark chairman Donald Kelly overbids KKR, and acquires Norton Simon for \$990 million.
February 1984	Rumors surface that Esmark is buying shares of Beatrice in anticipation of a possible takeover.
May 1984	KKR and Donald Kelly propose a \$55 per share leveraged buyout of Esmark. The proposal is approved by the Esmark board.
May 1984	Beatrice overbids KKR, acquiring Esmark for \$2.7 billion, or \$60 per share. Kelly and vice chairman Roger Briggs quit Esmark to form Kelly, Briggs & Associates. Frederick Rentschler and Joel Smilow, both top executives at Esmark, also leave shortly after the acquisition in policy disputes with Beatrice CEO James Dutt.
August 1985	Dutt is fired as CEO of Beatrice.
October 1985	KKR and Donald Kelly along with Briggs, Rentschler, and Smilow propose \$45 per share leveraged buyout for Beatrice

trumped his own proposal by sweetening the offer to \$60-a-share, or \$2.7 billion. Beatrice borrowed all of the \$2.7 billion purchase price of Esmark. According to Dutt, the largest benefit of the acquisition to Beatrice was Esmark's Swift/Hunt-Wesson grocery distribution/marketing operation, which included a staff of 500 salespeople. Ideally, Beatrice would integrate its regional brands into this network and distribute them nationally. Dutt declared that the Esmark acquisition was essential to make Beatrice "the world's premier marketer." Kelly received roughly \$2.7 million in a golden parachute from the Esmark acquisition, and netted about \$12 million on the sale of his Esmark stock (Esmark Proxy (1984)).

The financial press reported, however, that Dutt's Esmark acquisition was as much a retaliatory gesture as a business move. Dutt was purportedly galled by Kelly's purchase of Beatrice shares, and became determined to acquire Esmark at any the cost (Rublin (1985)). When asked what he would do if KKR tried to outbid him for Esmark, Dutt indicated that he would "go to the mat" to prevail "I don't lose," he said (Morris and Shellenbarger (1984)).

Following the merger, Kelly and Roger Briggs, vice chairmen, left Esmark to form Kelly, Briggs & Associates, an investment partnership intended to make large, highly leveraged acquisitions. Frederick Rentschler, head of Esmark's Swift/Hunt-Wesson food business, moved to Beatrice but was soon fired as a result of personality and management conflicts with Dutt. Similarly, Joel Smilow, head of Playtex International, came to Beatrice but resigned shortly thereafter. For fiscal 1985, Beatrice's earnings excluding realignment activity dropped 22% from fiscal 1984.

On Saturday August 3, 1985 Dutt resigned as Chairman and CEO of Beatrice; his early retirement was forced by the board of directors and members of his management team. Wall Street had become increasingly skeptical of Dutt's leadership, and Beatrice management was in revolt. Indeed, the final push that led the board to fire Dutt was an ultimatum from the five top operating officers of the company that either Dutt be fired or they would quit (Gazel (1990)). A number of factors were cited in Dutt's termination. The prudence of the Esmark acquisition was incessantly questioned, and Dutt was frequently accused of abusing the power of his office. One frequently mentioned abuse involved Beatrice's sponsorship of two auto racing teams, which necessitated in excess of \$70 million in corporate expenditures over several years. A racing enthusiast and collector of automobiles, Dutt outbid Anheuser Busch to sponsor the teams, in spite of the fact that Beatrice's only connection to auto racing was its STP Corporation subsidiary, that had sales of \$97 million and was already slated to be sold to Union Carbide.

Press accounts also suggested that the expansion of the company's marketing image smacked of self-aggrandizement: "Particularly perplexing to... analysts was the ['We're Beatrice'] corporate advertising campaign.... Analysts suggested that the company was getting little benefit from the costly advertising program, which they said seemed more to glorify Dutt and the company" (Potts (1985)). Such a conclusion is consistent with Horsky's

and Swyngedouw's 1987 analysis. They find that marketing expenditures which affect *corporate* image are wasteful in consumer goods companies, where individual brand identity matters more than corporate identity. Finally, Beatrice had experienced an unremitting exodus of executives since Dutt became chairman. From 1980 to July 1985, thirty-nine of fifty-eight executives had left the company.

Dutt resigned on August 3, 1985: Beatrice's three-day cumulative abnormal return around this date was 10.6%, implying a market adjusted value increased of \$301 million (see Table II). William Granger, a 66-year-old retired Beatrice vice president, was elected to replace Dutt, and William Karnes was brought back on the board as chairman of the executive committee. Both men were selected in part because of their conciliatory nature which, the board hoped, would stymie the flight of managers from Beatrice.

Destruction of Value: Strategic Muddle and the Failure of Governance

During the tenures of CEOs Rasmussen and Dutt, almost \$2 billion in market value was destroyed. As is clear from Figure 1, most of the decline in value occurred in 1979–1981, years before the Esmark acquisition or the allegations of Dutt's abuse of power. Indeed, it appears that the market had begun to lose confidence in Beatrice's strategy of growth by acquisition by the time Dutt became CEO. As Table II shows, every acquisition in excess of \$30

Table II
Market Reactions to Announcements of Acquisitions and
Divestitures, by CEO, 1965–1984

Company	Type of Transaction	Announcement Date	Announcement Price (\$m)	Transaction Price ^a (\$m)	Price ÷ Market Value ^b (%)	Three Day CAR	Market Value Change (\$m)
Karnes (Transactions more than \$10 million)							
Stahl Finish/Polyvinyl	A	01–20–65	17	—	1.12	0.006	10
Inland Underground	A	04–12–65	11	—	0.75	0.000	0
Colorado By-Products	A	10–15–65	11	—	0.79	–0.006	8
Melnor Industries	A	11–03–66	11	—	0.99	0.015	18
Air Stream	A	05–10–67	15	156	1.24	–0.008	–10
John Sexton	A	07–18–68	35	38	1.99	0.038 ²	72
Hart Ski	A	09–17–68	—	14	0.64	0.011	24
E.R. Moore	A	03–17–69	11	—	0.58	–0.026 ¹	–49
Eckrich	A	01–10–72	64	—	2.19	0.030 ¹	86
Southwestern Investments	A	11–30–72	62	54	2.07	–0.013	–42
Brookside Enterprises	A	01–10–73	—	16	0.39	0.006	24
Samsonite	A	04–12–73	100	80	3.13	–0.013	–42
Martha White Foods	A	08–01–75	—	25	0.83	0.021	60
Rasmussen (Transactions more than \$30 million)							
Harman International							
Industries	A	01–11–77	103	97	3.91	0.010	27
Culligan	A	01–12–78	54	51	1.83	–0.049 ²	–146
Tropicana	A	03–06–78	590	—	16.28	–0.001	–3

Table II—Continued

Company	Type of Transaction	Announcement Date	Announcement Price (\$m)	Transaction Price ^a (\$m)	Price ÷ Market Value ^b (%)	Three Day CAR	Market Value Change (\$m)
Dutt (Transactions more than \$30 million)							
Fiberite	A	10-19-79	60	—	2.41	-0.027 ¹	-67
Bob Evans Farms	A	09-08-80	200	—	8.78	-0.027 ¹	-61
Bob Evans Farms^c		12-30-80				0.057²	124
Dannon^d	D	06-24-81	84	—	3.71	0.020	44
Northwest Industries	A	11-09-81	600	580	31.61	-0.071 ²	-136
LouwerDrape	A	11-20-81	—	50	2.63	-0.041 ¹	-79
Soft Drink Division	D	12-16-81	105	—	5.61	0.027¹	50
Coca-Cola of S.D.	A	02-26-82	80	—	4.45	-0.021	-38
Termicold	A	12-15-82	—	115	4.94	-0.043 ²	-100
John Sexton	D	09-28-83	—	70	2.43	0.004	11
Esmark ^{e,f}	A	05-22-84	2500	2800	106.11	-0.065	-153
J. Dutt Resigns		08-06-85				0.106 ²	301

Transactions shown in bold are divestitures, or announcements of the cancellation of an acquisition.

^aTransactions price represents the value of the deal at the time of the final transaction. It is reported if terms were undisclosed at announcement or if the price changed between the announcement of the transaction and the final deal.

^bPrice ÷ Market Value = value of the transactions divided by the total market value of Beatrice at the time of the exchange.

^cBeatrice announced that it dropped its pursuit of Bob Evans Farms on 12-30-80. The deal was never finalized.

^dThis divestiture was of symbolic importance because it was the first Dutt's promised larger asset sales.

^eBeatrice's cumulative abnormal returns from 5-22-84 to 6-26-84, the period beginning with the rumors of the Esmark takeover and ending when Dutt became chairman and CEO of Esmark, was -0.118 for a total loss in market value of \$263 million.

^fAfter the Esmark merger, the market response to Beatrice transactions was highly confused by speculation regarding management changes and takeover rumors.

¹*t*-statistic greater than 1.

²*t*-statistic greater than 2.

million during Dutt's early tenure is met with a reduction in market value, and every divestiture or announcement of a withdrawal of an acquisition offer is met with an increase in market value. The Esmark acquisition appears to be merely the final act in a long series of ill-conceived and poorly received purchases by Dutt.

The decline in the market value of the firm arises in part from the reduced profitability of the company. Panel A of Figure 7 shows that the reported return on assets became much more volatile after 1980. Panel B shows that the trend of earnings net of realignment activities was largely downward from the time of Karnes's retirement. The company had also become very centralized. In 1976, the headquarters staff had numbered 161 people; by 1985 that number had risen to 750 (Gazel (1990)). Dutt was criticized by

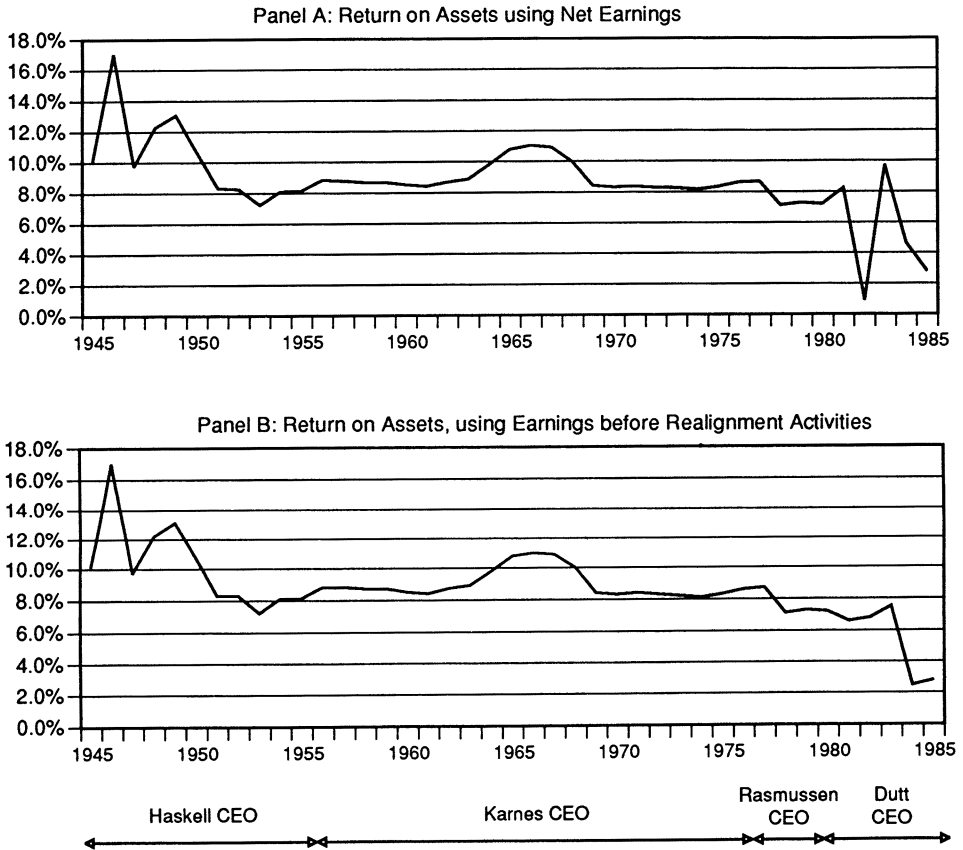


Figure 7. Return on assets, 1940–1985. Panel A shows net earnings divided by total assets. Panel B shows earnings before realignment activities divided by total assets.

many of the departing managers for his autocratic manner and his tendency, especially in the food business, to “get involved in the nittiest and grittiest of details, initiating management changes at practically every level and steeping himself in the minutiae of day-to-day operations” (Louis (1985)).

However, the decline in value is also not adequately explained by poor operating performance. Figure 8 shows that the company’s price-earnings ratio also fell during this period to below the level of the S & P 400: Beatrice’s P-E had matched or exceeded the S & P since 1974. The loss of value during the period 1979–1981 seems to have resulted from a loss of confidence in the company and its strategy on the part of investors. The evidence suggests two reasons for this change in investor confidence: a skepticism about management’s ability to implement the new strategic vision, and concern that the company’s governing body (the board of directors) would be unable to rectify the problems.

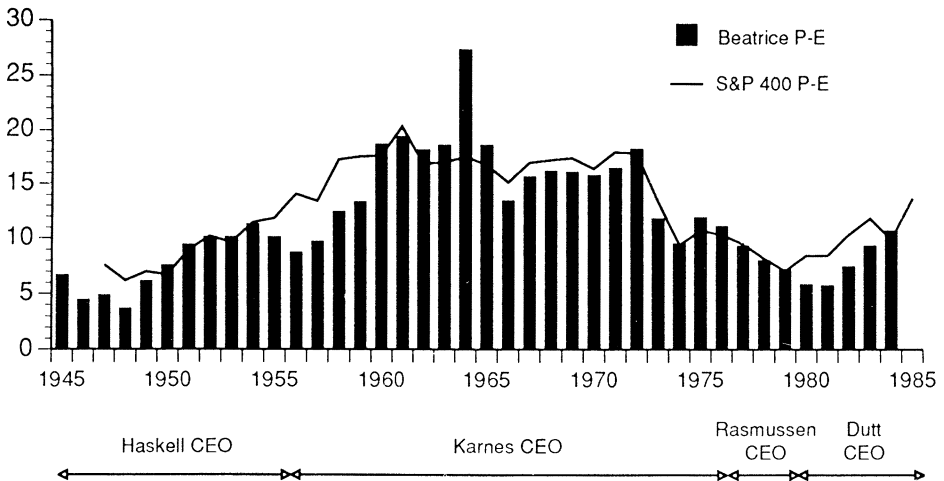


Figure 8. Beatrice-price earnings multiples and S & P 400 price-earnings multiples, 1945–1985. Price earnings multiples for Beatrice are calculated using year-end stock price and earnings before special actions. S & P 400 multiples are the average of the high and low P-E's for the year, as reported in Standard and Poor's *Analysts' Handbook*, 1987.

As early as 1978, the business press was taking note of the changing nature of Beatrice's strategy under Rasmussen. The Tropicana acquisition was seen as an important departure from the past, as this quote from *Business Week* suggests:

The Tropicana acquisition... represents a break with the traditional growth strategy at Beatrice. In the past, the \$6.2 billion company has steered clear of commodity-type businesses.... And despite its hundreds of acquisitions, it has rarely entered a business that competes directly with one of the nation's premier marketing companies. This too has changed because of Tropicana.

With Tropicana, Beatrice... faces the brutal prospect of going head-on with Coca-Cola. That will be a challenge, notes one food company executive.

Though Beatrice leads the industry in sales and profits, it trails such companies as General Foods, Pillsbury, and General Mills in terms of marketing savvy.

For the most part, Beatrice sells food and nonfood products that, by dint of either a quality image or an established position, have carved secure niches in national markets or dominate regional ones. Its Dannon yogurt, Louis Sherry ice cream, Peter Eckrich sausages, JBL stereo equipment, and Samsonite luggages are all examples.

Thus the Tropicana move seems to reflect a new emphasis at Beatrice on marketing and a willingness to take on the leading practitioners of that art (*Business Week* (1978)).

The business press and Wall Street did not begin to seriously doubt the value of this new strategy, however, until after the boardroom brawl that brought Dutt to power. The revelations of serious disagreement and infighting which came to light as a result of the Shwayder lawsuit served to, in the words of one Wall Street analyst, "break the facade of Beatrice as a 'golden company.'"¹¹ They revealed a deep mistrust of Rasmussen and Dutt on the part of several members of the board.

As part of Rasmussen's maneuvering to appoint Dutt to the CEO position, he demonstrated his ability to control the board. In 1978, he had appointed a three-person committee of outside directors to recommend changes in the Beatrice board composition and to choose a successor to himself. As part of his discussions with Durwood Varner, chairman of the committee, he expressed the view that "the company had too many inside directors and the nominating process—both for directors and for management succession—was not consistent with good practice . . ."¹²

During the meeting in which Dutt was elected, Rasmussen effectively ignored the recommendations of the committee to change the composition of the board, and retained a board which would vote with him. At this same meeting, Varner, along with Voell and another member of the outside committee, resigned. Varner delivered a speech to the board at this meeting, the transcript of which was later made public in a court filing, in which he said:

the action being taken today . . . will serve as evidence that some major corporations are indeed controlled by employee directors. It will heighten the anxiety existing in many quarters that self-interest is a factor in vital decisions in corporate affairs. It will serve as a clear warning that outside directors must beware—that unpopular positions may well result in punitive action . . . I am astounded by the actions taken here today.

Coming shortly after a major change in strategy, it is hardly surprising that this level of discord on the board would lead to a lack of investor confidence. Doubt about Rasmussen's and Dutt's abilities to implement the new centralized strategy, which would require shrinking the company and exploiting marketing capabilities that the company had never demonstrated, seems to be the reason that Beatrice investors earned a total return of negative 4.2% between January 1979 and January 1982, while the market returned 57.0%.¹³ In retrospect, it is clear that these doubts were well-founded; Beatrice's operations never again achieved the level of profitability that they had attained in 1975.

¹¹Telephone conversation with William McGuire of Merrill Lynch, April 29, 1991.

¹²From the complaint of King Shwayder v. Beatrice in The United States District Court for Northern Illinois, 1979. Exhibit C, p. 3.

¹³Value-weighted market returns, including dividends, from the CRSP database.

IV. 1986–1990: Leveraged Buyout and Divestiture

Within two months of Dutt's resignation in early August, rumors of a LBO by Kohlberg, Kravis & Roberts surfaced. On October 14, 1985, KKR and a management team headed by Donald Kelly offered \$45 per share for Beatrice. After several weeks of negotiations and a last-minute bid from Dart Group, KKR and Kelly offered \$50 per share, and the board approved the sale of the company in the then-largest LBO in history. The price represented a premium of 53% over the price the day after Dutt's resignation, resulting in a dollar gain to Beatrice shareholders of \$1 billion. As Figure 1 shows, the KKR bid for Beatrice resulted in the "recapture" of virtually all of the value lost during the Rasmussen-Dutt period.

KKR brought in four former Esmark executives to manage Beatrice. Donald Kelly was made chairman and CEO, Roger Briggs (previously vice chairman and CFO of Esmark) was made chief financial officer, Frederick Rentschler (who came to Esmark through Norton Simon) was to head the food division, and Joel Smilow (formerly of Playtex) was to head the consumer products group. These four were each given a seat on the board of directors, with KKR controlling the remaining six seats. The sources of the funds for the purchase, and the ownership fractions which resulted are shown in Table III.

Managers purchased 1% of the shares and were given options for an additional 11.5% of the stock outstanding on a fully diluted basis. Donald Kelly's advisory firm received a payment of \$6.75 million for helping to

Table III
Capital Structure of the Beatrice LBO, with Equity Ownership

	\$ Millions	% of Total Liabilities	% of Fully Diluted Equity
Debt			
Bank Debt	3,300		
Subordinated Debt	2,500		
Assumed Debt	1,050		
Total Debt	6,850	84.1	
Redeemable Preferred Stock			
Total Preferred ^a	880	10.8	
Common Stock			
KKR Stock	400		57.5
Management Stock	7		1.0
Management Options	0		11.5
Warrants	10		30.0
Total Common	417	5.1	100.0
Total Funding	8,147	100.0	

^aRedeemable preferred was valued at the time of the LBO at \$880 million. It was exchanged for \$1,200 million of exchange debentures four months later.

arrange the Beatrice LBO: Kelly's investment in stock cost him \$5.2 million. KKR bought 80 million shares at \$5 apiece. Warrants with an exercise price of \$5 were also issued. In the LBO prospectus, KKR estimated that \$1.5 billion of asset dispositions would be required to meet the first two interest payments in nine and eighteen months; after this, cash flow from operations would be sufficient to meet the interest obligation on all outstanding indebtedness.

Almost immediately after stockholders approved the LBO proposal, Kelly began large-scale divestitures at Beatrice, spinning off the bulk of its businesses in nine major asset sales engineered during a two-year period. Figure 3 shows all of Beatrice's post-LBO divestitures. The divestitures began on April 30, 1986 when Beatrice sold its Avis car-rental division in a LBO to Wesray Capital for \$255 million. In the same year, Kelly orchestrated the sale of Beatrice's Coca Cola Bottling Division, International Playtex, Americold cold storage warehouses, the Dairy Products division, and Webcraft Technologies, a speciality printing business. Of the six sales made by Kelly in 1986, four were LBO sales to the managers of the units.

By 1987 the Beatrice LBO demonstrated a degree of success even greater than KKR's initial predictions. Divestitures in 1986 generated \$3.5 billion in proceeds, allowing Beatrice to pay down virtually all of the bank debt in the first year. The asset sales were facilitated by the bull market, which resulted in higher asset prices than had been predicted at the time of the LBO. Kelly had also eliminated \$100 million in annual administrative expenses through staff cuts and the elimination of the "We're Beatrice" ad campaign. Ads that promoted individual brands were retained.¹⁴

Beatrice's next move was to spin-off E-II Holdings in May 1987. E-II was a conglomerate containing a melange of fifteen Beatrice divisions. It consisted of all the remaining nonfood businesses, including Samsonite luggage and Stiffel lamps, plus a number of specialty food concerns. It is interesting to note that the operating strategy of E-II was very similar to that of Beatrice under Karnes, and of Esmark prior to its purchase by Beatrice. The E-II prospectus explains the company's management philosophy:

Management believes that a substantially decentralized approach to managing operating companies is the best way to maximize a holding company's returns from such companies. Under the company's decentralized system, management of each individual operating company is responsible for attaining financial and other goals established jointly with them and then monitored by the holding company and segment managements.

¹⁴Indeed, in an interview in 1990, after the purchase of Beatrice by ConAgra, the Chief Operating Officer of ConAgra stated that Beatrice was spending more on advertising individual brands than the market average in virtually every product line (Liesse (1990)).

The E-II prospectus also quoted the following passage from a 1983 letter from Donald Kelly to the shareholders of Esmark.

“Constantly reviewing areas of opportunity in keeping with the realities of everchanging markets is considered an ongoing management responsibility. At Esmark there will continue to be changes as management and the Board strive to improve the overall value of your investment. Changes are not made for the sake of change, but rather as an extension of management’s philosophy that a holding company must constantly review its investment mix. As a consequence, no serious proposal for possible acquisitions, dispositions, joint venture, etc., regardless of size, will be passed without full and careful consideration.”

The company intends to follow this philosophy.¹⁵

Donald Kelly became chairman and CEO of E-II and remained chairman of Beatrice, retaining responsibility for selling the remaining businesses. E-II gave Beatrice \$800 million in debt for the assets included in E-II and distributed 41.1 million shares (initially estimated to be worth \$616 million) of E-II equity to the investors in the Beatrice LBO. At the time of the E-II spin-off, Beatrice also paid out an \$800 million special dividend to holders of common stock, warrants, and options. In May 1987, E-II filed to offer 28.7 million shares to the public, as well as \$750 million of senior subordinated notes and senior subordinated debentures. The stock offering and debt issues were expected to generate \$1.2 billion in cash, which Kelly purportedly referred to as his “acquisition war chest” (Johnson (1987a)). 7.3 million of the shares (worth \$109.5 million) were distributed to Beatrice investors and were sold in the E-II public offering. Management retained a 6.4% stake in E-II.

E-II’s first serious takeover target was American Brands. In December 1987 E-II disclosed that it had acquired a 4.6% equity stake in American Brands, with an estimated market value of \$5–6 billion (Johnson (1987b)). The following January, American Brands initiated a “Pac Man” antitakeover defense, launching a hostile \$13-a-share tender offer for E-II. After a short negotiation period, American Brands sweetened its bid for E-II to \$17.05-a-share or \$1.1 billion, and Kelly accepted the offer. The financial press reported that Kelly’s hand was forced because of the October market crash: E-II lost about \$147 million on its stock portfolio (in part consisting of losses from its American Brands equity holdings), and finding junk-bond financing for large LBOs became appreciably less likely. E-II public investors made a pretax return of 14% on their equity during a seven-month period. Beatrice investors received an additional \$650 million as a result of their E-II equity stake, with the result that they had already more than doubled their initial

¹⁵ Even the company’s name, “E-II,” was derived from Esmark: the newly-formed conglomerate was to be a reincarnation of Kelly’s former company.

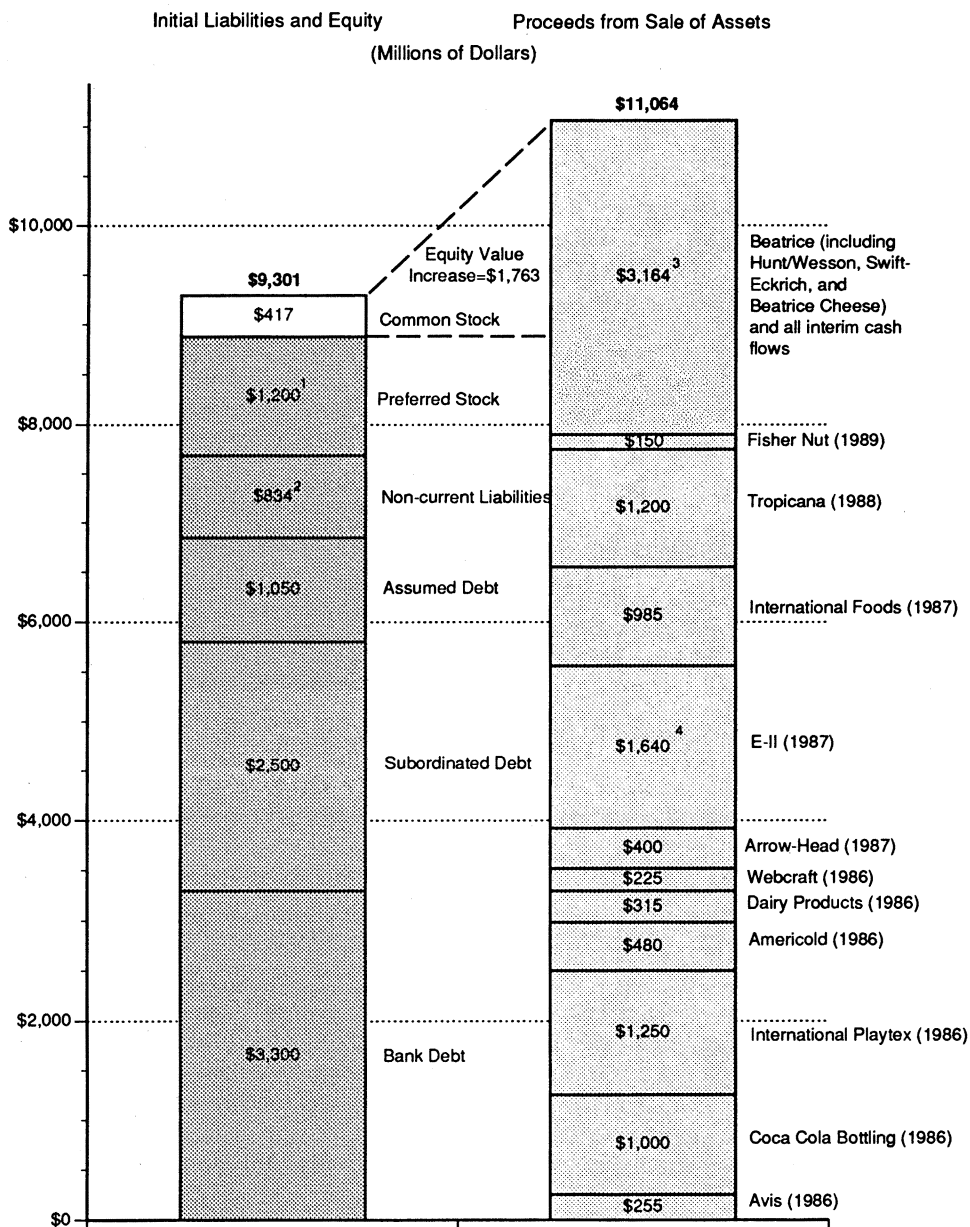
investment in the Beatrice LBO. American Brands ultimately sold most of the assets of E-II to the closely held Riklis Family Corporation in 1988. Donald personally made more than \$55 million on the E-II deal.

In addition to E-II, Beatrice sold its Bottled Water Division and its International Food Division in 1987. Figure 9 shows the initial capitalization of Beatrice after the LBO and the proceeds from the sell-off. By the end of the year, Beatrice had divested assets worth a total of about \$6.55 billion, and all that remained of the company was its domestic food group, consisting of Beatrice/Hunt-Wesson foods, Tropicana Products, Swift-Eckrich meats, and Beatrice Cheese. In 1987, these businesses had earnings of \$494 million on sales of \$7.5 billion. At this time, the Beatrice LBO appeared as if it would become the most profitable LBO ever. The *Wall Street Journal* reported that Kelly hoped to sell the remaining Beatrice assets for \$6 billion (Johnson and Smith (1987)). With such a sale, investors would earn a pretax profit of more than \$2 billion.

However, the deal did not continue as intended. During 1988, more than 100 companies reportedly examined the remaining Beatrice divisions, including every major food company, and all refused to buy the major business segments (Burrough and Johnson (1988)). KKR first hired Drexel, then First Boston, and finally Saloman Brothers to sell the remaining divisions, all to no avail.

Around this time, frictions between KKR and Kelly became severe. Henry Kravis insisted on maintaining final control over all major decisions affecting Beatrice, and Kelly resented the limitation. When the remaining businesses failed to sell, Kelly proposed to engineer an "E-III" transaction, under which Kelly would purchase or take public Swift-Eckrich as an investment vehicle for future LBOs. KKR rejected this proposition, probably to prevent being associated with future corporate raids. In September 1988, Donald Kelly resigned as chairman of Beatrice (Burrough and Johnson (1988)).

One more divestiture, that of Fisher Nut in 1989, was forced on the company by KKR's LBO of RJR Nabisco. The FTC insisted that KKR sell either RJR's Planters Nut operations or Beatrice's Fisher Nut. Planters was a much larger company, and Fisher was sold for \$150 million to Proctor and Gamble. Finally, in June of 1990, Beatrice Company was sold by KKR to ConAgra for \$1.34 billion, plus the assumption of roughly \$1.8 billion in debt and other liabilities. The price, widely reported to be below what KKR had hoped to receive, still represented a premium over book value (which had been generously restated only four years earlier in the LBO). It resulted in an annual compounded return on the equity investment in the Beatrice LBO (including warrants and management options) of 83%, and an annual return to the nonmanagement investors of 78%. The value of the Beatrice post-LBO equity increased by about \$1.8 billion, equal to about \$1.2 billion in market-adjusted value. The pre-LBO equity holders made approximately \$1 billion as a result of the LBO. Thus the total market-adjusted value increase for all equity investors in Beatrice was \$2.2 billion. Donald Kelly is estimated to have made over \$135 million from the E-II and Beatrice transactions.



1. Preferred Stock was valued at \$880 million when issued, but was redeemed for \$1,200 million in exchangeable debentures four months after the deal.
2. Includes mostly contingent tax liabilities resulting from previous M&A activity. The magnitude of these liabilities was roughly comparable when ConAgra acquired Beatrice.
3. Includes \$1,340 million pay-out directly to Beatrice shareholders, plus about \$1.8 billion in deferred taxes and other non-current liabilities, most of which represent contingent tax liabilities.
4. Includes \$840 million pay-out directly to Beatrice shareholders, plus the assumption of \$800 million in debt.

Figure 9. Beatrice liabilities and equity at the time of the LBO, and proceeds from sales of units.

Leveraged Buyout: Value Created or Value Recaptured?

Any explanation of the value increase which occurred during the Beatrice LBO and break-up is closely related to the causes of the value decline in the early 1980s. Clearly Kelly and KKR changed the strategy and restored confidence in the governance of the firm. If Rasmussen and Dutt had not changed the strategy and centralized the firm, would the LBO have occurred at all? The 1980s were marked by tremendous capital market activity both among conglomerates and companies in the food industry; would Beatrice have been caught up in this activity anyway? Of course, such counter-factual questions cannot be answered definitively, but some analysis can be brought to bear on them.

In several ways, Kelly restructured the company to resemble Beatrice under William Karnes. Recall that the successful company of the 1950s through 1976 was highly decentralized, with a small central staff and a very limited role for the headquarters organization. Karnes bought companies with competent management, and left them in place to run their organizations, providing little more than easy access to capital and training in modern management practice. Beginning with Rasmussen, and then intensifying with Dutt, the company became highly centralized. More and more decision rights were taken back by the central office in Chicago, especially in the crucial area of marketing. This centralization was arguably one cause of the decline in value of Beatrice in the early 1980s.¹⁶

After the LBO, Kelly restored Beatrice's highly decentralized organizational structure. He reduced the headquarters staff by 70%, down to 120 people, and streamlined operations. According to Beatrice executives, Kelly cut red tape for divisions dealing with headquarters and generously funded capital requests. Donald Rosuck of Culligan said "Under Kelly, you'd do the paperwork and pass it up the system, and in a couple of days, you'd have a decision." (Ipsen (1988)). Malcolm Candlish of Samsonite noted, "I never had Kelly turn down a single [capital] request" (Ipsen (1988)). Indeed, Kelly was at times criticized by his managers for his "hands-off" attitude toward Beatrice's operating units while they were owned by Beatrice (Burrough and Johnson (1988)). The fact that many of the assets of post-LBO Beatrice were sold to companies owned in large part by the managers of the units indicates that whatever value Beatrice once brought to those companies, the managers felt that they could operate more efficiently without a corporate parent.

Another cause for the decline of value during the Rasmussen and Dutt tenures relates to the problem of strategic muddle. During Karnes's tenure,

¹⁶Alfred Chandler (1990) argues that "Such... diversification created another new phenomenon in the evolution of the managerial industrial enterprise: it often led to a... breakdown of communications between top management at the corporate office—the executive responsible for coordinating, managing, and planning and allocating resources for the enterprise as a whole—and the middle managers who were responsible for maintaining the competitive capabilities of the operating divisions... [T]op managers often had little specific knowledge of and experience with the technological processes and markets of many of the divisions or subsidiaries they had acquired."

Beatrice was an almost archetypal example of Rumelt's (1974) acquisitive conglomerate, buying unrelated or loosely related companies, and managing them in a highly decentralized way. Following the leads of his competitors, Dutt tried to move Beatrice towards a more focused, less diversified strategy. This involved divestiture of the unrelated divisions and a more centralized organizational structure that would allow the firm to capitalize on its distinctive core competence in foods and beverages. However, it was never clear whether the firm had or could develop any such core competence. The success of Beatrice's brands was based on their regional appeal or their niche approach, and the firm lagged behind its national rivals in terms of marketing and advertising expenditures. Even after Dutt's 1983 consolidation of product lines and increased emphasis on marketing, Beatrice's (now national) County Line cheese brand spent only \$2 million on advertising, compared with Kraft's \$2.8 million on its Cracker Barrel line, and \$68 million on all of its cheese products. Similarly, Coca Cola's Minute Maid orange juice brand outspent Tropicana by 33%.

Once again, after the LBO Kelly reversed Dutt's changes and returned the firm closer to Rumelt's model of a decentralized, diversified company. Kelly decentralized marketing decisions, spending these resources at the brand rather than the corporate level, and in certain instances actually tried to reduce synergies between groups. Erik Ipsen describes how Kelly stopped a project to integrate Tropicana and Beatrice's cheese operations. Dutt had tried to centralize Beatrice's fresh food operations in order to integrate sales, marketing, research, and distribution. Kelly, who saw that such an integration would hamper his efforts to sell off pieces of the company, killed the integration attempt (Ipsen (1988)).

That Kelly was recasting Beatrice's organization back to the pre-1976 structure does not explain the value that was created during Kelly's tenure. Karnes had created value by *acquiring* firms, but Kelly was creating value by *divesting* them. How could 25 years of the acquisition of the assets of small private firms have created value and then several more years of divestiture of these same assets have added more value?

One possible explanation of these facts is that the market value increases that accompanied the acquisitions of the 1960s and early 1970s were the result of the capital market's misunderstanding of the effects of conglomeration. Such a hypothesis supposes that during the 1960s and 1970s investors were fooled into accepting the arguments of managers (and many management theorists) that centralized decision-making and capital allocation would lead to synergies which would make the whole worth more than the sum of the parts. It was largely these synergies on which James Dutt justified his centralization of Beatrice. What these management theories failed to account for was the importance of a detailed understanding of the operations of the businesses, and thus these theories did not predict that such organizations were doomed to fail when the centralized (and uninformed) bureaucracy acquired too many decision rights, and made decisions which destroyed value in the businesses. This hypothesis continues that around 1979 the market

recognized the weaknesses of the conglomerate strategy, and so discounted Beatrice's stock heavily. This discount is what explains the tremendous loss of value in 1979–1981, and also explains why the market bid the stock back up when the firm changed direction in the 1980s.

This hypothesis can be tested by looking at the stock market performance of a portfolio of conglomerates. If the decline in Beatrice value was the result of a generalized realization that the conglomerate strategy was flawed, then all conglomerates should have suffered a similar loss in value during the same period. To test this hypothesis, I constructed a portfolio of conglomerates and examined their market-adjusted performance over the period 1940–1986. This analysis, shown in Figure 10, demonstrates that the decline in Beatrice market value was not a result of a generalized loss of confidence in conglomerates. Indeed, during the period in which Beatrice lost much of its market value, the market adjusted returns to the portfolio of conglomerates were high. Thus, the loss and recapture of value cannot be explained by appealing to the market's changing views on conglomerates.

A second hypothesis about the apparent value increases from acquisition, and the additional value increase from divestiture, argues that both sets of transactions created real economic value. Data from several empirical studies of acquisitions and divestitures are consistent with this hypothesis.

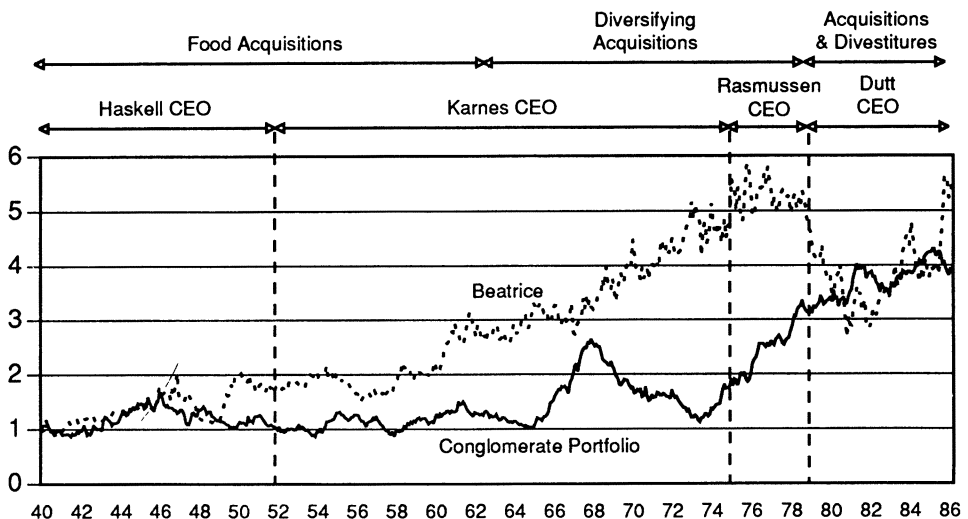


Figure 10. Stock market performance of Beatrice and a portfolio of conglomerates, 1940–1986. Conglomerate portfolio is made up of companies in *Business Week's* list of conglomerates for three out of four years 1972, 1975, 1980, 1985. The companies are Avco, Colt Industries, Household International, IC Industries, Kidde, LTV, Martin Marietta, Gulf & Western, Signal, Teledyne, Textron, and Whittaker. The performance index is calculated as follows: expected returns for Beatrice are generated using the Capital Asset Pricing Model, with betas estimated using a 60-month moving window. The performance index is the ratio of Beatrice's cumulative (multiplicative) actual return dividend by Beatrice's cumulative expected return. The performance index for the conglomerate portfolio is calculated in the same manner.

Matsusaka (1990) found that, for acquisitions in 1968, 1971, and 1974, acquiring companies that diversified had positive abnormal returns around the time of the acquisition announcements and that this result was strongest when the target was a strong performer in its industry and when target management was retained. Schipper and Thompson (1983) found significant positive stock returns to firms announcing acquisition programs in the 1950s and 1960s. Kaplan and Weisbach (1990) studied divestitures in the 1980s of units acquired in the 1970s. Using a sample of 271 large acquisitions, 44% of which were subsequently divested, they found that most of these divested acquisitions were not disasters. Thirty-four to 50% of these subsequently divested acquisitions were classified as failures, and 55% showed a market adjusted gain on sale when comparing the sale price to the preannouncement value of the target.

Hite, Owers, and Rogers (1987) studied the market's reaction to divestiture announcements. They found that in their sample, drawn mostly from the late 1970s and early 1980s, divesting firms show a positive stock price effect on the announcement of divestitures, while Hite and Vetsuypens (1989) found small but positive stock price effects upon the announcement of divisional leveraged buyouts in a sample of divestitures from 1973–1985.

One way that a set of transactions (acquisitions in the 1960s and 1970s) can be value increasing and a reversing set of transactions (divestitures of these same assets in the 1980s) can also be value increasing, is if there is some change in the economic environment which alters the constraints or opportunity sets for firms in these periods. Two important environmental changes, which allowed both the efficient build-up of companies like Beatrice, and their efficient dismantling, were the development of a high-yield bond market in the mid-1970s and the increased supply of well-trained professional managers in the American economy.

As argued above, Beatrice bought small private companies, often managed by the founders or their families that had very limited access to capital markets or bank financing. In this environment, companies like Beatrice could add substantial value by providing an internal capital market and providing training and know-how to these managers. Such a strategy was not without costs: The acquisition did eliminate the equity stake in the businesses which the former owners had, and thus reduced the incentives which unit managers had to run the business like their own. However, this cost was more than outweighed by the fact that the firms now had access to capital and the skills which allowed them to grow and prosper.

By the mid-1970s, however, two things had begun to change. One was the availability of high-yield bonds, which essentially securitized commercial lending and which provided access to growth capital for many small firms. Figure 11 gives the dollar amount of original issue high yield bonds issued from 1976–1986 and shows that by 1984, over \$25 billion in so-called “junk bonds” had been issued, little of which was for mergers and acquisitions activities. Another important change was the tremendous influx of professionally trained managers into the ranks of American management. Figure

12 shows the number of Masters of Business Administration degrees granted in the United States from 1956–1986. The point of this is not so much that these degree holders per se were in top management positions by this time, but that the diffusion of modern management practices was much greater by the 1980s than it had been in the 1950s and 1960s. Both of these changes had the effect of decreasing the advantages which a company like Beatrice had in owning and managing divisions. The benefits which the company headquarters had provided (access to capital and sophisticated management) were more readily available, while the disadvantage of corporate ownership (the weakened incentives due to the lack of an equity stake for the unit managers) was still present. In this new environment, companies like Beatrice should have been able to move assets to higher valued use, and thus create value by

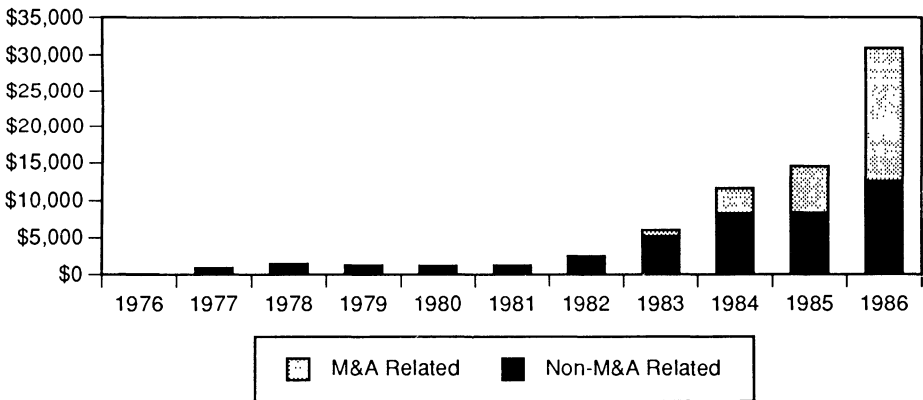


Figure 11. Original issue high-yield bond issues, 1976–1986. In millions of dollars. Source for totals: Asquith, Mullins, and Wolff (1989). Source for M&A related: Wigmore (1990).

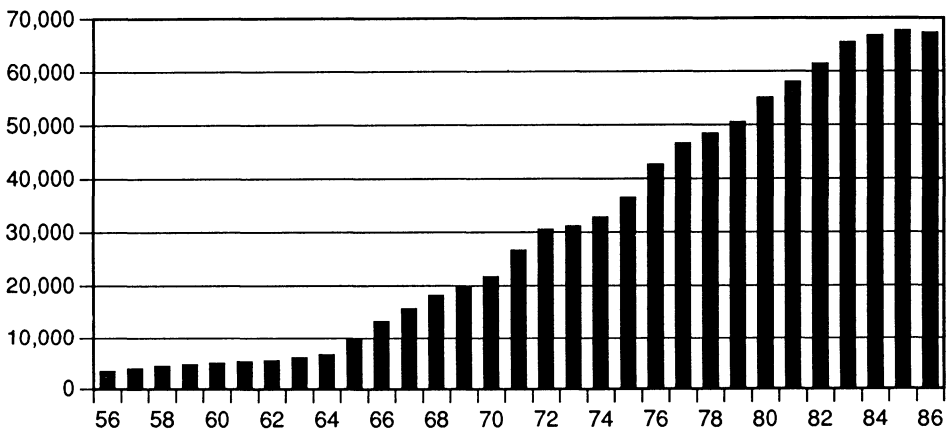


Figure 12. Number of MBA degrees granted, 1956–1986. Source: U.S. Department of Education.

selling the divisions either back to their managers or to related companies whose headquarters organizations could provide more valuable operating or marketing synergies.

Such a hypothesis is consistent with the findings of Bhagat, Shleifer, and Vishny (1990) in their study of hostile takeovers, including LBOs. They find that the majority (70%) of the assets sold off after a hostile takeover are sold to companies in their same industry, and 16% are sold to management in divisional LBOs. Beatrice's divestitures are consistent with the findings of Bhagat, Shleifer, and Vishny, but in Beatrice's case the incidence of asset sales to managers is substantially greater. Table IV shows all divestitures of Beatrice valued at more than \$80 million; these transactions represent over 90% of the value of all Beatrice divestitures. Of these assets sold, 42% were to companies with substantial management ownership, 47% were to public companies, and 11% were to foreign companies. A close examination of the ownership of the units divested before Beatrice bought them reveals a very interesting pattern: in almost every case, companies bought as small private firms were sold to investor groups with significant management ownership, while companies bought as public companies were sold back to public companies. The two significant exceptions, the sale of the dairy business, and the sale of Beatrice to ConAgra, bear closer scrutiny.

The assets of the dairy products division, sold to Borden, were bought by Beatrice before the diversifying acquisitions of the 1960s and 1970s. As argued in Section I, the basis for these acquisitions was increasing economies of scale in dairy production, not access to capital or management expertise. When Beatrice acquired these firms originally, the value of capturing these economies by buying the smaller firms outweighed the cost of weakened management incentives, and nothing had changed in the intervening years to alter this economic calculus.

The sale of Beatrice itself to ConAgra is confounded by tax issues. There was persistent speculation in the press that Beatrice was considering a recapitalization in an effort to stay private. However, there were compelling tax reasons to sell Beatrice to a public company. KKR wanted a transaction that would give Beatrice investors a choice either of liquidity or a tax deferred capital gain on the sale. If the company had recapitalized and paid a substantial dividend, or sold to another private company, the cash pay-out would have been immediately taxable. However, if KKR could sell the company for 50% stock, the stock portion of the proceeds would not be taxed until the stock in the acquiror was sold. By selling Beatrice to a publicly traded company, KKR provided liquidity to those investors who wanted it and allowed others to defer taxes on the gain indefinitely. Thus, while remaining private or selling to another private company might have been more efficient absent tax considerations, the end result was the sale to ConAgra.

Table IV demonstrates that most of the previously private companies bought by Karnes during the period of diversifying acquisitions were ultimately sold back to their managers by Kelly. The fact that Kelly had a strong incentive to sell these companies to the highest bidder suggests that manage-

Table IV
Major Divestitures of Beatrice

Year Sold	Unit Sold	Status when Acquired by Beatrice	Nature of Buyer and Price			Buyer
			Mgt./LBO	Public Company	Foreign Company	
1981	Dannon	Private company			84,300	BSN-Gervais-Danone
1981	Soft Drink Division	Private companies	105,000			Forstman Little
1984	Buckingham	Part of Northwest Industries			110,000	Whitebread & Co. PLC.
1984	Food-service equip.	Private companies	116,000			Gibbons, Green, van Amerongen
1984	Chemical operations	Private Companies			750,000	Imperial Chemical Industries
1985	Cookie Operations	Private Companies	253,000			Prospect Group
1985	STP	Part of Esmark		87,000		Union Carbide
1986	Avis	Part of Esmark	255,000			Wesray Capital
1986	Coca Cola bottling	Part of Northwest Industries		1,100,000		Coca Cola Company
1986	International Playtex	Part of Esmark	1,250,000			Playtex Holdings
1986	Americold cold storage	Private companies	480,000			Kelso Americold
1986	Dairy products	Private companies		315,000		Borden
1986	Webercraft Technologies	Private companies	225,000			Riordan Freeman & Spogli
1987	Bottled Water Division	Private companies			400,000	Source Perrier SA
1987	E-II Holdings	Private companies	1,640,000			E-II Holdings
1987	International foods	Private companies	985,000			TLC Group
1988	Tropicana	Public company		1,200,000		Seagrams
1989	Fisher Nut	Private company		150,000		Procter & Gamble
1990	Beatrice	Private companies and parts of Esmark		3,140,000		ConAgra
Total Value			5,309,000	5,992,000	1,344,400	
Percent of Total			42.0%	47.4%	10.6%	

ment ownership was once again the most efficient organizational form for these companies. The LBO in 1986 created an organizational form that was destined to break-up. Indeed, the financial structure of the Beatrice LBO demanded that substantial asset sales take place and provided rich rewards to Donald Kelly and his management team if they could successfully sell off the diverse businesses of Beatrice. The value increased which accrued to the owners of Beatrice before and after the LBO can be attributed to the movement of the assets of the company into more appropriate organizational forms, which, because of a changing economic environment, often resembled the forms from which Beatrice had bought the assets years earlier.

V. Conclusions

The history of Beatrice reflects the history of American business from the turn of the century to the 1990s. Begun as a small single-business firm, it grew by acquisition into a large, diversified company. The path that Beatrice took from a local creamery to an international consumer and industrial products firm had few sharp turns: the company's early acquisitions in the dairy industry were a response to a changing environment that made consolidation an economically efficient strategy. When further expansion in the dairy business was precluded, William Karnes leveraged his organization's capabilities to evaluate companies and managers, and his own organizational philosophy and systems, and bought companies outside the dairy industry, first in foods and then in a wide array of industries. This strategy proved very successful and provided Beatrice investors with superior returns over a twenty-five year period.

The success of the firm's diversification strategy appears due, in large part, to the organizational structure and systems set up by William Karnes. Karnes insisted that the company be run in a decentralized way, with minimal interference from headquarters. The subsequent decline in value suffered by the company in the late 1970s and early 1980s seems attributable to a flawed strategic vision that demanded organizational capabilities that the company did not possess, and to the break-down of the internal control system which might have prevented this strategic muddle. Rasmussen and Dutt centralized control of the firm in the CEO's office, stripping decision rights from the division managers and from the members of the board of directors. Once this centralization of control had occurred, and the firm's value had fallen, it was the capital market, in the form of hostile corporate control activity, that ultimately directed the firm's fate. When the dust had settled, control of the assets of what had been Beatrice had passed, in many cases, back into the decentralized hands of the managers of the assets themselves.

Several hypotheses and conclusions can be drawn from this analysis of the history of Beatrice. First, this analysis provides an organization-level explanation for the findings that the diversifying mergers of the 1950s-1970s

created value. To the extent that the acquirors of this period were buying smaller companies that valued the financial and managerial resources that these acquiring firms could offer, these transactions generated real economic value. Furthermore, the fact that many of these transactions were later reversed in the 1980s is not necessarily evidence of either the foolishness or the failure of these acquisitions; changes in financing technology and managerial sophistication available to small and large firms can explain these reversals. Finally, the history of Beatrice demonstrates the importance of organizational structure and governance in the creation of economic value. It was largely internal policies and organizational structure that created the value in Beatrice, and it was largely the failure of these policies and structures that lead to its destruction.

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