BANKS AND CORPORATIONS

THE HIDDEN COSTS OF CORPORATE TAKEOVERS

Jonathan Greenberg

In 1982, I completed a year-long assignment as the chief researcher for the first *Forbes* Magazine listing of the 400 wealthiest Americans. At that time, we placed 19 people on the list who had made their $100 million-plus net worth from the business of "finance." Just five years later, the 1987 Forbes 400 listing had a minimum worth requirement of $225 million. Of the 400 wealthiest Americans, 69 of them had made their fortunes from finance.

How did these financiers—whom *New York Magazine,* during the eighties, dubbed the "rock stars of this decade"— acquire their newfound wealth? Most of them cashed in on the wave of corporate takeovers that had swept the nation. Fueled by the Reagan administration's anti-antitrust and anti-labor policies, clever stock market manipulators found that they could take over publicly traded companies by borrowing huge sums of money, paying premiums for the stock, then demanding wage concessions from the companies' workers with the excuse that money was needed to pay back the new debt. In addition, the manipulators knew that our corporate tax structure would subsidize their purchases. Because the interest on all the money they borrowed to take over the company could be deducted from profits, the money that once went for federal taxes could now go toward financing these takeovers. So while a few ruthless number crunchers were earning hundreds of millions of dollars taking control of huge companies and reducing the wages of—or firing—tens of thousands of workers, we, the taxpayers, were making up the difference in the federal budget through cutbacks, increased taxes, and a larger budget deficit.

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The hidden costs of corporate takeovers are much larger than most Americans realize. Between the "hostile takeovers" of "corporate raiders," the leveraged buyouts of companies buying up their own stock to ward off the raiders, and the "friendly" acquisitions of corporations, such unproductive economic activity became the main focus of the nation's businesses during the eighties. This was money that did not go into building new plants, creating new products, or hiring new workers. It was siphoned out of the economy to inflate the value of stock, pay exorbitant fees, and make a few people extremely rich.

In 1988 alone, approximately $500 billion was spent on corporate takeovers.[1] That's greater than 20 times as much as had been spent on takeovers just eight years earlier, and more than double that year's combined profits for the nation's 500 most profitable companies. Almost all this money had to be borrowed. Every dollar that went to pay off debt service amounted to 50 cents or so that otherwise would have gone into the federal treasury to pay corporate taxes.

The most thorough analysis of how corporate taxes were affected by the takeover wave was written in late 1991 by Donald L. Barlett and James B. Steele, two Pulitzer Prize winning journalists for the *Philadelphia Inquirer.* In one section of their investigative series (entitled "America: What Went Wrong?"), Barlett and Steele revealed that throughout the eighties, corporations paid a total of $675 billion in income taxes, and $2.2 trillion in interest on borrowed money. [2] At least half of this debt expense probably could be attributed to corporate takeovers, which means that well over $500 billion that would have gone to federal taxes instead went to fund the takeover binge. During the 1950s, the writers explained, corporate America paid $4 in taxes for every $1 it paid in interest. Through the 1980s, however, this ratio had reversed itself: corporations paid out $3 in interest for every $1 they paid to Uncle Sam.

According to Barlett and Steele, because of the interest deduction on debt, throughout the 1980s corporations paid $67.5 billion per year in taxes, *and avoided paying $92 billion per year!* Their analysis left no room for doubt over who has been making up for the shortfall. During the 1950s corporations paid a 39% share of all taxes collected in the U.S. During the 1980s, that corporate share had dropped to 17%, and the share paid by individuals had risen to 83%.[3]

Even *Forbes* Magazine, generally a booster of corporate takeovers, acknowledged that taxpayers have been subsidizing them. In late 1988, a *Forbes* cover story analyzed some of the largest takeovers of the eighties. It estimated that the $26 billion leveraged buyout of RJR Nabisco would result in a tax shortfall to the federal treasury of $7 billion. That's because the company, which had been paying $682 million per year on $2.6 billion of operating profit, had taken on so much debt that it would pay no taxes at all for the foreseeable future — *and would probably even collect a $2 billion tax refund from the federal treasury for taxes it had paid during the three previous years!*[4]

The same story held true for each and every company that was saddled in debt so that one manipulator or another could take it over. Macy's paid $206 million in taxes the last year before it underwent a leveraged buyout. In 1988, the company collected a $32 million tax refund from the federal government.[5] All of these tax deductions, and all this debt, might somehow be justifiable if they improved the financial well-being of the corporations that were being taken over and their workers. But it has had the opposite effect. During the past few years, millions of Americans have been waking up to a terrible hangover because the corporate takeover phenomenon required even more money than the hundreds of billions of dollars in tax deductions. To pay down all that debt, and pay all the lucrative fees for those who engineered the takeovers, hundreds of thousands of employees of those companies that were taken over were fired, while millions of others were forced to accept wage concessions that would have been considered unconscionable just a decade earlier. The AFL-CIO Executive Council called the takeover frenzy "a waste of scarce resources" resulting in employees being "Traded and bartered like chattel." In some cases, the council noted, new owners were buying companies "for the sole purpose of reaping whatever gains can be achieved from breaching contractual commitments."[6]

Under the Reagan Administration, the National Labor Relations Board took a stiff anti-union stand while all this was going on. Because the union contracts of a company's labor force could be renegotiated if the ownership of a company changed hands, many corporate raiders used this loophole to borrow money, buy out the stock, then force down wages. Other "financiers" went so far as to buy out companies, then use "excess" money from workers' pension funds to pay off the crippling interest on their debt. According to Barlett and Steele, of the *Philadelphia Inquirer*, nearly 2,000 businesses dipped into their pension funds and removed $21 billion during the 1980s.[7]

Far from protecting workers from this new form of economic piracy, the "government of the people" encouraged it. The enormous growth in the number of takeovers during the 1980s coincided with a drop in the number of attorneys employed by the Antitrust Department of the Justice

Department, from 429 in 1980 to 240 in 1986. In 1982, the divisions' guidelines were relaxed to make takeovers easier. Whereas 11 civil monopoly cases were brought by the Antitrust Division between 1976 and 1980, from 1981 to 1985 only two were filed. Charles Rule, the Assistant Attorney General who headed the Antitrust Division under Reagan, made the administration's policy crystal clear during a speech to the American Bar Association on October 9, 1987. "The goal of anyone who is truly concerned about customers and shareholders should be to *reduce* costly regulation of the market for corporate control, not to increase it . . . takeovers generally increase the competitive vigor of the targets. Moreover, current merger policy implicitly promotes the social and political values upon which our nation was built."

What type of social and political values was Rule speaking of? To give an example, why not look at the corporate takeover of Safeway Supermarkets, which is widely regarded in business circles as one of the most "successful" leveraged buyouts of the eighties.

In 1986, Safeway Supermarkets owned 2,365 stores and employed 172,000 workers. Its motto to employees was "Safeway Offers Security". The company did its best to live up to this, offering good job benefits and decent union wages. The previous year, Safeway reported record profits of $231 million.

Then all the rules changed. In July 1986, after a hostile takeover bid by a group of corporate raiders, Safeway's management called in Kohlberg, Kravis, Roberts & Co. (KKR), a leveraged buyout specialist. KKR came up with $130 million of its investors' equity, then borrowed more than $4.3 billion to buy up all of the company's stock. KKR received $60 million in consulting fees for the transaction; when added to fees received by the investment bankers, junk bond financiers, lawyers, and accountants, more than $200 million went to take Safeway over.[8]

At this point, the new owners needed to come up with more than $500 million a year to pay off interest and debt. Jane and Joe taxpayer, involuntarily, have been kicking in their share; the company immediately stopped paying $122 million a year in annual taxes and even received a U.S. treasury "refund" check for past taxes of $11 million. But that only paid off part of the debt. The rest had to come from liquidating stores, firing workers, and cutting people's pay. Eventually more than 1,200 stores were sold, putting 63,000 people out of work. According to a 1990 analysis of the closing of Safeway's Dallas area stores by *The Wall Street Journal*, one year after losing their jobs, 60% of the workers still had not found new jobs. Those lucky enough to find work for the companies which bought out the Safeway stores saw their hourly wages drop from $12 to $6.50.[9]

These Dallas-area Safeway workers had an average of 17 years service with the company. They had refused a $5-an-hour pay cut. Although the company was making a small profit from their stores, far more money could be made liquidating them and selling off their inventory and equipment. "There's so much debt in a leveraged buyout that you have to look at your assets in a cld and calculating way," Safeway chairman Peter Magowan explained. Employees lost all health benefits within two weeks and received a maximum severance pay of eight weeks. Magowan kept his million dollar-a-year job and wound up with options to buy 2 million shares of Safeway stock at one-sixth its current value. This translates into a personal profit of more than $20 million — probably more than every severance check the company cut for the 9,000 Texans it put out of work. Today Safeway's headquarters sports a new corporate motto: "Targeted returns on current investment."

In late 1990, *Forbes* Magazine wrote an article entitled "The Buyout that Saved Safeway." It noted that profit margins were higher, largely because the leveraged buyout "freed" the company "from the albatross of uncompetitive stores and surly unions." The article reported that the threat of store closings forced unions to negotiate concessions. Indeed, workers in Denver took a 14% pay cut, and truck drivers now complain of being forced to work 16-hour shifts.[10] Yet *Forbes* felt that this undermining of the American worker, subsidized with an indirect tax subsidy which will eventually exceed $500 million, was good for the economy. No mention was made of the welfare, unemployment, and health benefits which the firings have cost all Americans, nor the loss of those hundreds of millions in taxes which tens of thousands of former Safeway workers no longer pay. As for the damage done to the economy by having fewer consumers with the money to purchase products and services, that is another intangible which corporate takeover boosters would rather not address.

Boosters of corporate takeovers, like *Forbes*, speak of "saving" a company which had paid good wages and made good profits, because now it can pay people less and make even higher profits (although when calculations include debt service, Safeway nets far less than it ever did). Other apologists, like Safeway's Chairman Magowan, observe that Safeway had no choice, that if KKR had not taken it over, a worse "corporate raider" would have. But such arguments purposely avoid the most critical question of the corporate takeover phenomenon: Would America have been better off had our government stepped in to prevent the eighties takeover binge from happening in the first place?

There are other even more dramatic examples. In 1992, Macy's, the 134-year-old retailer, was forced to declare bankruptcy. Although the company had been very profitable, six years earlier Macy's management borrowed $3.5 billion to buy up all its stock and "go private," thereby avoiding a hostile takeover. After hundreds of millions in taxpayer money indirectly subsidized the leveraged buyout, the once-decent livelihoods of tens of thousands of employees are now in jeopardy.[11] The 134,000 employees who once worked for the formerly profitable Federated Department Store chain, as well as Allied Stores, were even less lucky. Junk bond financing and eager investment banking firms loaned a little-known Canadian tycoon named Robert Campeau $11 billion to buy up both these important companies during the late 1980s. The companies were so highly leveraged that they both went bankrupt within six months, throwing thousands out of work.[12]

So why did anyone arrange to lend $11 billion for so dubious a venture? Because more than $600 million in fees was paid out, up front, to bankers, accountants, and merger and acquisitions specialists like First Boston, which alone billed $200 million for its services on the deal.[13] Such deals became not a means to a stronger company, but a fee-generating end unto itself. And who has been paying the piper when the deals went sour? The American taxpayer, of course.

Nowadays, with the weakening of the market for junk bonds, corporate takeovers have slowed down considerably. Words like "greenmail" and "hostile takeover" don't make it into the business pages every day. But we are still paying for them. To understand the corporate takeover phenomenon is to understand how the American economy has been legally manipulated into denying workers their living wages, all to benefit a small number of financial manipulators. It is essential to unmask the hypocrisy of the Reagonomics free enterprise rhetoric that all business activity performed under the cloak of the "free market" is good activity, and that any form of financial manipulation which makes somebody rich is good for the economy. Only when the average American taxpayer and worker understands that he or she is the one who footed the bill for the get-rich-quick corporate takeover frenzy of the eighties will we compel our politicians to bring about an equitable tax structure and regulatory system. Had the government acted, by insisting that existing labor contracts needed to be enforced and limiting the tax deductions that corporations could take for their interest expense on debt to finance unproductive economic activity, the corporate takeover wave of the eighties, and much of the damage it caused, would never have happened.

Over the past decade, a number of well-meaning free market theoreticians have told me that this solution would interfere with the marketplace. They argued that the answer should be for business people to act more altruistically.

I find this an absurd notion. Business will act like business. Period. "Should" never enters into the equation. Business will act in whatever way legally allows it to make money. Has R. J. Reynolds (part of RJR Nabisco) withdrawn its "Old Joe Camel" cigarette ads, despite direct requests from both the American Medical Association and the Surgeon General of the United States to withdraw the ad campaign because it is contributing to cigarette use among children?[14] No. RJR wants to make money. And the Bush Administration, despite its much ballyhooed "War on Drugs," allows it to make money peddling cigarettes to kids. According to authoritative studies, Camel's share of the illegal 12- to 18-year-old smoker's market has climbed from 1% to 32%. Thanks to Joe Cool, Camel cigarette sales to children now bring RJR an estimated $476 million a year.[15]

Interestingly enough, RJR Nabisco, like Safeway, was bought out by KKR. As mentioned earlier, RJR Nabisco is the company that received the equivalent of a $7 billion subsidy from you and me for allowing KKR the privilege and profit of taking it over. Henry Kravis, one of the firm's two principals, served as chairman of President Bush's first Presidential Inaugural Anniversary Gala for top Republican Party givers. In 1988, Kravis personally donated more than $100,000 to the party.[16]

I am not suggesting that Henry Kravis has ever broken the law. Or even that society should expect him to act differently. It is not up to business to decide how to most charitably benefit society. Business channels greed in profitable directions. It has no conscience. But it is up to the government of the people to see to it that our economy balances the fulfillment of private greed with the needs and welfare of the public. It is the role of government to reform the free market when it is used in destructive ways, to protect Americans from the excesses of the marketplace run amok. It is also up to our elected representatives to act on behalf of the majority of the people in this nation—not just those who make large campaign contributions. (That is why campaign finance reform, as thoroughly explored in Craig McDonald's essay a bit earlier in this book, is an integral part of creating a more equitable—and more efficient—economy.)

The free market is often the most suitable regulator of the economy. But its aberrations need to be reformed. To those who would dispute this concept, I would call attention to the child labor laws of a century ago, which sought to protect nine-year-olds from coal mines and sweat shops.

It was government intervention which interfered with the ability of big business to have its way with poor children. And what limited the cruel power of the vicious monopolies during the early part of the century? It was antitrust regulation—not an appeal to the goodness of the robber barons. In the same way, a century ago union organizers who tried to strike were being shot dead by the dozen by private corporate armies. Workers' rights in the United States—whether for child labor laws, decent hours, pensions, or protection from racial or sexual discrimination—have always come from federal intervention, not corporate largesse. These "reformations" of capitalism's crueler edges are now widely accepted as "advances" in the creation of our modern society.

The United States is the only major industrialized country in the world in which the government would tolerate—and even encourage—the sort of economic behavior that allows hundreds of thousands of workers to be fired from their jobs at healthy corporations simply to enrich the pocketbooks of a small number of financial manipulators. In 1989, 42% of American households earned below $25,000: a figure that had risen from 31% a decade earlier. Unemployment rates do not tell the whole story of the millions of Americans who have seen their real wages, health benefits, and job security fly out the window. While contributing greatly to this decline in the livelihood of American workers, corporate takeovers have also slashed corporate taxes, increasing the huge federal deficit, which in 1992 reached a record $350 billion.

This is what takeovers cost us. What have they done for us? Such questions should be directed to politicians like New York senator Alfonse D'Amato. Chairman of the Senate Banking subcommittee on securities D'Amato received more than $500,000 in contributions from Wall Street firms between 1981 and 1986. In late 1985, D'Amato decided to omit from a draft bill a provision which would have tightened the regulation of corporate takeovers. Within a week of his decision, 36 executives from the Wall Street firm of Drexel, Burnham, Lambert, the former kings of junk bonds, each donated $500 to D'Amato's reelection campaign.[17]

It took two centuries for the United States to build the world's largest, most robust middle class. During the past 12 years, with the endorsement of the Reagan-Bush administrations, big business has been allowed to hack away at the health care benefits, pension plans, job security, and wages of millions of Americans. All under the banner of making a "free marketplace more competitive." All to support the myth that the economy *always* functions best when left alone. But who has been paying the tens of billions in taxes that newly indebted corporations once paid? The American taxpayer. And who pays for the unemployment, hospital care, or welfare benefits for those hundreds of thousands like the Texans who lost their jobs when Safeway closed their stores? The taxpayers, again.

The twisted logic of the robber barons of the Reagan era is that the living wage of middle America has decimated our economy. Listen to the words of George Roberts, KKR's other principal partner. Like Henry Kravis, Roberts is worth more than $450 million. Roberts, Kravis and three partners put up some $2 million of their personal money to buy Safeway; their group's investment of some $2 million in Safeway stock is likely to yield more than $200 million within the next decade. In 1991, Roberts justified Safeway's mass firings and wage cuts by telling the *Wall Street Journal* that the supermarket chain's employees "are now being held accountable. . . . They have to produce up to plan, if they are going to be competitive with the rest of the world. It's high time we did that."[18]

One of the biggest Big Lies of the Reagan-Bush era has been that what is best for the short term profits of corporate America is best for America. There once was a time when a good job with an American corporation meant security and a decent livelihood, when the rising tide of a company's fortunes lifted all boats. But that was before top management and financial manipulators, with junk bond financing, discovered a way to buy boat after boat, then increase their value by throwing the crews overboard. The legacy of this lie will haunt our nation for years through a growing disparity between the haves and have nots, through millions of shattered lives, through an increased deficit and tax burden shouldered by our paychecks and those of our children.

In fact, what's best for corporate America is simply best for the owners of corporate America. And their enrichment is coming out of everyone's pockets. Yet despite more than a decade of such abuse, the complexity of the situation has insured that most Americans still don't get it. The truth of the era of corporate takeovers has little to do with economic competitiveness. It's this simple: we've been robbed.