TAKE TWO ON TAKEOVERS

Raiders Rehabilitated

ORDON GEKKO, the antihero of the 1987 movie Wall Street, epitomizes the excesses of the U.S. financial sector in the 1980s. Gekko embraces insider trading and the strip-and-flip model of the hostile takeover—buy a company, ruthlessly lay off workers, cut corners wherever possible, and sell soon after for a huge profit. "I am not a destroyer of companies," he proclaims during one memorable speech. "I am a liberator of them!"

Helped along by media coverage focused on deals that were the exception, not the norm, the corporate-raider stereotype of buyouts took hold in the public consciousness. But in a recent study of 5,000 buyouts that occurred between 1980 and 2005, Josh Lerner, Schiff professor of investment banking at Harvard Business School, and colleagues call into question just about every component of this unflattering stereotype.

The research updates an academic liter-

ature that had not seen much work since the 1980s, when buyouts were a new phenomenon and when, says Lerner, "there were almost as many papers about buyouts as there were buyouts." The absence of systematic analysis in the interval has led to a reliance on anecdotal evidence—a newspaper story on the \$26-billion

Clear Channel buyout here, a CNN clip on the \$17-billion Albertson's supermarkets buyout there. Labor unions have long described buyouts in terms of American jobs shipped overseas. Lobbyists and trade groups for the private-equity industry, meanwhile, depict a sector that provides an invaluable contribution to the U.S. economy by making companies more efficient, jarring them out of inertia, and improving corporate governance. Lerner and his coauthors suspected

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'Take over' is such a harsh term. We prefer corporate 'make over.'

the truth lay somewhere in between.

Their analysis, originally presented at the World Economic Forum's 2008 annual meeting in Davos, Switzerland, examined 300,000 factories and offices associated with companies that were bought out, and compared those with a control group of six million more facilities. The results suggest that buyouts tend to happen to companies that are already struggling, but do not increase the likelihood that a company will fail. The authors found evidence that

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the private equity firms home in on management controls and invest in R&D during the holding period—evidence, says Lerner, that the goal is to make companies not just leaner, but better organized.

Sometimes this entails cutting jobs, he notes, but the notion of buyout firms taking an ax to employment rolls doesn't hold water. In fact, the study found that companies were more likely to cut back in the two years before a buyout; takeover targets had 4 percent lower job growth than similar firms that were not bought out. In the two years following a buyout, the targeted corporations did cut jobs-7 percent more than comparable firms—but they added employment in other U.S. locations. In fact, new facilities opened by the bought-out companies grew 6 percent faster than comparable firms in terms of jobs created. (The study did not look at jobs created outside the United States, and did not count them as offsetting domestic shrinkage.) "Buyouts," says Lerner, "increase the pace of 'creative destruction'—the pace of job creation and destruction both accelerate."

News accounts mostly cover public-toprivate deals, partly because investors care about companies in which they hold stock, and partly because public companies are easier to cover due to the financial statements they must file. But the average buyout involves a private, rather than public, company; Lerner and his colleagues found that the vast majority of the deals in their database—more than 93 percent—affected companies that were not publicly held. Even accounting for the fact that the public-to-private transactions typically involve bigger companies, such transactions were less than 30 percent of the total by value.

The study also found that quick flips (companies that went public again less than a year after a buyout) make headlines—but the average holding time was far longer. Lerner's study found that only 12 percent of the private-equity firms exited within two years; 58 percent took more than five years to exit. Another headlinegrabbing situation, the company that collapses in the wake of a buyout, is also not the norm. Among firms that were bought out, the five-year failure rate—6 percent was actually *lower* than the rate for all U.S. companies that issue public debt.

Although Lerner teaches a course on venture capital and private equity, and has spent much of his career studying those sectors, he says even he was surprised by the findings. "If you read something in a business magazine a hundred times," he says, "you sort of begin believing it." ~ELIZABETH GUDRAIS

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What Stress Reveals

VOLUTION, the fossil record shows, sometimes proceeds in sudden leaps. Millions of years of stasis can end abruptly with multiple changes in forms and functions. To distinguish this evolutionary process from Darwin's gradualism, the late Harvard professor Stephen Jay Gould famously described it as "punctuated equilibrium." (Gould's detractors, he was fond of pointing out, called it "evolution by jerks.") But one of the great scientific challenges of punctuated equilibrium has been explaining how—if mutations are random-multiple, interdependent mutations can occur all at once, giving the appearance of coordination.

A living example of this mystery is found in monkey flowers from the Rocky Mountains, explains Radcliffe Institute fellow Susan Lindquist, Ph.D. '77, a professor of biology at MIT. One form of the plant has a long trumpet suited to pollination by hummingbirds; the other, with a conventionally shaped flower, is pollinated by bumblebees. The two forms don't interbreed in nature, but scientists can pollinate the plants by hand to generate hybrid offspring. The offspring aren't likely to do well in the wild, though, says Lindquist: because they "don't have the right genes coming together," they are not easily pollinated by bumblebees *or* hummingbirds.

How *do* four or five different changes, which work together, happen simultaneously—in evolutionary time, in an individual organism—when having only two or three of those changes generates functions and forms that don't survive? Lindquist, a Howard Hughes investigator, has discovered and elucidated during the last decade an extraordinary molecular mechanism

that allows organisms to do precisely this—by revealing during times of stress the accumulated genetic variation lying dormant in their genomes. Selective pressures such as heat or drought, she has shown,

One form of the Rocky Mountain monkey flower has a long trumpet suited to pollination by hummingbirds; the other is pollinated by bumblebees. Their hybrid offspring don't do well in the wild, however, because they are not easily fertilized by the birds or the bees. then act upon the revealed variation, so the mutant organisms best adapted to the new stress become widespread and the beneficial traits they carry become enriched and subsequently fixed in a population.

Lindquist stumbled into evolutionary biology by accident. As a graduate student at Harvard, she began studying the stress, or "heat-shock," response in yeast. "If you take a cell doing one thing," she says, "and expose it to high temperature, it immediately switches on a new set of genes." At the time, biologists didn't understand how cells did this. Eventually, however, they were able to connect what was happening at the level of the gene (a



10 July - August 2008

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