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## Strategic Management Consultants

### TERMINAL CEO DISEASE – A GROWING EPIDEMIC

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Roughly seven years ago, we wrote a tongue-in-cheek monograph entitled “*Terminal CEO Disease*” identifying the symptoms of under-performing, yet remarkably self-serving CEOs. We updated and expanded on the notion of a Terminal CEO Disease (TCD) in 1999 at the height of the stock market and technology booms. Since our last update on the disease, we have witnessed a meltdown in CEO behavior and corporate governance at many companies.

Having watched the sensationalistic coverage of “*rogue CEOs*” over the past year, we thought it would be valuable to cut through the hype and highlight the underlying symptoms that define Terminal CEO Disease. The intent is to highlight symptoms (or warning signs) so that corporate boards and investors can diagnose a problem before it gets out of hand.

The simple truth is that the vast majority of CEOs are ethical, hard working, and accomplished businessmen and women. But, with CEO pay continuing skyward and growing shareholder activism, public company CEOs, in particular, face an unprecedented “*carrot and stick*” environment – tremendous rewards for those who perform well, but swift and public condemnation for underperformance.

#### **WHAT TERMINAL CEO DISEASE IS NOT**

There are two key factors that we have excluded from the list of TCD symptoms. While they are obviously undesirable, we do not think they provide worthwhile warning signs – either because by the time they emerge it is too late or because the behavior is too pervasive to help distinguish the good from the bad.

- First, we need to set aside the symptom that has garnered the most press – criminal behavior. By the time accounting fraud, tax evasion, or other crimes come to light it is obviously too late to prevent it. There are safeguards and an extensive legal system to deal with criminals and this monograph is not going to rehash the stories of accounting fraud – heinous as some of them have been.
- Nor are we going to address greed, although it has certainly been a factor in what has happened over the past few years. Public company CEO compensation has been on an absurd climb unrelated to performance and the compensation consultants – often retained by management – have been stoking the furnace. But, since so many CEOs (the good ones and bad ones) have made a cash grab, it has ceased to be a distinguishable symptom of Terminal CEO Disease.

#### **SYMPTOMS OF TERMINAL CEO DISEASE**

We have identified six symptoms, however, that can enable a board, an investor, or an enlightened senior or middle manager recognize the onset of the disease – before it is too late.

##### **Unabashed Narcissism**

Abraham Zelenick, a psychoanalyst and professor emeritus at Harvard Business School, made an insightful observation in a recent *Business Week* regarding Dennis Kozlowski – disgraced former CEO of Tyco. He believes that Kozlowski suffered from a “*rampant sense of entitlement*. *By entitlement I mean an aspect of a narcissistic personality who comes to believe that he and the institution are one. Thus, he can take what he wants when he wants it.*”

This unabashed narcissism is extraordinarily dangerous for a company. It starts simply enough with the CEO taking care of himself or herself – first and foremost. But, if it is not kept in check, that narcissistic sense of entitlement ultimately can manifest itself in tremendously destructive behavior.

- For Kozlowski, unabashed narcissism manifested itself in many ways.
  - He moved corporate headquarters from Exeter, NH to Manhattan, while attempting to portray Exeter as the “*real headquarters*.”
  - He used the corporate jet to throw a 40<sup>th</sup> birthday party for his wife on a Mediterranean island.

- He donated \$43 million of Tyco funds to his favorite philanthropic causes – often accepting the accolades that accompanied those donations in his own name.
- Ultimately, he went off the deep end and essentially stole \$300 million from the company.
- Lord Conrad Black, Chairman and CEO of Hollinger International (owner of the Chicago Sun-Times, London Daily Register, and Jerusalem Post), has effective voting control of his public company via a super-valued class of shares he owns (Lord Black’s holdings amount to about 30% of the company’s equity).
  - Shareholders charge that Lord Black has channeled over \$300 million over the past five years from Hollinger to entities that he and his lieutenants control.
  - Hollinger also pays Lord Black’s investment management company, Ravelston Group, \$25 million in fees annually. Those fees are channeled directly back to Lord Black’s holding company to cover interest payments on the notes used to secure effective control of Hollinger.
  - Further, Lord Black and other key executives personally pocketed \$73 million in payments for signing non-compete agreements with companies to whom Hollinger sold newspapers between 1999 and 2001. The company received nothing in exchange for these non-compete agreements. Meanwhile, newspaper holdings were sold to a private company owned by Black and his cronies.
  - As Jeffries & Co. analysts put it, *“what investors dislike about (Hollinger International) is that it is a public company being operated by Lord Conrad Black as his private fiefdom.”*
- John Rigas’ case of narcissism ultimately became so pronounced that his CFO son (Tim Rigas) had to put him on a \$1 million per month leash. Again, before the clearly criminal behavior emerged, the warning signs were all there.
  - John Rigas was Coudersport, PA’s civic Santa Claus – he flew symphonies to Coudersport every Christmas to play for the town’s 3,000 residents (using Adelphia funds and planes).
  - He poured \$13 million of Adelphia’s money into a private golf course (although the company was already footing the bill for \$700,000 worth of Rigas family country club memberships).
  - Adelphia maintained three corporate jets – used frequently to fly John and Tim to homes in Cancun, Mexico; Beaver Creek, CO; Hilton Head, SC; and Manhattan.
  - Court papers indicated that the Rigas’ had *“a pattern of using Adelphia’s funds to purchase & maintain their own real estate assets.”* John Rigas did not see a problem in blending his personal investments with the finances of Adelphia – in his own mind he and the company were one.
- Joseph Nacchio of Qwest lived in a hotel in Denver (paid for by Qwest) and flew back to his New Jersey mansion every weekend (at company expense). At some point, a less narcissistic personality might have purchased a residence in the city where his company was headquartered.

This narcissism and sense of entitlement might be understandable coming from a company founder (like John Rigas) or a family long associated with a company. But, there are many examples of founders or families who behave responsibly – Corky Walgreen of Walgreens, Bob and Chris Galvin of Motorola, and many others. On the contrary, unabashed narcissism appears to be an out growth of unrestrained CEO hubris.

### **Monuments to One’s Self**

A corollary to CEO narcissism and hubris is the need among some to erect monuments to themselves. Often this takes the form of building a grand new corporate headquarters designed by a world-renowned architect – for instance, HALO CEO John R. Kelley, Jr.’s Helmut Jahn designed headquarters outside Chicago. The building ended up being the visible symbol of the company’s failure and bankruptcy – the proverbial straw that broke the camel’s back.

But, for sheer self-indulgence nothing beats a building bearing your name at the old alma mater.

- Sotheby’s price fixing CEO Alfred Taubman endowed Harvard’s *“Taubman Center for State and Local Government.”* The building includes an ethics center – who says irony is dead?
- Kozlowski endowed *“Kozlowski Hall”* – the home of Seton Hall University’s business school.
- Kenneth Lay of Enron endowed a number of chairs – all bearing his name – at Missouri, Houston, and Rice.

We certainly are not opposed to charity or supporting your alma mater – heck, my partner John Smock serves on Villanova’s Alumni Board. And, some very good CEOs have chosen to unselfishly give back to their alma mater – eBay’s CEO Meg Whitman’s strong support of Princeton is a case in point. But, when the CEO starts building monuments to him or herself Terminal CEO Disease is setting in.

## Hypocritical Piety

Without question there are CEOs who have deeply held religious beliefs. No one questions Jonathan Ward's (or Bill Pollard's before him) commitment to ServiceMaster's four objectives – to honor God in all we do; to help people develop; to pursue excellence; and to grow profitably. But, too many pious CEOs turn out to be as hypocritical as Jim and Tammy Faye Baker or William Bennett.

- WorldCom CEO Bernie Ebbers opened every meeting with a prayer – and immediately followed that with a short brainstorming process on “*how to get the stock price up.*” Prayer evidently did not dissuade him from committing accounting fraud, but making sure the stock price did go up was a prime factor in the fraud.
- The Rigas' were Olympic caliber hypocrites – running ads with the tag line “*cable theft is a crime,*” while stealing hundreds of millions of dollars from the company. And, on many acquired cable systems the Rigas' eliminated Playboy Channel and the like in order to protect the moral standards of the community. John Rigas went so far as to personally censor selected local public access cable shows.

Like politicians who proclaim their piety only to grossly disappoint their constituents later, be on guard for publicly pious CEOs. It may be real, or it may be hypocrisy covering up a grave character flaw.

## Nattering Nabobs of Nepotism

We have nothing against nepotism per se. Family businesses – passed from generation to generation – have been the engine of the American economy for at least a half-century. Furthermore, nepotism has led to some cases of truly exceptional CEO performance – when blended with a genuine meritocracy. Jim Collin's book *Good to Great* presents ample evidence in the form of Corky Walgreen at Walgreen's and George Cain at Abbott.

The real problem with nepotism is when it leads to (or is accompanied by) self-dealing. For instance:

- Sam Waksal of ImClone pled guilty to insider trading charges – in part brought on by his tipping off his daughter to the coming announcement that a key drug was not going to gain FDA approval.
- Then there are those zany Rigas' again! A father and his two sons ran completely amok with self-enriching deals all while running up unsustainable debt in publicly held Adelphia.
- Charles and James Dolan, father/chairman and son/CEO respectively of Cablevision, gorged their company on acquisitions creating \$7 billion of debt in a company with \$4 billion in revenues – evidently trying to prove that they could compete on a level playing field with the Rigas family.

Further research demonstrates that self-dealing and nepotism also strike at the next level down in corporations.

## Shady CFOs and/or Seconds-in-Command

Like the caped crusader, every dirty CEO needs a sidekick. And the public record is littered with shady sidekicks. Terminal CEO Disease may be an addictive psychosis – to which others serve as enabling co-dependents.

- Hollinger's Lord Black has a cadre of sidekicks who have been enriched by self-dealing activities involving the public company (e.g., low-ball sales of newspaper properties, rich non-compete agreements, consulting fees, etc.).
- Tyco's Kozlowski had CFO Mark Swartz to help him “*borrow*” \$300 million from the company.
- Enron's Lay and Jeff Skilling had CFO Andrew Fastow – who took the further step of cutting his friends, family and political allies in on the riches flowing from Enron's self-dealing “*special purpose entities*” (the off-balance-sheet companies used to hide over \$2 billion in debt).
- Bernie Ebbers of WorldCom had the very shady Scott Sullivan as his CFO.

This list could go on and on without even mentioning multiple co-dependent in-house general counsel and the complicit outside sycophants otherwise known as consultants, lawyers, and auditors. Perhaps the most staggering thing to realize is that these shady sidekicks were incredibly good at what they did – both Fastow and Sullivan were named CFO of the Year (by *CFO Magazine*) before the collapse of their respective companies.

## Cashing Out

The final symptom – and one that should surely be a warning sign for boards and investors – is the uncanny ability of some CEOs to cash out at just the right moment. Fortune magazine found that executives and directors at companies that lost at least 75% of their value **sold over \$66 billion in stock** in their own companies – at the top of the market. Frankly, if your CEO is selling his or her own stock “*to diversify his holdings,*” grab your wallet.

- Oracle CEO Larry Ellison exercised 22 million options in January 2001 for a gain of \$706 million and promptly sold 29 million shares on the open market. Within six weeks Oracle announced it would miss analysts' estimates and its stock tanked.
- Philip Anschutz, Chairman of Qwest Communications, unloaded billions of dollars of Qwest stock shortly before accounting improprieties came to light. Likewise, Qwest CEO Joseph Nacchio sold nearly \$250 million in stock just before the collapse.
- Steve Case, Chairman of AOL Time Warner, sold \$475 million of stock at the peak of the company's stock price – since then accounting improprieties have come to light and the stock is down over 75%.
- Global Crossing's Chairman, Gary Winnick, sold over \$700 million in stock – the company is now bankrupt and shareholders have lost everything.
- Peregrine Systems' Chairman, John Moore, sold \$646 million worth of his company's stock – shortly thereafter accounting problems came to light.

Undoubtedly, there is a special place reserved in hell for the CEO who cashes in weeks or months before divulging bad news to Wall Street – while it is perfectly legal, is it the right thing to do?

### **ANTIDOTES AND SOLUTIONS**

The antidotes and solutions to the Terminal CEO Disease remain largely the same as they were in 1999. This disease can be stopped or avoided – but, the primary responsibility remains with governing boards of directors – if they do not act, they become complicit. There are some clear antidotes and solutions.

#### **Start the CEO Search from Within**

The rise of celebrity CEO's and the accompanying escalation of CEO compensation are a byproduct of boards' tendency to look outside the company for new CEOs. But, as was amply demonstrated in Jim Collin's *Good to Great* research, so-called "level five leaders" (the best leaders) tend to come from within – in fact, "Chain Saw" Al Dunlap (in our TCD Hall of Fame) is as far away from Collins' level five as you can get. Boards must take stock of this lesson and begin (and, preferably, complete) their search for the new CEO from within.

#### **Align CEO Pay with the Interests of Shareholders and Employees**

Boards of Directors must also step up and truly link CEO compensation to corporate performance (another reason to avoid celebrity CEOs who negotiate – up front – a feathering of their own nest, unrelated to performance). Options are not the answer – particularly if the strike price is adjusted with every downturn. And, boards have to stop chasing ever rising average compensation targets.

#### **Involve People in the CEO's Vision and Strategy**

The key to rebuilding trust – between boards and their CEOs and between CEOs and their employees – is to involve people in the vision and strategy. There are many benefits to having the board and workforce involved and ultimately bought into the strategy. Implementation and execution improve, monitoring and accountability become easier, and the corporation becomes more nimble and ready to adapt to changing market conditions.

#### **Hold the CEO Accountable for Bad Results and Bad Events**

It would appear that accountability is on the rise. Booz Allen Hamilton's survey of the world's 2,500 largest publicly held companies found that 253 CEOs left their companies in 2002 – a 10 percent increase over 2001. Nearly 100 of those changes resulted from the CEO being forced out – a 70 percent increase over 2001.

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Smock•Sterling Strategic Management Consultants' vision is to "become known as the best strategic management and planning firm in the U.S." We have served companies across a broad range of industries since our founding in 1991.

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