# Best Strategy

## Consultants Can Help You Make the Right Move

*Introduction By* JIM BRADFORD

Independent advice, not biased by circumstance or position, is hard to come by, and the CEO or board or owner who finds consistent wisdom in the advice of a consultant has found a rare jewel.

*Photography By* DANIEL DUBOIS

*The need to take decisive action to* **IMPROVE** *or* **MAXIMIZE** *business* **PERFORMANCE** *is germane in every economic cycle.*

IN THIS SPECIAL SECTION, THE READER will find insight into consulting from leading consulting firms[1] in North America, many with world wide practices.

Some common themes play out in these pages: (1) the belief that external consulting continues to add unique value to the business landscape; and (2) consulting offers independence and breeds objectivity, which many companies lack. This objectivity is especially useful in these times of Sarbanes-Oxley and scandal. Consultants offer other benefits including (a) expertise of subject matter or industry, (b) the ability to grade or benchmark process, product, or practice with other industry participants, and (c) human resources and knowledge to examine alternatives, organize and evaluate data, and draw logical conclusions or sift through a myriad of choices. Although not discussed, consultants also often provide the board of directors or governing authority the exact data and conclusions that company management could have provided[2]. The value of the consultant is often in this last role: to add a degree of authenticity, which management is deemed not to have because of the obvious conflict of interest that management possesses from its position of status quo.

Consultants are often criticized for the temporal nature of their advice, which arises from the brevity of their employment. They are maligned for the fact that they often use management's knowledge and company data to project alternatives, applying their own judgment and experience when recommending choices to the problems identified. This criticism, while common, is often unfounded. They are not often employed to implement their own recommendations. Engagements are typically designed to identify choices and perhaps to recommend best solutions but rarely to bring solutions to fruition.

The insights presented here also lead to the conclusion that excellent consulting is based upon longstanding relationships and achieved results. This is a business of understanding your customers' needs and bringing the brightest and best talent to the problem at hand. It is a business with high burn rates at entrance level and long-standing relationships at the top. CEOs need good advice—advice that is often not available from their boards of directors. Boards often need legal and ethical advice—independent advice not colored by the personal gain or loss that a CEO might suffer from a selected course of action. Independent advice, not biased by circumstance or position, is hard to come by, and the CEO or board or owner who finds consistent wisdom in the advice of a consultant has found a rare jewel. Upon such wisdom and integrity, the consulting world was built. Maintaining this tradition, adding value to the clients' businesses, and bringing workable solutions at a reasonable cost are the challenges facing the industry today.

New developments have occurred in the consulting world over the past five years. First, it is more competitive. A decade ago, McKinsey, BCG, Accenture, Deloitte, and PWC dominated the market. Now, many large and small firms compete for leadership[3]. Like other industries, consulting has experienced the outsourcing and off shore relocation of portions of its work to lower cost centers. Evidence exists that consultants may now be competing on price, an unwelcome turn of events from the consultants' viewpoint, brought on by increased capacity of the consulting universe, the recent recession, and lack of merger and acquisition activity (a frequent user of consultant talent). And the capacity expansion has not limited itself to external firms. Many major corporations have created internal consulting departments to perform the very duties outside consultants previously held exclusive. While such internal departments lack independency in drafting opinions for the board or external use by the company, their existence has eaten into the traditional role of consultants. The consulting industry also will likely face consolidation as it struggles with overcapacity. It will be interesting to watch whether consultants are able to apply their own advice, to differentiate and find new strategies, and to compete other than on price.

Despite these recent events, consulting remains a popular area of interest[4]. With the recent rise in GDP, the projected coming growth, the governance and compliance changes, the world supply chain issues, and the margin compression taking place in many traditional segments of the North American economy, consulting will remain an attractive area of practice for MBA graduates.

JIM BRADFORD *is acting dean of the Owen School.*

1. *McKinsey declined to participate as a matter of public policy, seeking not to draw attention to the firm .*
2. *The consultants' value in these circumstances is their independence and wisdom from handling many similar cases.*
3. *The combination of IBM and PWC consulting has created a new and powerful force in consulting.*
4. *Approximately 30 percent of entering MBA students express an interest in consulting.*

## A MASTER STRATEGIST

THE LATE BRUCE HENDERSON, a 1937 Vanderbilt engineering graduate and founder of The Boston Consulting Group, helped to set the course for the Graduate School of Management, defining his notion of a good new business program in a series of letters in 1967 to Chancellor Alexander Heard.

Vanderbilt knew his advice would be valuable. Under Henderson's leadership, BCG's thinking about the way costs vary over time (the experience curve) and the allocation of investments (the growth/share matrix) rejuvenated the concept of strategic management, so much so that *Financial Times* credited BCG with "inventing corporate strategy," and the *Economist* once labeled them the "most cerebral" of management consultants, according to one BCG executive.

So it was not unusual that when Henderson retired from the company and returned to Nashville, that Dean Sam Richmond suggested that he spend a few months as an executive in residence at the school then known as Owen. If all went well, he might then consider becoming a professor. So at age 68, Henderson returned to his alma mater to teach business policy to graduate students.

At BCG, Henderson had the reputation of being a brilliant thinker, but of not being easy to keep up with in conversation or argument. Vanderbilt students apparently saw him in the same way. His widow Bess recalls that years after students had taken his class, "he'd receive letters saying, 'Dear Professor Henderson, when I was in your class and you talked about such and such, I didn't have a clue what you were talking about. Let me explain my problem of today and how I know now what you were talking about, really and truly.' And that made him so happy."

# Turnaround Leadership

## Improved business performance needed in good times and bad

RECENT YEARS HAVE BROUGHT A wake-up call to corporate management and yielded numerous lessons. First is the need for early recognition and admission of problems before they become crises. Management must encourage a culture that enables others to come forward and identify problems. Overly optimistic scenarios and unrealistic assumptions only defer trouble and can squander precious time and resources. Issues must be met head-on, and management sometimes must augment their capabilities with experienced outside advisors.

While these lessons derive from troubled times, the need to take decisive action to improve or maximize business performance is germane in every economic cycle. Companies should avoid the temptation to use an economic up tick to divert focus from addressing underlying operational issues. Facing and correcting such issues proactively will position the company to prosper in good times and in bad.

In times of crisis, turnaround professionals work directly with company management to stabilize operations, address liquidity concerns, develop business plans, execute asset sales, provide ongoing communications with key constituencies, and position the company for successful financial or operational restructuring. They sometimes assume such interim management positions as chief restructuring officer, chief financial officer, or chief executive officer to provide crucial stability and guidance to clients, customers, creditors, and employees. Placing outside professionals in such roles can add valuable support to the turnaround process, reduce the time necessary for implementing turnaround initiatives, and mitigate the impact on employees.

*Today, most problems* **DEMAND** *greater nimbleness and robust combinations of business* **INSIGHT** *and* **TECHNICAL EXPERTISE**, *calling for smaller, but more potent engagement teams.*

Turnaround professionals also bring a sense of urgency to the situation and develop action-based initiatives and provide hands-on assistance in assuring prompt execution, rather than simply offering advice that may never be implemented.

—William Runge,
*managing director, Atlanta Office, Alvarez & Marsal*

## Power of Specialization

### Specialists can apply specific knowledge quickly for bottom line results

The economic slowdown and ever-increasing client demands for bottom line results has shifted some client demand from large consulting firms to smaller, more specialized firms.

Issues in financial services, for example, are increasingly complex. Decisions that confront large financial service companies today usually involve budgets of hundreds of millions or even billions of dollars, thousands of employees, and millions of customers. Clients have little desire for consultants who must be brought up to speed on their industry, but expect consultants to be able to apply specific knowledge immediately. Clients increasingly demand thoughtful and actionable ideas, since quarterly earnings pressures drive most organizations.

Specialist firms may find their greatest strength is in their ability to provide thought leadership and innovation. The specialist firm can draw on its extensive experience and contacts to flesh out key implications from the trends it sees on the horizon.

Long-term collaborative relationships allow the consultant to add ever more value to the situation. If the client is satisfied with the consultant's solution (i.e., it took into account the client's issues, identified the best plan in the agreed-upon time, set the stage for implementing the solution, and advanced the client's thinking on critical issues), then there is a high probability of a return engagement. Satisfied clients often ask members of the consulting team to assist during implementation phases.

—Gordon Goetzmann,
*senior partner, First Manhattan Consulting Group*

## Consulting Transformed

### Scandals/business challenges reshape demand for service

The current transformation in consulting is driven by a basic economic principle: A major shift in demand will trigger substantial responses in supply.

Two developments have significantly reshaped the demand for business advisory services. First, the corporate scandals resulted in increased emphasis on corporate governance and spurred Sarbanes-Oxley, which bans accounting firms from doing most consulting work for their audit clients.

Second, the nature of business challenges has changed. During the previous economic expansion, many tough issues involved large-scale projects requiring significant "horsepower" and large consulting teams. Today, most problems demand greater nimbleness and robust combinations of business insight and technical expertise. This calls for smaller—but more potent—engagement teams that can quickly bring together top-notch talent and deliver authentic and quantifiable results.

These developments have reverberated throughout the supply side of the consulting community causing decreased hiring or even significant lay-offs at many large firms and spawning new consulting firms. Many Big Four accounting firms have separated or significantly altered their consulting operations as increased Sarbox scrutiny has caused company managers and boards to look beyond their audit firms and turn to independent consulting companies to assist them with complex issues.

There is also a market today for forensic accounting, data discovery, and investigative capabilities, stemming in part from increased demand from management and boards for help in more closely scrutinizing business operations. These "investigative" skills can also be used to pinpoint a correct source of information and in creating analyses necessary to shed light on critical questions facing companies in today's business environment.

—Shandy Husmann, E'98,
*managing director, Huron Consulting Group*

## Better Productivity

### Ergonomics, or better workplace design, brings real ROI's

For two decades, North American manufacturers have leaned out their operations in the name of cost reduction. To stay competitive with offshore labor costs, companies have relentlessly driven out waste and variation with Lean Manufacturing and Six Sigma strategies. Through ergonomics, or better workplace design, companies can build on these processes and achieve double digit improvements in productivity with little or no capital investment.

Ergonomics enables companies to utilize systematic and simple tools to optimize human performance, producing measurable gains such as the $1.2 million per year in productivity and quality improvements realized at Lucent Technologies. Companies find that ergonomics can be an engineering-driven, manufacturing improvement initiative with impressive ROIs, rather than a costly health and safety activity.

Ergonomics has a good future in the next few years with the confluence of two trends: manufacturing activity and capital expenditures returning to more historic levels, and ergonomics maturing as a recognized business improvement process.

—Jeffrey Smagacz,
*director, Humantech*

## STRATEGY COURSES ALLOW STUDENTS REAL CONSULTING EXPERIENCE

Owen students taking the strategy concentration have successfully completed projects for Fortune 500 companies and even a few Fortune 20 businesses.

"We've gotten very good reviews back from the companies," says Acting Dean Jim Bradford. "The attraction for the students is that they get to work on real problems, but the other positive is that it sometimes results in jobs for those students."

Strategy is the newest concentration at Owen, being added to the curriculum in 2001. It equips students with the core concepts and techniques of strategic management, defined as managing an enterprise to achieve superior performance. Bradford says about 30 to 40 percent of each entering class chooses the concentration, usually pairing it with another discipline for a double concentration.

All students, regardless of concentration, are required to complete a major project and deliver a paper and power point presentation to senior administration. The project does not have to be strategy related, particularly for those taking a different concentration, but most have a strategic positioning component.

"Strategy is also a key element in the Executive MBA program," says Martin Rapisarda, associate dean for Executive Programs. Strategic management is introduced in the third semester of the EMBA program, when the class focuses on a case, a case analysis memo, and student teams are required to deliver an in-class presentation. The next semester involves a business strategy project, where each group analyzes and consults for a business. During the semester, the group meets with the company's executive team, assesses the company's internal strengths, and weighs its competition and potential. The course culminates in a formal consultancy report, often 40 to 50 pages in length, as well as a presentation to the faculty and the company's executive team.

Faculty members teaching strategy or strategy-related courses include Gary Scudder, David Parsley, Mark Cohen, Mike Shor, David Scheffman, visiting professor Myeong Cho, Toshiaki Izuka, Luke Froeb, and Bradford.

—Lew Harris

*Most* **CONSULTING PROJECTS** *done by strategy firms for high-profile failures were probably* **SUCCESSFUL**—*as projects.*

# Competitive Advantage

## Transformational, rather than incremental, change needed

CONSULTANTS NEED TO BE AWARE OF and responsive to a number of developments in the corporate landscape: an increased emphasis on values—especially those having to do with business and personal integrity, a backlash against conflicts of interest of all kinds, a corresponding rise in the value of objectivity, and a greater desire for accountability.

A central issue is competitive advantage versus incremental improvement. Most consulting projects done by strategy firms for high-profile failures were probably successful—as projects. Each may have achieved the incremental improvement that the client sought and the consultant promised. But over the years, the projects collectively failed to move the needle on competitive advantage. This is a disaster for the client—and, though seemingly profitable year-in and year-out—a brand-destroying trap for the consultant. More fundamentally, it is morally indefensible. Any consulting firm taking mega-fees from a client over a number of years had better well help that client achieve real transformational change.

Most CEOs are looking beyond this current period to discover how to shape their companies for the next five-to-ten years. Helping clients achieve transformational change requires staying at the forefront of new ideas. Keeping creativity and insight high requires recruiting and retaining smart, motivated, curious people from a variety of backgrounds. For best results, consulting firms should use mixed project teams composed of some people with finely honed intuitions from experience and others with highly developed analytical skills but too little experience to know what cannot be done.

—TED BUSWICK,
*special projects, Marketing and Communications, The Boston Consulting Group*

# Teaching from Experience

## Veteran business executives provide focus and perspective

BUSINESSES TODAY FACE COMPLEX issues at every turn and often desire an objective, third-party perspective. This complexity also leads to the need for extra band-width on the senior leadership level during certain periods.

Consulting firms composed of business executives who have served "in the trenches," with experience in all aspects of business operations, can offer their expertise to emerging companies, businesses in transition, or organizations needing strategic advice.

Such firms may consult with private and publicly owned business of all sizes. Project lengths vary, depending on clients' needs. Broad corporate issues sometimes require an ongoing, advisory relationship. But clients sometimes simply need additional leadership on a short-term project or a quick assessment and improvement plan. Short-term clients can become long-term, however, when they realize the benefits of the consulting firm's fresh perspective to their business.

Principals can occasionally become interwoven in their client's organization, sometimes serving in an interim management role and helping to make hands-on, strategic decisions. With today's cost containment focus, organizations can utilize these firms to supplement their leadership team and to help lead critical initiatives, providing focus and ensuring success.

—LAVONA RUSSELL, A'72,
*principal, Nashville Management Group*

# High Performance

## Great companies balance present and future agendas

WHAT DRIVES GREAT COMPANIES? IN an environment of unprecedented complexity, traditional explanations are no longer adequate, nor does the e-revolution point of view provide an adequate basis for understanding business today.

Powerful, interconnected trends, such as increased volatility, resurgent geopolitics, and increased organizational scale and complexity have created a new era for global business: an environment of fluid market and industry boundaries; shifting regional risk and opportunity; rapidly changing formulas for economic value; disparate economic shocks; and geometrically increased decision variables.

In this environment, characteristics of high performance need to be redefined in the context of specific industries and time-frames if they are to be practical and helpful. Consultants can help companies understand and develop features common to most high performance companies:

- Insight to discern important industry drivers of present and future value.
- Ability to translate their unique insights into differentiated operating models and business architectures.
- Understanding of which of their core competencies are critical to driving current and future value.
- Not obsessed with "made here," and outsource or seek alliances and partnership opportunities.
- Ability to anticipate and shape changes in customer values, accelerate insight to action, unleash the organization's energies and collective capabilities, and manage for both the present and the future.

The presence of all five features explains one of these companies' common capabilities: balancing present and future agendas.

—TIM BREENE,
*chief strategy officer, Accenture*

## STRATEGY: FUN AND GAMES FOR TOYS Я US

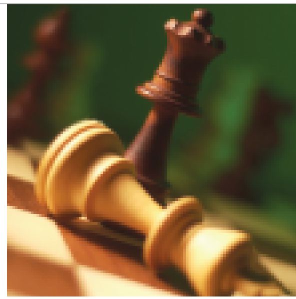
WHEN JOHN EYLER BECAME CEO OF TOYS R US IN 2000, he inherited a company in distress. The company, started in 1957 and dominating the toy market for more than three decades, hit a snag in the 1990s: Having reached a critical mass of big stores, it started building smaller stores in less desirable locations and faced new competition from discounters Walmart, Kmart, and Target. From 1993 to 1999, Toys R Us lost market share every year. In addition, the firm propped up its profitability by not reinvesting in its systems or stores, and by 1999, it was on a five-year slide in profitability as well.

"By 2000, the company figured out that our brilliant strategy dominating the business for so long was not viable against the current competitive set," said Eyler in his talk as Distinguished Speaker at Owen last year. "We needed to redefine the business or we wouldn't have a business."

To regain their position, Toys R Us decided to concentrate on having the right content, the right store environment, the right service, a reasonable pricing proposition, and to communicate their story to the public.

Eyler said strategic decisions included developing more exclusive product and becoming the venue where almost every new toy is launched; renovating the stores; increasing training and knowledge of sales personnel; creating their "low price superstars" program, which matches discounters' prices on certain items; and starting a new advertising campaign, starring Geoffrey the talking giraffe, voted the most successful television campaign in 2002.

"We have more heavy lifting on the infrastructure side and more supply chain work to do, and we are consolidating our services," he added. Total sales for the fourth quarter of 2003 were $4.94 billion, up 1.4 percent from $4.87 billion for the fourth quarter of 2002. This past February, the company announced the planned closing of its freestanding Kids R Us and Imaginarium Stores. —BETH MATTER



*Partnering* **OFFERS** *a company the* **POWER** *to win with a world-class team. Successful* **ALLIANCES** *share common features.*

# Strategic Partnering

## The right partnership can determine success or failure

THE ABILITY TO DEVELOP AND NURTURE strategic partnerships can make the difference between success and failure in the high-tech industry. Just ask independent software vendors, a segment of the industry that earns more than 40 percent of its revenue through successful partnering. ISVs have created an "ecosystem" of partners that opens up new opportunities and revenue streams for them.

The pace of innovation today is too fast for any one IT company to be all things to all customers. Last year alone, the U.S. patent office awarded more than 16,000 patents to the top 10 global high-tech companies. Even a brief look at the industry's history reveals a graveyard of once successful companies that failed to adapt fast enough to industry changes. Despite its long record of success, IBM suffered a near-death experience in the early '90s. New leadership and a new strategy were instrumental in engineering IBM's turnaround, and so was the power of its alliances with more than 90,000 business partners.

Partnering offers a company the power to win with a world-class team. How can you develop relationships with partners to increase your competitiveness and win in the marketplace? Five factors lead to successful alliances:

1. Make the strategic decision to partner at the highest executive level, and secure buy-in from all levels of employees, especially those who interact directly with customers.

2. To determine if a potential partnership is the right match, share your business strategy, learn each other's core competencies, and check synergy in goals, technology, and target markets.

3. Remember that an alliance is a formal business agreement, not just a hand shake over lunch. Get a contract in writing to avoid misunderstanding, build in rigorous commitments on both sides, and have clear measurements for those commitments.

4. Be clear that you may still compete with a partner in some areas, while collaborating in others. Your business strategy will determine when you partner and when you compete.

5. The most common reason for alliances to fail is neglect. Both partners need to put in the time and resources to make the relationship work. Partnerships need to evolve with market conditions and be flexible enough to be transformed when necessary. But if both partners decide it makes business sense to exit, then a well-executed exit plan can save time, capital, and human resources.

—BUELL DUNCAN, A'75,
*general manager, IBM Developer Relations, Software Group*

# Game Theory: Win, Lose or Draw

*By* MIKE SHOR

IT IS DIFFICULT, WHEN ASKED, TO explain the courses I teach. Most people understand what a course in finance, accounting, or negotiation entails. But my response, "I teach game theory," usually results in a quizzical look and queries into whether that is a class on beating the casino or helping MBAs hone their reflexes for Nintendo.

Game theory might be more aptly called multi-player decision theory, because it involves situations in which profits of firms are intertwined. Business decisions traditionally are made by examining corporate internals, crunching numbers, and assuming that competitors will do tomorrow more or less what they did today. Yet, while we decide how to react to our competition, game theory directs us to consider that our competition is simultaneously trying to react to us. What is our best course of action given that our competitors are deciding on their best course of action, which depends on our likely actions, which are linked to theirs … ? Game theory provides an order to this infinite regress.

Game theory emerged with the onset of the Cold War. In that climate, the pastime was undertaken with a sober task: prevent nuclear war between the superpowers. Game theorists noted that the traditional goal of "parity"—having the same number of missiles as your adversary—is irrelevant to long-term stability. What matters is having sufficient stores to assure the enemy's defeat, even if he attacks first. Any less (parity or not) encourages a first strike by the enemy. Any more is (ahem) overkill. If each side has sufficient weapons to respond effectively, then there are only two possible paths for each side to consider: no attack or mutually assured destruction. The incentive to attack is eliminated, leading to long-term stability. When the game is nuclear war, stalemate is the "winning" strategy.

Businesses also wish to avoid detrimental battles. Consider price wars. If a firm thinks it can win by capturing greater revenues through customer acquisition, there is incentive to attack by slashing prices. How can retailers achieve stalemate? One way is through price-matching—offering customers the lowest price advertised by a competitor. Marketing professionals note this appeals to consumers psychologically by signaling lower prices. Yet, empirical evidence suggests industry-wide price increases follow such implementation. Game theory provides an explanation.

Each firm in effect is empowered to select industry-wide prices, eliminating the need to undercut competitors' prices. Lower prices no longer imply greater sales, since customers can still patronize their favored establishment but demand the lowest advertised price. Prior to price matching, a lower price resulted in more customers and thus higher profits—a price war was winnable, so there was an incentive to fight it. With price matching, however, reductions are automatically matched by others. There are only two outcomes available to a firm: keep prices high, or lower prices and margins industry-wide. A price war is no longer winnable. Stalemate.

Game theory suggests that we also need to consider how our actions create and alter incentive structures for others. The airline industry provides a cautionary example. Concerned with child safety, regulators urged airlines to discontinue their policy allowing small children to sit in parents' laps. The added cost of purchasing a separate seat made many parents opt to drive to travel destinations. But since the incidence of auto accidents is much greater than air travel accidents, the number of child injuries actually increased as a result of the precaution.

Unintended consequences in corporations can also be caused by ignoring personal incentives. Reward managers based on market share and watch profits tumble as managers give away the farm. Reward managers based on year-over-year growth, and unsuccessful years are further sabotaged to make the baseline for next year's growth more favorable. Base rewards on year-end benchmarks and watch efforts decline six months into the fiscal year as managers discover that targets are either unattainable or a sure thing.

Game theory is less a discipline and more of a way of thinking that forces a continual reassessment of how others—competitors, suppliers, customers, or other market participants—see us. Students of game theory do not inherit a toolbox of tricks but instead learn to recognize strategic incentives, responses, and counter-responses in everything from business to sports, from card games to movies, from politics to life.

MIKE SHOR *is an assistant professor of economics at the Owen School.*

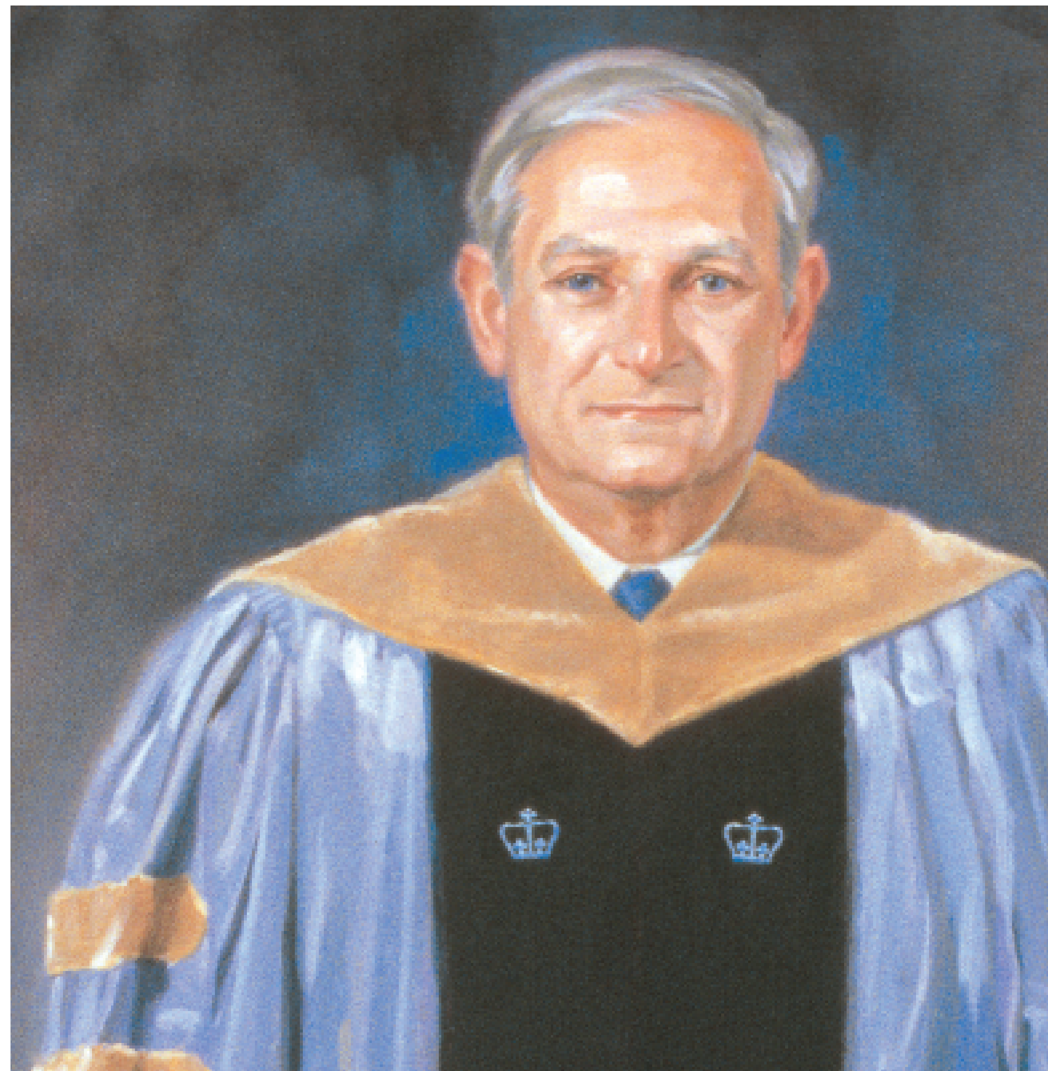
### GAME THEORY

GAME THEORY CAN BE APPLIED to everything from professional sports to evolutionary biology. Visit Mike Shor's Web site, http://www.gametheory.net/, to discover what large advertising budgets, *The Hunt for Red October*, and the color of a sparrow's egg have in common.

# Sam Richmond: The Man and His Mission

*Dean Richmond is best remembered for transforming the Owen School from a small regional school of business into one of the nation's best.*

*The portrait of the man with the incredibly lifelike blue eyes hangs mid-point in the lobby, a perfect vantage point for the man who is responsible for building Management Hall and the reputation of the Owen School.*



SAMUEL B. RICHMOND LEFT A distinguished teaching and research career at Columbia University in 1976 to move to Vanderbilt, where he transformed the Owen School from a small regional school of business into one of the nation's best. It is this achievement, among many others, for which the dean emeritus will be best remembered. He died in December 2003 at the age of 84.

"Dean Richmond is truly the rock upon which this business school was built," says former Dean Bill Christie. "At great professional risk, he assumed leadership of this school and, after 10 years of perseverance and ingenuity, created a world-class institution. Every alum owes him a deep sense of gratitude, and he will be missed by us all."

"Sam was an extraordinarily positive influence on the business school," says Chancellor Emeritus Alexander Heard, who hired him. "He demonstrated originality in his leadership and was innovative in the program development of the School."

"His was first and foremost an extraordinary teacher, but his equally important legacy is as a builder and steward of one of the great business schools in the country," adds Chancellor Gordon Gee, who first met Richmond when he was a law student at Columbia. "Vanderbilt and Owen were forever changed by Sam's leadership, and his accomplishments will be felt for generations to come."

Richmond was a professor of economics and statistics at Columbia when Heard and a group of influential Nashville business leaders persuaded him to become dean of the school now known as Owen. During a 31-year tenure at Columbia, including service as acting dean of its Graduate School of Business in 1972-73, Richmond built a reputation as a passionate and enthusiastic teacher, a distinguished scholar, an expert on air transportation, and a respected authority on management issues.

He was a much sought-after management consultant to numerous national and international corporations and government agencies including Eastern Airlines, El-Al Airlines, Coca-Cola, General Motors, Pillsbury, DuPont, the U.S. Secret Service, the Civil Aeronautics Board, and the U.S. Department of Agriculture.

It was the challenge of building and running a program of his own with the strong support of the University and the local business community that attracted him to Vanderbilt and what he would later call the "crowning achievement" of his career. "I didn't know about the joys of building something, of setting something up and making it run," he said in an interview in the September 1982 issue of Nashville's *Advantage* magazine. "I was a professor. I was studying, teaching, writing books. I never thought of myself as a manager or entrepreneur. Suddenly I found myself thrust into that position and loved it."

From the beginning, he had specific goals for the School. On a blackboard in his office, he wrote his first four goals: curriculum, faculty, students, and building. Through the years, he added more goals, and crossed off each as it was achieved.

During the 10 years he was dean, the student body grew from 80 students to 400, the faculty increased from seven to 40, and the curriculum was transformed from one emphasizing a behavorial approach to management to one based on strong core courses that relied on proven educational methods. It remains the course of study used today in the School's MBA program.

**Sam and Evelyn Richmond**

He accomplished the fourth of his original goals in 1982 when the School moved into its current $6 million building, for which Richmond had worked tirelessly to raise money and whose construction he had overseen diligently. Instrumental in that fund-raising effort was the support of Nashville executive Ralph (Peck) Owen and his wife, Lulu Hampton Owen. The School was named for the Owens in 1977. Over the years, the couple donated approximately $60 million to Vanderbilt for the School, including in 1996 a $33.5 million bequest, at the time the largest-ever gift to an American business school.

As dean, Richmond also established the Executive MBA program to afford persons in mid-career the opportunity to earn their MBA while continuing in their jobs, and he guided the School through the complex and often trying process of achieving accreditation from the American Association of Collegiate Schools of Business.

Hans Stoll, Anne Marie and Thomas B. Walker Jr. Professor of Finance, was one of the faculty that Richmond brought on board to strengthen the School. Stoll, who was recruited in 1980 from the University of Pennsylvania's Wharton School, said, "When recruiting me, he made Owen sound like the greatest place in the world—at the time the School only had 80 people and was still housed in a funeral home. But it was the greatest place, because he made it the greatest place. He set the course for the School that we still follow today. He made the case for a first rate business school; he had a vision that was clear; he was able to articulate it, and people followed him."

In a January 27, 1983 article in the *Tennessean*, Richmond shared his approach to business education. "My philosophy is that business schools should lead the business community, not follow it. Current practice in the business com-

*Continued on page 64*

# TRADING PLACES

## First David Scheffman, Then Luke Froeb Bring Economics Heft to the FTC

*By* CHARLES CONTE

Last fall, the new director of the Federal Trade Commission's Bureau of Economics was set to speak at the Owen Finance Conference, after MCI's new chairman and CEO, Michael Capellas.

The director, and Owen professor for the past 10 years, Luke Froeb, stepped to the podium in the wake of the conference keynoter, who was guiding MCI out of the largest bankruptcy claim in U.S. history. "I knew he was going to be a tough act to follow," says Froeb. "I looked out at the audience, and said: 'Michael Capellas has it easy. Let me tell you about a real management problem….'"

Froeb took off from there, asking his audience to imagine what it's like trying to manage an organization where, he says, "there are no sticks and no carrots, where everybody has lifetime tenure and very strong ideas about what the organization should be doing, and not all of those ideas correspond to my ideas about what the organization should be doing. How do you manage in this environment?"

After a long pause, Froeb continued, "I am a government bureaucrat. Welcome to my world." The flatness of this statement had its intended effect, even as Froeb went on to explain that the bureaucracy he heads is made up of highly trained and dedicated colleagues who, each in his or her own way, want to see the FTC fulfill its mission.

Froeb's colleague at the Owen School David T. Scheffman had some sage advice for his friend when Froeb succeeded him in the directorship in August. As the twice-former director of the Bureau (July 1986 to September 1988 and June 2001 to August 2003), and as the man who advanced Froeb's name with the FTC chairman for the position, Scheffman was certainly in a position to offer words of wisdom: "I told Luke, 'You taught the economics of organization management for years, but you have little idea what dealing with the specifics of real management issues is like.'"

Scheffman admits a fondness for "overstating the case." But with a similar fondness for overstatement, Froeb adds: "There's a certain irony in the fact that after teaching management for 10 years, I am finding out that I had a lot to learn about actual management in actual organizations." Still, it's doubtful that any sort of "training" could have prepared Froeb for the job of managing the Bureau of Economics. He explains: "The Bureau has about 110 people, 75 of whom are Ph.D. economists—essentially an energetic, motivated group of my peers. Unless you come in with a strong agenda, you will quickly lose the initiative."

So you have to "manage." Even if that means managing with a small "m," as Scheffman says. "You set some goals," says Froeb, "and make people accountable. You get them in the office once a week and ask what they have done to further your goals. No sticks, no carrots. But everybody here wants to do the right thing."

The experience at the Bureau is quite different from the experience at Owen. "In academia," says Froeb, "what you do does not have a direct consequence. Here at the FTC, everything I do has a direct consequence. It's hard to get used to. I tell people that I fully expect to be fired before my term is out…. It's not quite 'Mr. Smith Goes to Washington.' But I am trying to live down the stereotype of 'Those who can, do. Those who cannot, teach.'"

"Luke is a great professor, and here he has the opportunity to go beyond his practical experience," says Scheffman. "When he comes back to Owen, his experience at the FTC is going to make his course even better."

DAVID DEAL

Froeb, left, and Scheffman

### Teaching the Relevance of Economics

In August of last year, Scheffman and Froeb passed each other in the hallway, figuratively speaking. Scheffman left the directorship of the FTC's Bureau of Economics to return to the private sector, and Froeb took leave from Owen to become the new director of the Bureau.

Scheffman is a consultant with LECG, Inc., an international economics, accounting, and finance consulting company, which has recently gone public and of which he is a member of the board of directors. Both Froeb and Scheffman still teach in Owen's Executive MBA program.

The two economists first crossed paths when Scheffman served in a variety of roles at the Bureau from 1979 through 1986, when he first became director, and while Froeb was with the U.S. Department of Justice's Antitrust Division (1985 – 1993).

Froeb had left a teaching position at Tulane for the Justice Department, where the experience changed his view of economics from an abstract academic discipline to a science that informs real decisions, and set in motion what he calls his "demand-driven research agenda." A long string of merger, price-fixing, and bid-rigging cases and a fellowship at the University of Chicago Law School deepened Froeb's interest in antitrust analysis and led to a series of articles critical of the government's merger guidelines and how the department analyzed mergers.

"David was writing in this area too," says Froeb. "We became acquainted through our academic research. I knew his work long before I knew him."

After eight years at the DOJ, when Froeb felt he had accomplished what he had set out to do there, Scheffman recruited Froeb to Owen. At the time, Scheffman was the Justin Potter Professor of American Competitive Enterprise. "When I got there, Dave told me, 'Nothing that you know right now is very relevant for teaching MBAs.'" Behind that crack, Froeb knew, was Scheffman's successful experience teaching and a teaching style that, "forces you to question everything you know." (Scheffman was voted 2002 Executive MBA Professor of the Year at Owen.)

Froeb began teaching microeconomics as he had learned it, using graphs and charts, formal models, and public policy applications. Student evaluations of his class were not positive that first year, and the late Dean Marty Geisel "took me out to the proverbial woodshed and told me that unless customer satisfaction increased, he was going to fire me," Froeb recalls. The next year, he completely changed his teaching, adopting a business applications approach where he took the problems and questions that naturally arise in the business environment as his starting point. At the end of the year, he was one of the highest rated teachers in the program. (In 1998, he was named Outstanding Professor by the students of Owen's International Executive MBA program, in 2000 he won the Dean's Award for Teaching Excellence, and in 2002, the Dean's Award for Outstanding and Widespread Research Impact. In 2003, he was named the William C. and Margaret W. Oehmig Professor in Entrepreneurship and Free Enterprise.)

"It's not easy to make economics relevant to MBAs, who aren't professional economists," says Scheffman. "At the FTC, we're economists in a sea of lawyers. Unless you can convince the attorneys and commissioners, who are not economists, that the economic analysis you do in connection with an investigation is relevant, they are not likely to give that economic analysis much weight."

While Froeb agrees with that observation, he also comes at the problem from a complementary angle: "I'm interested in what MBAs or attorneys can teach economists about what is important," he adds. "Too much of economics is driven by academia. We often end up answering questions that no one is asking."

### History, Legacy, Mission

Froeb's mission at the FTC, and Scheffman's before him, is best understood against the broad background of antitrust law in this country.

The antitrust laws on the books are very brief. They outlaw anticompetitive behavior. The depth and complexity of antitrust law in general that has grown up around these specific laws stems from the ongoing effort to define exactly what "anticompetitive" means. This effort is largely due to the actions of the FTC over the years since its creation in 1914. (See sidebar: "The Federal Trade Commission and the Bureau of Economics.")

The definition of "anticompetitive" has changed dramatically over time. "As both case law and the antitrust guidelines have evolved to be more about benefit and cost analysis of a course of action," says Froeb, "economists have become increasingly important to public policy. Economic analysis now enjoys a primacy in the antitrust process that it has never had before."

The work of both Scheffman and Froeb fed into the evolution of antitrust law, with Scheffman's work during his 12 years (including his two stints as director) playing an important role. FTC Chairman, Timothy J. Muris, in his announcement of Froeb's appointment as the new Bureau director, cited the work of his predecessor: "Dave has focused the agency on developing and using reliable, empirical economic analyses in evaluating investigative matters and other agency business. The consistent use of empirical economic analyses is probably Dave's most notable legacy."

Though the increased use of empirical economic analyses is traceable back to the 1950s, it came to prominence in the Reagan era. "David was a foot soldier in the change in antitrust policy and law that began in the '80s," says Froeb, who during this time was working in the DOJ. "I was still trying to find my way, figuring out how I could contribute."

Now as director, Froeb describes his mission in the broadest sense: "Making sure that the economic analysis is relevant and that it is heard." Unlike most economists at the FTC who are trained in the specialized area of industrial organization, into which antitrust policy typically falls, Froeb was trained in econometrics, the analysis of data. "My approach has been typically quantitative and empirical in analyzing antitrust policy, and I was brought into the role of director specifically to further that approach."

Though Froeb describes himself as more of a "formal modeler" than Scheffman, he says they are in fundamental agreement that the days are gone when two expert witnesses could look at the same set of facts—without enough formal analysis to make an informed decision—then both swear on the Bible, and reach the exact opposite conclusion on an issue. "If you have a story you have to tell," says Froeb, "it ought to be supported by quantifiable evidence. Let's put your story up against the data and test it."

The "transparency" effort at the FTC and the DOJ—making the internal deliberations of the agencies more public—is also part of the legacy that Froeb inherits from his predecessor. "Within legal constraints that guard the confidentiality of the information we collect from parties, we have a mission to show the world more clearly and plainly what we do and why. Dave has been in the forefront of the transparency effort, and that commitment passes on to me.

"The mandate of the FTC is very broad," Froeb continues, "and it's to protect the consumer. My role is to see that we apply sound economics in pursuit of that goal." VB

## THE FEDERAL TRADE COMMISSION AND THE BUREAU OF ECONOMICS

THE FTC IS A CONSUMER PROTECTION agency with two mandates under the FTC Act: to guard the marketplace from unfair methods of competition, and to prevent unfair or deceptive acts or practices that harm consumers.

The Commission enforces federal antitrust laws that prohibit anticompetitive mergers and other business practices that restrict competition and harm consumers.

The creation and administration of the National Do Not Call registry is the work of the FTC. (If you haven't already, you can sign up to be on the Registry at www.donotcall.gov.) The care labels in your clothes, product warranties, and stickers showing the energy costs of home appliances all exist by the requirement of the FTC. Laws requiring truth in advertising and prohibiting price fixing are administered by the FTC.

The FTC's work is performed by the Bureaus of Consumer Protection, Competition, and Economics.

The Bureau of Economics helps the FTC evaluate the economic impact of its actions by providing economic analysis and support to antitrust and consumer protection investigations and rulemakings.

In the antitrust area, the Bureau participates in the investigation of alleged anticompetitive acts or practices and provides advice on the economic merits of alternative antitrust actions. (Some anticompetitive practices—such as hard-core price fixing—are prosecuted as criminal violations under the Sherman Act, and are handled by the Department of Justice.)

If the FTC believes that a company has violated the law or that a proposed merger may violate the law, the agency initiates an enforcement action. They can attempt to obtain voluntary compliance by entering into a consent order with the company, or (if a consent agreement cannot be reached), issue an administrative complaint, or seek injunctive relief in the federal courts.

In all of these potential actions, the Bureau of Economics integrates economic analysis into the proceeding (sometimes providing the expert witness at trial) and works with the Bureau of Competition to devise appropriate remedies.

Outside the enforcement arena, the Bureau also conducts economic analyses of various markets and industries. This work focuses on the economic effects of regulation and on issues that are of importance to antitrust as well as consumer protection law enforcement.

The FTC website, www.ftc.gov, provides in-depth and continually updated information on the Commission and the work of the Bureau, and is the primary source for the material presented here.

# NAVIGATING the TURBULENCE

## Michael Capellas and Doug Parker Chart New Paths in the Air and On the Ground

*By* GRACE RENSHAW

This past year, the Owen School and First Tennessee Bank cosponsored a high-octane conference, "Managing in Turbulent Times," featuring two talented CEOs as keynote speakers: MCI's Michael Capellas, who assumed leadership of the company as it was heading into bankruptcy due to the WorldCom accounting scandal, and Douglas Parker, '86, who ascended to the top slot at America West Airlines 10 days before the tragedy of Sept. 11 rocked the airline industry.

In addition to the real-life dramas of the America West and MCI stories, the audience of business leaders and Owen students was treated to panel discussions on such topics as "Taking Your Company Private," facilitated by Acting Dean Jim Bradford; "The Clouded Crystal Ball: An Economic Forecast," led by Professor of Entrepreneurship and Free Enterprise Luke Froeb; "Bankruptcy and Workout," facilitated by First Tennessee's Mike Edwards, president of the bank's Nashville region, which also featured Lazard Freres turnaround expert and MCI advisor Terry Savage; and "A Bright Line on the Floor: Challenges of Leading in Turbulent Times," a star-studded panel facilitated by Professor Bart Victor and featuring Parker, Capellas and Kroll, Inc. Executive VP Michael Shmerling.

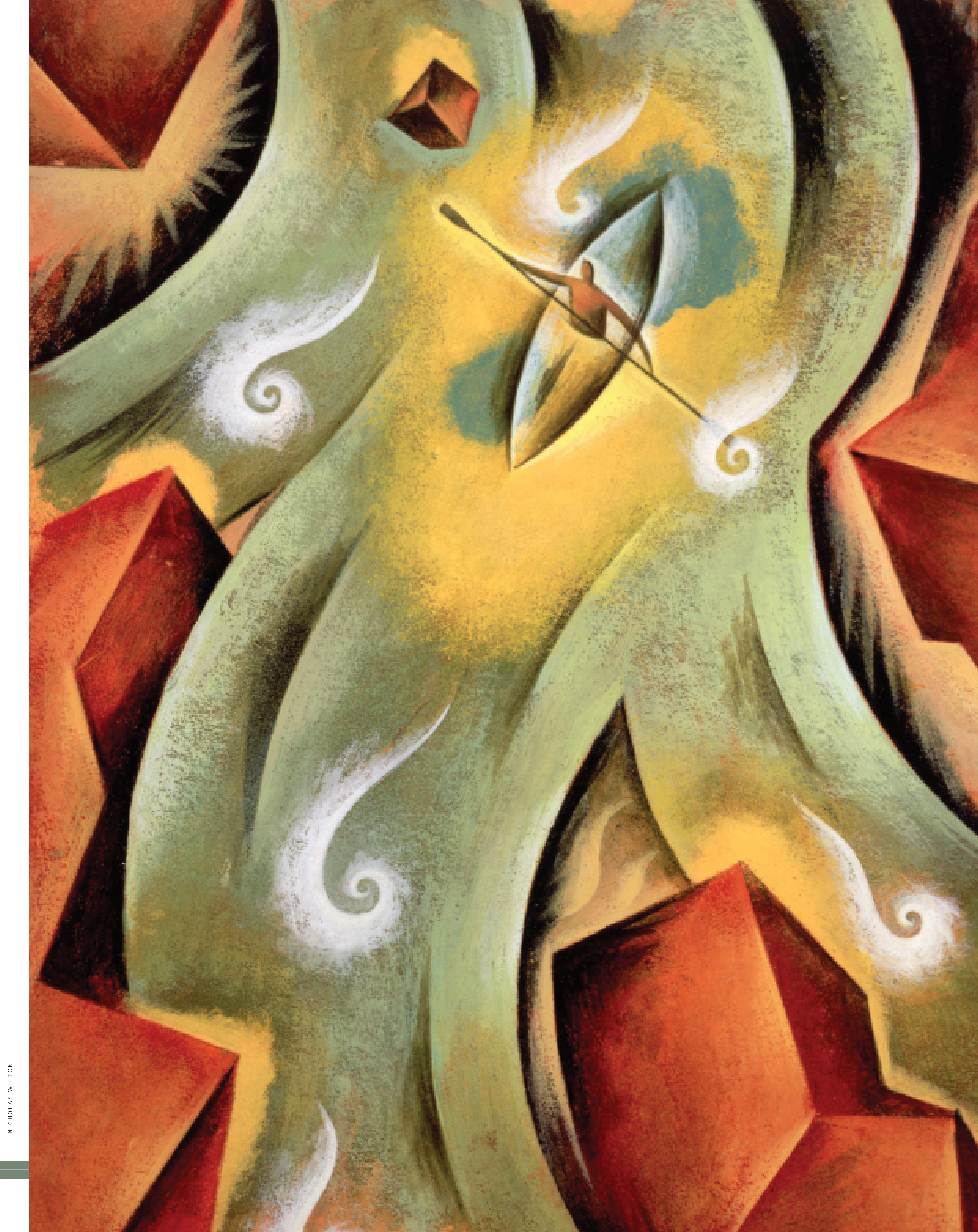
As the first in a series of planned annual conferences that address pertinent issues, "Managing in Turbulent Times" set an extremely high standard upon which First Tennessee and Owen intend to build. "The theme was very appropriate—we are indeed in turbulent times," says Edwards. "But I'm confident anyone who attended this conference left feeling much better prepared to successfully confront both predictable and unpredictable business challenges."

**About Face, Forward March**
*Mike Capellas Tells the Compelling Story of MCI's Turnaround*

If you're listing the skills needed to save a company heading into bankruptcy with the speed of a four-man bobsled on a steep track, a sense of humor probably isn't at the top of the list. But the fact that Michael Capellas' sense of humor and MCI, the company he stepped in to head in November 2002, are both still intact is no coincidence.

Capellas talks at lightning speed, as fast as you might expect the man who engineered MCI's 180-degree about-face in under a year to talk. That's a pity, because Capellas drops more good one-liners than Bob Hope in his prime, and none are throw-aways. At the "Managing in Turbulent Times" conference, he managed to teach a roomful of MBA students the fundamentals of business strategy during challenging times while simultaneously telling a vivid, entertaining story.

Capellas has a right to be cheerful. In April, MCI emerged from its well-publicized bankruptcy. Earlier, on October 31,



NICHOLAS WILTON

shortly before appearing as a keynote speaker at the conference, he got the good news that U.S. Bankruptcy Court Judge Arthur Gonzalez approved MCI's Plan of Reorganization under Chapter 11. Developed in the same sort of war room Capellas used to achieve a less dramatic but equally difficult turnaround at Compaq Computer as its CEO in 1999, the plan allowed MCI to emerge from Chapter 11 with $5.5 billion of debt (reduced from $41 billion) and a $750 million payment to settle civil fraud charges.

The plan's approval came less than a year from the day Capellas agreed to join the ailing company as its CEO, and it lifted a shadow from the company that is currently the world's leading provider of data services, owns and operates one of the largest international voice networks, and employs 55,000 people in the U.S. and 64 foreign countries. Capellas proved he had the stomach for a high-stakes turnaround requiring decisive action and affording little room for error at Compaq, which he joined in 1998 as the company was acquiring Digital Computer Corp. The acquisition proved less than successful, and Capellas was named CEO in 1999 as Compaq's stock hit the skids, a victim of the fiercely competitive personal computer market and Compaq's failed bet on Digital's computer server technology.

Capellas had just shepherded Compaq through its successful 2002 merger with Hewlett-Packard when he was approached by MCI employees. "I saw similarities to the situation at Compaq, which had been a good experience for me and one of which I was proud," he says. "I knew the technology, and I certainly knew the customers—they were the same customers I'd been working with for years, and I talked with some of them. They said, 'We encourage you to do this, because [MCI's technology] is a hugely integral part of our infrastructures.'" Convinced that it was vital that MCI not only survive but thrive, and that he could "make a difference," Capellas turned down a more lucrative offer of the number-three slot at Microsoft to head what he now describes as "a company probably in the biggest turmoil of any company, ever. And the fraud wasn't over, by the way."

Although one of Capellas' favorite lines, borrowed from Benjamin Franklin, is "sense isn't common," he attributes his astute, rapid-fire management moves to common sense. "One of the first things I did was put profit and loss responsibility into the business units," he says. "The company had this huge financial consolidation. Everything had been tightly held, and that's what led to an environment that allowed fraud to happen. The people who ran sales only saw sales, the people who ran network operations only saw network operations, and they were not connected with results. I came out of the school where I expect the operating managers to know from month to month and quarter to quarter where gross profit changes and why expenses changed. That's the real business control that hadn't been there."

But the real challenge, Capellas acknowledges, was to rebuild the company, which also meant rekindling employee morale. "I didn't come there to be an investigator," he says. "I came there to be the guy who took control from the get-go." His opening speech enabled frightened and bewildered employees to focus on something other than the steady onslaught of negative media coverage of the WorldCom accounting fraud: the company's 20 million customers, a group that remained surprisingly intact. "People need something to rally around," Capellas says. "My opening speech to employees was, 'We're focused on three things, and I want you to say them with me: 'Customers, customers, customers.' Don't worry about revenues right now. If you focus on customer service, you keep customer loyalty, and we'll be OK.'"

Capellas then announced a plan to develop a plan. "I stood up in front of the entire organization and said that we were going to create a plan of reorganization in 100 days," he recalls. "People thought we were nuts." But Capellas proceeded to do just that, with the help of a small team of advisors headed by restructuring expert Terry Savage of Lazard.

"The 100-day plan reassured employees that we weren't ignoring what was happening behind the scenes," Savage says. "It was an ongoing hum they had to deal with, but it was our job to deal with the hum and theirs to deal with the customers. The message was 'Focus on your job, and don't worry about the sideshow.'"

It also put pressure on creditors, who faced potentially greater losses if the company failed to get out of bankruptcy. "Developing a 100-day plan was kind of in your face," Savage says. "Michael said, 'You want to get out? Here's a plan.'"

Capellas stresses that his team of advisors was small and carefully chosen. "When you have armies of advisors and external constituents, you lose control of your own destiny." With Savage's help, MCI's management team—a team Capellas quickly rebuilt, along with the company's board—assembled a small team of advisors and developed a new

## TAKING YOUR COMPANY PRIVATE

**GOING PRIVATE SEEMS TO BE IN VOGUE,** and that makes Charles Byrge '85, a busy man. Byrge, senior managing director, head of Investment Banking at FTN Financial Securities Corp, said the responsibilities required by the Sarbanes-Oxley Act has made being public more onerous and costly for many small companies. As a result, the environment is conducive for "going private" transactions, namely management or leveraged buyouts or reverse stock splits.

Byrge joined other executives in a panel discussion entitled "Taking Your Company Private" during the Owen Finance Conference. Acting Dean Jim Bradford facilitated the discussion among Byrge; Brian Carr, former president and director of Ameripath; William Argabrite, partner at Hunter, Smith & Davis, LLP; and Richard Roberts, former SVP, general counsel and secretary of Landair.

Current conditions provide sound reasons for undergoing this unusual process, in which management or a financial bidder purchases a public company from its board of directors and shareholders. The transaction is typically financed with a high level of debt.

An increasing number of small-cap companies exist in what Byrge describes as a "penalty box"—their stock price has lagged as research coverage and institutional investor interest in small caps has dwindled. The penalty goes beyond valuation; it may impact employee morale, incentive pay schemes, and the ability to access additional capital.

Carr said that Ameripath, provider of diagnostic medicine, after a 1996 IPO, evolved through acquisitions but saw its stock price struggle in the wake of problems with physician-managed PhyCor and uncertainty in the malpractice environment.

The value of the company's steady cash flows exceeded its public market value, and the laboratory segment of the business could be leveraged. A merger was an obvious first look, as a strategic buyer can usually pay more than a financial one; ultimately, a buyout made sense.

Roberts outlined how Landair had trouble getting the market to understand the distinct parts of its business. The trucking service for airline freight had two parts: a capital-intensive truckload (TL) business for which the company was best known; and a higher margin, less capital-intensive, "less than truckload" (LTL) business that should have buoyed its flagging stock price. The LTL business was spun off; the TL business, with heavy insider ownership, was taken private by management.

Argabrite, who served as Landair's corporate counsel, explained that a management buyout is unusual in that it puts management in a new role—at arm's length from the board, which has a fiduciary responsibility to the shareholders. This underlines the importance of an independent board and the role of the board-appointed special committee.

*Continued on page 65*

## CAPELLAS' MANAGEMENT BASICS FOR TURBULENT TIMES

1. Set targets people can achieve, and measure them. "You need shorter, clearer targets in turbulent times, because people will rally around something they can measure," Capellas says. "In business in general we don't think in three-year or five-year time horizons now. You have to say, what do I want to do in the next 30 to 60 to 90 days, and how does that fit with where I want to be a year from now, and then continually adjust from day to day."

2. Communicate constantly, using multiple vehicles. Capellas communicates directly to employees via e-mail, voice mail, town meetings, Q&A sessions, and Web casts. "And when you send an e-mail to 55,000 of your closest friends," he says, "you expect that it will be a public document as fast as Control F."

3. Maintain the personal touch. Although Capellas admits this "is really sort of aw shucks," he insisted that his top managers contact top customers as the reorganization plan was under development, and he personally visited every MCI site worldwide. "At the end of the day, management is about human relations," he says.

business plan. "I didn't want to look at it as a reorganization plan," Capellas says. "The very first day, the management team told Terry they had never seen a business plan. I wanted to see a business plan, with products, revenues, and organization plans. When we were done, we turned it over to Terry's team, and they helped us make a bankruptcy plan out of it."

Following Capellas' lead, MCI then presented the plan to the 100-member bankruptcy committee "like a business plan," Capellas says proudly. He was already announcing his next rallying point: The rebranding of the company as MCI. Capellas had known from the outset that the WorldCom/MCI merger had never been effected culturally, and sheer numbers dictated MCI's as the pervasive culture among employee ranks. WorldCom had 5,000 employees, compared to MCI's 50,000, and the accounting scandal had occurred among the ranks of WorldCom management, leaving MCI employees angry, demoralized, and suddenly bereft of their pension and 401(k) benefits.

"People had lost all their money and felt terrible about themselves," Savage said. "Every day, they were calling on customers thinking they had to explain what three or four other people had done, and the competition was ridiculing our company. If you can imagine someone who's 45 years old and thought he had a nest egg and a retirement account, and then suddenly he had zero, plus he thought he was a scumbag because whenever he talked to customers, the AT&T guy had already been there calling him a crud. You had 55,000 people who, before the fraud, thought they were with a go-go telecommunications company, and literally in one day, they weren't. They were smart people, but they were beat."

Savage quickly discovered two saving graces. MCI had lost very little business, particularly the key business-to-business accounts the company's competitors were busily targeting. In addition, the company had more cash available than anyone realized. "In July, the company projected that if we continued to lose cash, we'd have to borrow money. But when we added it up, there was actually $5.6 billion in cash. They just didn't know it was there. We had a billion dollars in bad receivables, and Michael said, 'Go get 10 cents on the dollar,' and lo and behold, people got on the phone and said, 'Hey, you owe us money,' and they would send us a check."

With many of the company's assets and its customer base largely intact, Capellas' goal was to rejuvenate MCI's culture and its product-oriented business focus. "Any leader who comes in and says, 'I'm going to revamp the culture,' really thinks too much of himself," he says. "You can accentuate the good, you can bring some new thoughts, and you can work on some weaknesses, but you have to appeal to the inherent culture, and you have to learn how to motivate what I call groups of interest, both formal and informal." The decision to shed the WorldCom name resulted from Capellas' initial observation that "nobody would wear a golf shirt or hat with the company name on it."

From the start, he attacked the morale problem on several fronts: Constant communication via e-mail, voicemail, web cast, town meetings, and site visits where he would answer employee questions; a new initiative each month for employees to rally around, and an infusion of discipline. "I wanted a disciplined product roadmap—where we were going with product development—and we rebuilt our product development organization," he said. "We put metrics and a balanced scorecard in—a lot of pragmatic management."

Capellas also insisted that the management team move to MCI's corporate headquarters in Ashburn, Va. "None of the management was connected," he says. "The CEO lived in Mississippi, the CFO and HR departments were in Boca Raton, the general counsel worked out of Washington, D.C." The first time Capellas asked the management team to join him onstage at an employee meeting, he realized that employees did not recognize them, and that they did not know each other. "So I had them sing, 'If You're Happy and You Know It,'" to mortify them all," he recalls, grinning.

Employees were only one of the constituencies Capellas had to satisfy. "Remember the old saying about managing your constituencies if you can find them?" he asks. "This company had them from every angle. You had the SEC, the old board, the new board, the new management team, the old management team, the creditors, and the only way to manage them was face to face. All the negotiations we did on the bankruptcy, as large as it was, were actually done face to face."

Although the company is now out of bankruptcy, the story is far from over. But Capellas is confident he's changed the plot. "This was an accounting scandal, not bad operations," he says. "This is a great human interest story—the real untold story is what 55,000 people will do when they have something to rally around." VB

DANIEL DUBOIS

## AMERICA WEST MANAGES SMOOTH RIDE

"THE AIRLINE INDUSTRY WROTE the book on turbulence," said Doug Parker, '86, chairman and CEO of America West Airlines, the perfect keynote speaker for the "Managing in Turbulent Times" conference.

"Words associated with turbulence include 'wild commotion,' 'irregular atmospheric motion,' and 'departure from a smooth flow.' Those words don't inspire confidence; rather they inspire fear and dread. Inspiring change during good times is challenging, but in turbulent times fear often drives actions. Fear is countered with courage. Courage requires a willingness to take risks."

Parker enjoyed an extremely short "honeymoon" after being named to his current position on Sept. 1, 2001.

"I had a nice 10 days and then I woke up to the tragedy of Sept. 11," he said. "Sept. 11 impacted all of us, and it had a material, profound impact on the airline industry. We had to ground the fleet, and when the airlines resumed flying [three days later], there weren't many customers for a long time. The industry saw revenues drop 50 to 60 percent overnight."

Parker pointed out that America West was already "running a bad airline" when he took over prior to 9/11. The airline's on-time performance was just 64.3 percent in July of 2000, percentage of flights cancelled was 6.2 percent, mishandled baggage was 8.59 percent, and customer complaints were 10.7 percent.

By September of 2003, on-time performance was up to 86.4 percent, percentage of flights cancelled was lowered to just 0.6 percent, mishandled baggage was down to 2.40 percent, and complaints had melted to just 0.71 percent.

These improvements came through a comprehensive restructuring of the entire operation, he said. "Not only are we improved from where we were, we are in the top three airlines across the board."

The investment world took note of the positive changes taking place at America West: The airline's stock had risen 750 percent during the year at the time of the Owen conference—the highest increase of all stocks traded on the New York Stock Exchange.

Parker at the November Finance Conference

The transformation of America West involved six platforms:

- Improving such operations as on-time performance, flights cancelled, mishandled baggage, and complaints.
- Restructuring the company's finances with the help of government loans authorized by Congress for the airline industry after 9/11.
- Rewriting the pricing structure in favor of greatly reduced fares like those offered by other low-cost carriers such as Southwest Airlines.
- Redeploying aggressive cost control measures such as closing the Columbus, Ohio hub, reducing the management ranks by 20 percent, and convincing vendors and suppliers to cut their rates by 20 percent.
- Rebuilding the company's culture through better communication with employees, and instituting a $50 bonus for each employee every month the airline ranks among the top three airlines in terms of on-time performance.
- Repositioning America West's business strategy so that the company is now the nation's second largest low-cost carrier. The company is also taking on "legacy" airlines such as American and United on certain routes, and is flying point-to-point routes that bypass America West's hubs.

—LEW HARRIS