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## SIN NO. 1: TOO BIG

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*“Man is small, and, therefore, small is beautiful.”*

(Ernst Friedrich Schumacher, economic thinker, in the 1970s)

*“Sometimes I have to admit that our company is so gigantic and the inertia of the system is so big that it is for us impossible to play our role as managers.”*

(Alfred P. Sloan Jr., CEO of General Motors, in the 1930s)

## VIRTUE: THERE ONCE WAS A SYSTEM

Entrepreneurship, competition and innovation.<sup>1</sup>

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<sup>1</sup> *"Innovation and Entrepreneurship. Practice and Principles"* is the title of a management book written in 1985 by Peter F. Drucker that still makes compelling reading (HarperCollins, 1985).

## THE FLAWS

Early in 2009, Pfizer's CEO told the Financial Times (January 5, 2009) that his company was considering the acquisition of a "large rival" to improve its financial health, adding that "*The real goal is to grow revenues*" and that, naturally, it should (sic) "*meet the criteria of shareholder value.*" FT journalist Andrew Jack pointed out that the CEO's remarks were reflecting a strong need to compensate for a forecasted sharp drop in sales of existing patented drugs "*exposed to competition.*" That says much about one of today's worrying trends in the capitalist system: being bigger for the sake of it, and doing this by acquiring competitors instead of trying to grow your own revenues -and innovate- by your own means, products and resources.

The sickness and its (in)direct consequences for companies is perfectly illustrated in the case of Pfizer. After having been conservative (in the positive meaning of this word) for decades with regard to external growth and epitomized large-scale innovative entrepreneurship with William Steere at the steering wheel<sup>2</sup>, Pfizer embarked on a frantic buying spree. Numbers matter. In 1990, sales were \$4,757 million, ROE (return on equity) was 16.9%, EPS (earnings per share, here for continuing operations) were \$0.17. In 1999, sales were up to \$14,135 million, ROE had more than doubled to 35.9%, and EPS reached \$0.85. For those who pay more attention to market value, this had jumped from \$3.37 per share to \$32.44 over the same period. And then came the years 2000 and later. The New York-based firm bought, directly or via purchases, Warner-Lambert, Pharmacia, Upjohn, Parke-Davis, Agouron, Searle, Sugen... Does anybody but the accountants remember the acquisition costs? No. But many more paid the price and felt the pinch. "*Shareholder value,*" he said? Share price was divided by two between 1999 and 2007, meaning a \$140 billion loss in value. Sure, as an immediate effect of acquisitions, revenues almost tripled in six years. End-2007 EPS (continuing) were at \$1.19, i.e. progressing less than over a comparable period based on organic growth. What about the vital ROE? After a mysterious surge to 55.2% in 2002, it fell back to a 15% average for the last five years. Less than one month after Pfizer's intention was materialized in the planned purchase of rival Wyeth for \$68 billion, with \$22.5 billion coming from a consortium of banks... and a dividend cut (with that "*shareholder value*" still in mind, we assume!). Has the drug giant learned from its past errors? Hopefully, both the acquirer and the acquired will find pills for memory and diet treatments in their pipeline.

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<sup>2</sup> See performance indicators as reported in Pfizer annual reports from 1991 to 2000, from which our figures were sourced. Incidentally, or coincidentally, it is worth noting that the quality of information (and the number of ratios) in annual reports started decreasing in the early 2000s.

Never mind! Pfizer CEO promised that this *“takeover will be different”*.<sup>3</sup> Heard that tune before, haven't we?

To be fair, Pfizer preceded or followed the crowd and is far from being the sole company in its industry to have showed such an addiction to size: consider e.g. GlaxoSmithKline (GSK), whose full name should now be, hold your breath, Burroughs-Wellcome-Glaxo-Laboratories-Smithkline-Beecham, had imaginative (?) brand experts not shortened the company identity. Hopefully, also, if not mainly, for their shareholders and employees, healthcare companies will discover weight-watching and anti-obesity prescriptions that apply to themselves and not only to patients. But from what we are seeing and hearing here and there, many in and out the sector have not learned<sup>4</sup> from turning their own labs' know-how into effective medicines which, after all, concern executive and managers' eyes, skills and, er, brains! Instead, they keep on repeating the same mistake and suffer from me-tooism. In the case of Pfizer, isn't just because some on the boards were sick of watching Johnson & Johnson becoming n° 1 in the American pharma industry<sup>5</sup>? A few weeks after Wyeth's takeover by Pfizer, the rival Merck announced its plan to acquire Schering-Plough. Let us note the astonishing comment made about this by an analyst: *“It seems somewhat inevitable... There is overcapacity and (the companies) need to take each other's capacity out of the market.”*<sup>6</sup> In other words, it is about growing fat to get fit! A strange prescription, isn't it?

Exactly the same “size syndrome” affected IBM in its heyday: some remember the then CEO declaring that he was *“mad at losing market shares”*. Or, more recently, General Motors (GM), probably angry at watching Toyota overtaking it. Playing by the rules of free markets seems increasingly replaced for large corporations by searching for market domination. Before turning to Chrysler, GM had first turned to Ford for a possible merger. What for? Piling up losses? Not for decentralizing, for sure.<sup>7</sup> With hindsight GM's attitude looks even more disgraceful, as it shifted from almost all possible merger options to announcing the sale (or something else) of some of its biggest brands. Proving that it had become unmanageable, mainly due to its size. Shamelessly begging for taxpayers' money (sorry, just for a “bailout” in today's words) in the U.S., Sweden (for Saab, an ailing division that GM has never managed to reignite since it had bought it!), Germany (for Opel, that would probably have fared better without Detroit bureaucracy), in a pure blackmailing style, made it all even more shameful.

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<sup>3</sup> Reports on [www.reuters.com](http://www.reuters.com), the Financial Times, BusinessWeek (January 26, 27, 28, 2009).

<sup>4</sup> According to Dealogic ([www.dealogic.com](http://www.dealogic.com)) and as reported by the New York Times (January 5, 2009), the combined global volume of M&As announced in 2008 amounted to \$3.3 trillion. That was down 28 percent from 2007, but still the fourth-highest yearly total ever.

<sup>5</sup> Johnson & Johnson overtook Pfizer in the n° 1 position in pharmaceuticals in the 2007 and 2008 Fortune 500 rankings.

<sup>6</sup> Information and analyst's quotation on [www.reuters.com](http://www.reuters.com) (March 9, 2009).

<sup>7</sup> In one of his first books (*“The Concept of the Corporation”*), Peter Drucker advised GM's Alfred Sloan to decentralize. That was dismissed as a betrayal. That was in 1946...

Too many M&As (mergers and acquisitions) are driven by that fear of being left behind, or by a bad desire, or a clear design, to choke off rivals; or even by a runaway solution to internal problems.

Continued in **“The Seven Deadly Sins of Capitalism”**