DEALS OF THE CENTURY

Wall Street, Mergers, and the Making of Modern America

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At the turn of the twentieth century, a New York writer summed up a Wall Street deal that many thought marked the twilight of capitalism. “The world, on the 3rd day of March 1901, ceased to be ruled by so-called statesmen,” he wrote. They had been replaced by the moneymen of Wall Street, the “world’s real rulers,” who had helped fashion the largest merger deal ever recorded. Wall Street struck its richest payday ever and the world indeed changed.

Since that time, mergers and acquisitions (M&A) has been a specialty that many securities houses and banks view enviously. Many would like to be in the business, but few actually achieve success in this area. There is a reason for this envy, and its roots extend far beyond the confines of Broad and Wall Streets. This esoteric side of the securities business has been the major architect in changing the face of American industry and society. The giant corporations that emerged in the early twentieth century owe their origins to Wall Street, the place where capital and business meet. Practitioners of the M&A art have the unique distinction of being highly paid social architects who can have more impact than a truckload of politicians, academics, and social theorists. And yet very few members of the
public can name any of them. This has not always been the case, however.

The M&A business is as old as American industry, having gotten its start before the Civil War as companies in similar lines of business began to merge. During the 1880s and 1890s, the giant trusts were formed as strong companies often absorbed smaller, less powerful competitors to become modern corporations. But only with the dawn of the twentieth century did M&A gain serious momentum as influential Wall Street bankers became more heavily involved in the process. Some, like John Pierpont Morgan, the creator of U.S. Steel and a host of other huge companies, used their considerable influence to fashion mergers and maintain control over their creations by holding seats on the boards of the companies they created. Occasionally, others—like Clarence Dillon, the formative deal maker behind the Chrysler Corporation—actually tried running the businesses they created, with less success. In either case, most made sizable fortunes from their efforts, continuing the tradition of what was known as finance capitalism.

The term was originally used by socialist writers and critics to describe the role of financiers in the M&A process. According to the socialists, mergers were put together simply to benefit the bankers, who used other people’s money to deal themselves into newly formed companies. Once in, they could then exercise control out of all proportion to their importance. Wall Street bankers had been exercising that sort of power for decades, but it was Morgan who was the epitome of the wheeling-and-dealing banker with his hands on the controls of money and credit. V. I. Lenin recognized Morgan’s role at the center of American finance, although there sometimes was a strange awe in the manner in which he discussed the banker. Lenin had in mind Marx’s idea about the redistribution of wealth, but it was Morgan who best practiced it. Unfortunately, wealth and power were not accruing to the people but only to those who sat at the pinnacle of Wall Street power.

What some critics found so insidious about Wall Street was that finance capital appeared to have taken precedence over entrepreneurs and innovators. Everyone knew that Thomas Edison had
created the lightbulb and that Cyrus McCormick had invented the reaper and that both inventions had helped change society. But the changes had come under the auspices of Wall Street bankers who had financed the companies rather than the leadership of the inventors, who often were bewildered or just bored by finance itself. The key to the bankers’ success was access to the large sums of capital necessary to help the companies expand. Since the capital depended upon a small group of financiers, the entire process smacked of crony capitalism. Money needed for expansion was concentrated in the hands of a few who were neither elected to their jobs nor accountable to anyone for the way they practiced them.

Since the middle of the nineteenth century, concentration of capital has been key to the merger movement. More than any other Wall Street activity, with the exception of corporate securities underwriting, concentration of capital is understood as a measure of an investment bank’s prowess and influence in the market. Over the past 50 years, access to large amounts of capital and the ability to reorganize a company usually have been associated with the larger securities firms and banks. When smaller firms unknown outside of Wall Street exercise their prowess, it only adds to the general suspicion that crony capitalism is still rampant despite the bevy of banking and securities laws passed since the 1930s. How could a small investment bank have helped organize huge conglomerates in the 1960s? How could a few men unknown outside Wall Street have had so much power over American workers and the products they made? Lenin’s answer to these questions would have been the same as that of the average person in the street—crony capitalism.

The M&A process is so pervasive in American life that probably most medium- and large-size companies have been affected by it at some time in their corporate histories. And for every notable deal there have been dozens of others that never made the press. The deals included here necessarily are confined to the largest, with the longest legs. They either helped shape an industry for a long period of time or were of such size that they cannot be ignored. Some clearly were not successful; in fact, there is considerable opinion that most did not accomplish their objectives but did nevertheless benefit
bankers and executives. What is clear about the trend, however, is that it relies heavily upon a strong stock market and the small investor for its impetus. Without these two factors, the M&A train quickly becomes derailed because inflated stock prices, used to finance many acquisitions, are not present. In all merger binges—whether in the 1920s, 1960s, or 1990s—the market was necessary to bid up prices. Strong stock prices meant that companies could use their stock as currency, paying high premiums for their acquisitions, sometimes even surprising Wall Street by the amounts. When the urge to merge struck buying companies, no price was too high for a company they just had to have. The phenomenon is not new. In 1931, The Magazine of Wall Street remarked, “It is a peculiar fact that past history clearly shows that the merger movement is very much stimulated by good times, particularly a bull market in stocks, while there is a marked tendency for consolidations to decrease in number under the reverse conditions when one would think economy were most needed.”

The history of deal making reveals two interesting themes repeated time and again over the past century. The first tends to agree with Lenin and critics of consolidation, especially when the only apparent beneficiaries are company executives and their bankers. The structure of investment banking in this specialty is unusually oligarchic, even by Wall Street standards. Deals are done by the influential and the powerful, often with far-reaching results in both finance and the society beyond. This oligarchic nature has been evident since the first significant deal of the century in 1901 and remains so today despite the fact that the business world has grown larger and securities firms have multiplied in number. The oil and airline industries in the 1970s and 1980s were severely shaken by several key figures and their bankers—to the point where it was legitimate to ask exactly who these people were and how they got to exercise so much influence over vital industries.

The other theme deals with an equally entrepreneurial part of human nature. In 1878, a group of clever businessmen built a railroad designed to link Chicago with the East Coast. The route was currently served by a line owned by William Vanderbilt, the son of “Commodore” Cornelius Vanderbilt. Afraid that the competition would cut
into his profits, Vanderbilt begrudgingly bought out the Nickel Plate Railroad at a heavy price. Competition was thought to be ruinous in the nineteenth century, so buying out a competitor was seen as a necessary expense of doing business. It would not be the last time the practice was attempted successfully against Vanderbilt. The Nickel Plate strategy became a clever way of making money, especially in a boom market. The major company in the field had to be convinced that buying out the competition was cheaper than living with it. Soon, no shortage of “competitors” appeared in all sorts of industries.

Another significant piece of the M&A puzzle can be found in the widely used term synergy. The concept became popular in the 1960s as a means of describing the magic Wall Street and corporate America claim occurs when a suitable merger between two companies maximizes future value. Wags in the nineteenth century referred to the idea as alchemy. In nontechnical terms, synergy means that the new, combined entity is greater than the sum of its parts. More precisely, it means that synergy is equal to the value of a new, merged company plus the premium paid to create it by buying the acquired company. In the first significant deal in merger history, Pierpont Morgan brought the newly formed U.S. Steel to market for $1.4 billion in new stock. The premium over its asset value at the time was $700 million. The amount was astonishing at the time and many commentators could not fully grasp the amounts involved. The term synergy was not known, but another, more colorful term—watered stock—was used to describe expensive stock valued well above its asset value. In order for the U.S. Steel deal to work over the long run, it would have to produce profits that would justify its high premium. When it became clear that the profits were not what had originally been expected, Morgan turned to political pressures to keep steel in demand by advocating a strong navy to keep the peace. Ironically, he did not see the newfangled automobile as producing enough demand for steel and ignored Detroit in its early years. The influence of M&A was extending far beyond the confines of Wall Street, even with the first significant deal of the century. The U.S. Steel deal was only the most recent example of the close connection between finance and politics.