Washington Decoded

8 October 1989

Who's Bankrolling the Buyout Artist?

By Max Holland

Sometimes one does not know whether to laugh or rail at the gullibility of Congress, and the hypocrisy of Wall Street.

During the past nine months, lawmakers on Capitol Hill have engaged in a desultory debate over the wisdom of leveraged buyouts. There are several reasons why the debate is mostly going nowhere while the buyouts change the face of corporate America. But one of the most potent arguments for doing nothing has been the specter of foreign takeovers.

Buyout artists have argued, and with considerable success, that if Congress tampers with the tax subsidies that fuel buyouts it will hasten foreign takeovers of American businesses. In June, for example, Merrill Lynch & Company ran a full-page advertisement in *Roll Call*, a newspaper read widely in Washington, to warn against any proposals that might limit the deductibility of interest incurred after a buyout. One of the most prominent "severe negative effects" citied by Merrill Lynch was that foreigners who borrow abroad would have an advantage over American bidders for our companies.

There is a case to be made for equal treatment of foreign and domestic investment. But before Congress allows Wall Street to wrap itself in the American flag, it's worth taking a closer look at the buyout lobby's loyalties.

Truth be told, buyouts are a driving force behind the rapid rise in direct foreign investment in the United States, especially foreign ownership of indigenous manufacturing assets. In some instances, debt-laden corporations can no longer make the investments they need to compete, so they are put up for sale to foreign concerns seeking greater access to the world's most lucrative market. A case in point is the recent sale of Uniroyal Goodrich Tire Company to the Michelin Group, the French tire maker. As Martin Dublilier, chairman of Clayton & Dublilier, the buyout firm that took Uniroyal private in 1988 and then sold it to Michelin, explained to *The Wall Street Journal* on September 25: "We were leveraged. It would have been difficult to spend the kind of money we needed to spend over a long period in order to be in the forefront."

Buyouts also foster foreign takeovers because so many of them go bad. The percentage of companies that get into difficulty in "middle market" buyouts, which do not grab the headlines, is between 70 to 80 percent, according to Daniel Morris, head of Morris Anderson & Associates, a financial consulting firm in Glenview, Illinois. Most of these companies don't ever file for bankruptcy, yet between 30 and 50 percent get into financial distress and have to pay the price of a buyout gone bad. In other words, a drastic restructuring occurs, which means that assets are sold to meet interest payments.

With growing frequency, the foreign purchasers who are coming to rescue are Japanese. While some Japanese acquisitions have been huge and have had no relation to buyouts, the great majority of Japanese acquisitions have been in the $15 million to $45 million range – precisely the kind of companies likely to be jettisoned by leveraged corporations in trouble.

Moreover, in recent years, as the buyout mania has burdened companies with ever-increasing mountains of debt, many deals have been predicated on asset sales. Not surprisingly, foreign buyers have been quick to snap up these long-term bargains. Good opportunities for Japanese investors occur "when major parts of American companies are sold following an acquisition," one American takeover specialist recently noted at a Tokyo conference, adding that "the opportunity to acquire pieces of these companies is particularly suitable for the Japanese." American corporate executives used to complain bitterly that the Japanese can buy us but we cannot buy them. Now they insist on checking out the Japanese market, so that they do not miss out on a high price for their assets.

The 10 largest American securities firms all have offices in Tokyo that specialize in selling off American assets. Morgan Stanley & Company just raised $2.3 billion to engineer buyouts, one of the largest pools of buyout funds around. At the same time, 8.5 percent of all Morgan Stanley employees worldwide are working in Tokyo. Some sell stock, others trade currencies. But many are dealing in American assets sold because a buyout has gone sour.

In some cases the ties between buyout firms and Japanese investors are virtually hand-in-glove. The 12th-largest buyout boutique, the Blackstone Group, is concentrating its $850 million buyout pool on Rust Belt companies. Blackstone also happens to be 20 percent owned by Japan's mammoth Nikko Securities, the third-largest securities firm in the world, and Japanese investors make up 25 percent of Blackstone's buyout fund. Blackstone's chairman, Peter Peterson, makes no secret of the fact that one of Blackstone's purposes is to help pave the way for the Japanese to invest another $300 billion in the United States over the next decade.

Nor is Blackstone unique. Wasserstein, Perella & Company and the Lodestar Group, two other large buyout houses, also have significant shares owned by Japanese securities firms eager for direct access to and experience in the American market. Wasserstein is training employees from the Nomura Securities Company, and Lodestar is schooling trainees from its 20 percent shareholder, the Yamaichi Securities Company. And most recently, Clayton & Dublilier reached a working agreement with Japan's Dai-Ichi Kangyo Bank, the world's largest. In addition to investing as much as $100 million in a new buyout pool, Dai-Ichi will help Clayton & Dublilier locate Japanese buyers for American assets.

While the Japanese are not shy about pursuing opportunities being handed to them on a silver platter, it is interesting to note their attitude toward the leveraging of corporate America, and the asset fire sales that result. Contrary to the attitude of American investment bankers, who casually reshuffle assets, the Japanese view a company up for sale as an occasion for shame, and a stark admission of failure.

The problems afflicting American business, and manufacturing in particular, are broad and deep. But surely, permitting buyout artists to speculate in, and profit from, a liquidation program for American assets is not an answer.

This article first appeared in *The New York Times*, 8 October 1989