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Controlling stockholders and the disciplinary role of corporate payout policy: a study of the Times Mirror Company

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Abstract

The Times Mirror Company, a NYSE-listed Fortune 500 firm controlled for 100 years by the Chandler family, hired an industry outsider as CEO in 1995 following an extended period of poor operating and stock price performance under non-family management. This change was apparently an unintended consequence of actions taken by old management to fund its capital expansion plans while satisfying the family's desire for dividends. Specifically, in 1994 old management agreed to (1) sell TM's cable business and reinvest most of the $1.3 billion proceeds in new technology, and (2) maintain the Chandlers' dividends while radically cutting those to minority stockholders. While Wall Street reacted favorably to the cable sale, it punished TM's stock when it later learned about management's reinvestment plans. Shortly thereafter TM's board brought in a noted financial disciplinarian, who as CEO substantially increased stockholder value by terminating low return investments and distributing free cash flow. While pressure to pay dividends and monitoring by large block stockholders ultimately improved TM's performance, the path to this outcome was slow and circuitous, so that these disciplinary forces were weaker than theory typically implies. © 2000 Elsevier Science S.A. All rights reserved.

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1. Introduction

This paper reports results of a clinical study of the Times Mirror Company (TM), a NYSE-listed Fortune 500 firm whose primary asset is the Los Angeles Times. For virtually all the firm's 117-year history, TM has been controlled by the Chandlers, a socially prominent family that has played an important role in shaping the political and cultural history of California.[1] In 1995, after eight years of poor operating performance and longer below-industry stock price performance, TM's board brought in as CEO Mark Willes, a top executive at General Mills with no newspaper experience but with a reputation for strict financial discipline. Mr. Willes immediately ordered the first layoffs in the history of the L.A. Times, closed two of TM's other newspapers (one of which had lost at least $100 million over its ten-year history), and scrapped old management's strategic plan that called for substantial investments in new technology. In the first $2\frac{1}{2}$ years of Mr. Willes' tenure, TM paid out, through dividends and stock repurchases, some $2 billion, an amount far greater than the total payout of $417 million over the prior three years. Over the same $2\frac{1}{2}$-year period, TM's abnormal share price appreciation totaled 157.5%.

The TM case is remarkable not simply because the new CEO was able to unlock substantial value for stockholders, but also because TM's subpar performance had been evident to stock analysts and other media commentators for many years before the firm's board opted for radical change. Our analysis focuses on events that precipitated the 1995 hiring of Mark Willes to help understand why change occurred when it did and not earlier. We conclude that pressure to pay dividends and monitoring by large block stockholders ultimately helped bring about improved managerial performance at TM. This governance process, however, was a slow and circuitous one, with the net result being that these two disciplinary forces were far less effective than is typically posited in the academic corporate finance literature.

In the years immediately before Mark Willes' hiring, old management was under cash flow pressure due to TM's persistent poor operating performance, coupled with (1) the controlling Chandler family's desire for dividends, (2) TM's large ongoing capital expenditures, especially those for its cable television operations, and (3) the requirements of old management's strategic plan, which called for substantial investments in new technology. In theory, management

[1] "It is a dynasty, one of the few remaining in American society, surviving the dual contemporary onslaught of modern inheritance taxes and normally thinning genes. Its power and reach and role in Southern California are beyond the comprehension of Easterners, no Easterner can understand what it has meant in California *to be a Chandler*, for no single family dominates any major region of this country as the Chandlers have dominated California, it would take in the East a combination of the Rockefellers *and* the Sulzbergers to match their power and influence. In California the Chandlers are *the* dominant family…" (Halberstam, 1979, p. 94).

should respond to such pressure by improving operating performance, especially its core newspaper business, since the Chandler family was prohibited by trust from selling its interest in the L.A. Times. (But see the postscript that follows section 6 below, which indicates that the Chandlers were ultimately able to circumvent these trust provisions.) Instead, in 1994 old management undertook a complex asset sale to dispose of TM's cable operations (with most of the $1.3 billion cash proceeds earmarked to fund its strategic plan) and substantially reduced dividends to all stockholders except the Chandlers.

Events that followed the 1994 cable transaction contributed to the board's decision to hire as CEO an industry outsider who would take TM in a radically different strategic direction. First, while TM's share price increased at announcement of the cable sale, it fell sharply when old management disclosed details of its reinvestment plans. Not only was Wall Street's highly visible verdict on old management's reinvestment plans strongly negative, but this condemnation followed a series of financial press reports that questioned the wisdom of a number of old management's strategic decisions, the latest of which had appeared just two weeks earlier. Second, the Chandlers' differential dividend treatment, specifically the minority's dividend cut, alienated non-family stockholders, who sued to enjoin the asset sale. Finally, at age 64, CEO Robert Erburu was scheduled to retire soon, so that TM's board had a one-time opportunity to make a radical shift in corporate strategy without directly rebuking an executive who had been employed by the firm for over 30 years. In the same month the cable transaction was announced, TM's board expanded its CEO search to include outside candidates, and within the year had hired Mark Willes to replace Mr. Erburu.

We conclude that radical change at TM was precipitated by the confluence of events following the sale of its cable operations and the related dividend cut, and not by factors that the academic literature hypothesizes should play a central role in disciplining management of poorly performing companies. Since TM is majority controlled by the Chandlers, hostile takeover pressure (Manne, 1965) played no role in the CEO change. The possibility of a negotiated sale of the Chandlers' control block (Shleifer and Vishny, 1986) was not an effective disciplinary mechanism because the Chandlers' shares are held in trusts that restrict their sale. Debt-related pressures (Jensen, 1986) were not material, since TM maintained low leverage and investment grade debt ratings for at least 15 years before the 1995 CEO change, and its leverage position had improved in recent years. Nor were there material changes in the stock ownership or compensation incentives of operating management that could plausibly explain such an abrupt change in corporate direction (Jensen and Meckling, 1976).

In theory, another mechanism that disciplines managers to improve operating performance is the pressure to pay, or to continue paying dividends (Rozeff, 1982; Easterbrook, 1984; Jensen, 1986). Dividend pressure should be especially strong in firms such as TM that have controlling stockholders. In this particular

case, however, old management was able to circumvent such pressure for many years through asset sales that allowed it to pay dividends above the level sustainable given TM's continued poor earnings. This strategy ultimately backfired with the 1994 sale of TM's cable operations, in part because announcement of old management's plans to reinvest the proceeds generated an immediate negative response from Wall Street. Thus, at TM dividend pressure did not generate improved operating performance directly or immediately, but rather eventually helped precipitate an asset sale, which in turn set in motion events that ultimately clarified the need for a radical and decisive shift in corporate strategy.

We discuss the important lessons of the Times Mirror case in Section 6 below. Section 2 documents TM's poor operating and stock price performance before 1995, when the firm hired Mark Willes, and describes outside observers' concerns, as reported in the financial press, about a number of questionable strategic decisions made by old management. Section 3 shows that TM's old management faced little debt-related pressure to improve operations, but did face ongoing, albeit ineffective, pressure from the firm's historically generous dividend policy. The pressure to pay dividends was a major reason for the 1994 cable transaction, which we discuss in Section 4. Section 5 describes the changes made by Mr. Willes and his performance to date, and assesses potential explanations for the differences between his strategic decisions and those of his predecessor.

2. Times Mirror's financial performance prior to the 1995 CEO change

TM's operating performance declined substantially beginning in the late 1980s and, by virtually all measures we examine, was also subpar relative to that of other publicly traded newspaper firms. TM's poor performance reflects its relatively low operating margins and revenue growth rates, and its high corporate overhead (see Section 2.2). The stock market started to view TM as a poor performer relative to other newspaper companies by the mid-1980s, and came to view TM as lagging the market as a whole by the late 1980s (as described in Section 2.3). Finally, outside observers raised questions about a number of strategic decisions made by pre-Willes management, a fact that suggests that TM's poor performance was not solely attributable to factors beyond management's control, such as the regional recession in the early 1990s (see Section 2.4).

2.1. Background on Times Mirror

Times Mirror has been publicly traded since 1938, and NYSE-listed since 1964. At the time of the 1995 CEO change, the Chandler family held 57% of the

voting rights and 31% of the dividend rights through a dual class equity structure. Before 1980, Chandlers or their ancestors had managed the firm and/or its flagship L.A. Times newspaper for nearly 100 years. Otis Chandler, great-grandson of the initial family owner, is widely credited with transforming the L.A. Times from a provincial, highly conservative daily often used to advance Chandler family political causes into a high-quality national newspaper. Daily circulation increased from 536,000 copies in 1960, when Otis Chandler became publisher of the L.A. Times, to over one million copies in 1980, when he resigned his managerial duties to become TM's Chairman. By 1980 TM had expanded operations by purchasing other newspapers, and was also involved in newsprint and forest product operations, book and magazine publishing, information services, art and graphics products, and broadcast and cable television. On the 1980 sales-based Fortune 500 list, TM ranked number 201, an increase of about 100 places during Otis Chandler's 20-year tenure.

Robert Erburu, named CEO in 1980, continued TM's diversification strategy of purchasing other newspapers and related businesses. In 1980 TM bought the Denver Post, in 1984 it began to publish a New York City edition of Newsday, its Long Island newspaper, and in 1986 it purchased the Baltimore Sun and Evening Sun. Mr. Erburu also began to prune businesses whose performance was lagging. In 1986 TM sold the Dallas Times Herald, in 1987 it sold the Denver Post, in 1991 it sold Broadcasting and related magazines, and in 1992 the Los Angeles Times closed its San Diego edition. In 1992, TM reached its highest Fortune 500 ranking at number 130. In 1995, after TM's largest divestiture, the $2.3 billion sale of its cable television operations, TM fell to number 294. Since then, TM's Fortune ranking has continued to fall (to number 446 in 1999) due to further divestitures and corporate refocusing under Mark Willes.

2.2. Operating performance prior to the 1995 hiring of Mark Willes as CEO

Fig. 1 shows that TM's operating income and earnings before extraordinary items (EBEI) initially increased under Robert Erburu, then subsequently fell close to their 1980 values in 1994, Mr. Erburu's last full year as CEO. Operating income peaked in 1987 at $589.4 million, while EBEI peaked in 1986 at $408.1 million. The decline in operating performance was fully underway in 1988, and by 1994, operating income had fallen to $294.3 million. EBEI reached its low of $56.8 million in 1992, recovering to $126.2 million in 1994. In 1994, operating income exceeded its 1980 level by just 16%, while EBEI was 9% below its 1980 level. As a comparison, the consumer price index increased 74% from 1980 to 1994.

Some portion of TM's deteriorating operating performance under CEO Robert Erburu reflects industry-wide and economy-wide factors beyond

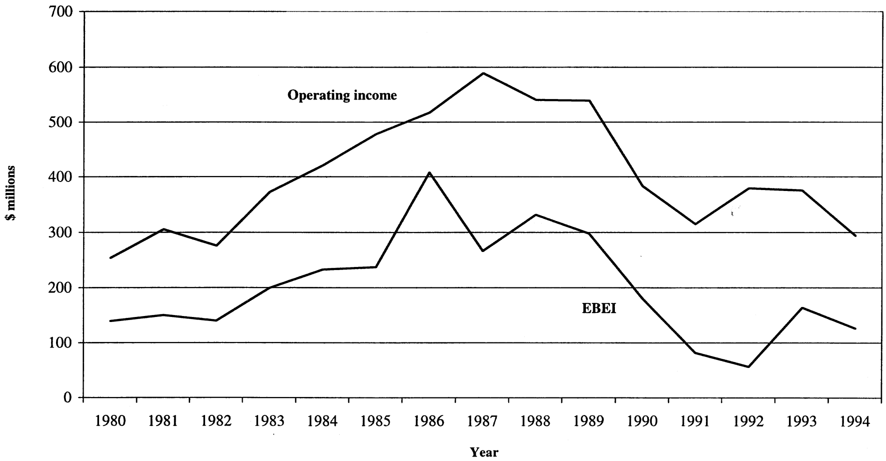

Fig. 1. Earnings performance at the Times Mirror Company: 1980–1994. The figure presents operating income and earnings before extraordinary items (EBEI) for the Times Mirror Company. Operating income is defined as sales minus cost of goods sold minus selling and general administrative expenses. All data are drawn from company annual reports.

managerial control. Industry-wide, daily newspaper circulation has been in steady decline since its 1987 peak.[2] The 1988–1994 period includes a major recession in 1990–1991, which precipitated a steep industry-wide decline in newspaper advertising revenue. Los Angeles was especially hard hit in the early 1990s, with severe downsizing in the defense industry and a regional collapse in real estate values. TM's advertising revenue, which peaked at 83% of newspaper revenue in 1985, declined to 76.8% in 1991, a level from which it has still not recovered (in 1997, it was 76.6%). Daily circulation at the L.A. Times peaked in 1990 at 1.196 million copies, and declined every year thereafter during Robert Erburu's tenure, falling to 1.062 million copies in 1994, his last full year as CEO.

Table 1 reports 1985–1994 revenue growth rates (Panel A) and operating margins (Panel B) for TM and the other six publicly traded firms that own one of the ten largest U.S. daily newspapers. The six comparison firms are Dow Jones, Gannett, Knight-Ridder, the New York Times Co., the Tribune Co., and

[2] Daily newspaper circulation refers to daily circulation for morning and evening editions published Monday through Saturday, per Standard & Poor's Industry Surveys: Newspaper Publishing (May 12, 1994). In 1994, 61.5% of all adults read a newspaper every day, versus 77.6% in 1970 (New York Times, April 20, 1995, D4). In 1993, according to the Audit Bureau of Circulations, 44 of the 100 largest newspapers had circulation declines, while the remainder generally experienced little or no growth.

the Washington Post Co.[3] We focus on 1985–1994 because, as Fig. 1 shows, TM's operating performance began to decline in 1987–1988. While the newspaper industry in general faced difficulties in the early 1990s, Table 1 shows that TM's operating performance lagged that of the comparison firms. Panel A reveals that TM's 1985–1994 average revenue growth is the lowest of all seven firms, and TM's annual revenue growth falls below that of the mean and median comparison firm in every year but two. Panel B shows that TM's 1994 operating margin is 45.7% below its 1985 level, the greatest percentage decline among all seven firms. In only one year (1987) does TM's operating margin exceed that of the mean or median comparison firm, and then by a trivial amount. For TM, 1990 marks a dramatic decline in operating margin, from 15.3% to 10.6%, a level from which the firm failed to recover until 1996, after Mark Willes was hired.

Table 2 reports 1985–1994 newspaper operating margins (Panel A) and corporate overhead as a percent of revenue (Panel B) for TM and the six comparison firms. TM's newspaper operating margins, like its overall margins, fell some 45% over the period, again the largest decline among all seven firms. In every single year, TM's newspaper margins are below those of the mean and median comparison firm. In 1990, TM's newspaper margins fell to half their prior level. In the 1990s, they are consistently half those of the mean and median firm. Panel B of Table 2 indicates that TM's corporate overhead ratio exceeds that of the mean and median firm in all but three years (1987–1989). This finding is partially due to the fact that TM reports data for "corporate and other" activities, so that its overhead ratios are not directly comparable to those of the other firms. However, since 1991, TM's overhead ratio exceeds that for the mean and median firm by 54–72%, which is greater than the differential in every prior year, suggesting that TM's overhead ratio was increasing in relative terms. TM's relatively high overhead ratio likely reflects what the Wall Street Journal (WSJ) calls the firm's "plush and laid back" work environment, commonly called the "velvet coffin" by employees of the L.A. Times which, unlike many other newspapers, has never been unionized.[4]

2.3. Share price performance prior to the hiring of Mark Willes

Fig. 2 plots market-adjusted and media firm-adjusted cumulative returns on TM common stock over 1980–1994. The market-adjusted return is TM's

[3] The ten largest newspapers (publicly held parent firm in parentheses) are: 1. WSJ (Dow Jones and Co., Inc.), 2. USA Today (Gannett Co., Inc.), 3. New York Times (The New York Times Co.), 4. Los Angeles Times (Times Mirror), 5. Washington Post (The Washington Post Co.), 6. New York Daily News (parent not publicly held at the time of interest), 7. Newsday (Times Mirror), 8. Chicago Tribune (Tribune Co.), 9. Detroit Free Press (Knight-Ridder, Inc.), 10. San Francisco Chronicle (parent not publicly held). The rankings are based on daily circulation at September 30, 1993 according to Standard and Poor's Industry Surveys: Newspaper Publishing (May 12, 1994).

[4] See WSJ, June 6, 1994, A1, and WSJ, July 17, 1995, A1.

Table 1
Revenue growth rates and operating margins for The Times Mirror Company and six comparison media firms: 1985–1994.

Panel A gives the percentage rate of change in annual sales revenue, while Panel B gives the operating margin, defined as operating income (revenue minus cost of goods sold minus selling and general administrative expenses divided by revenue). The far right column of Panel A gives the geometric growth rate over 1985 to 1994. The far right column of Panel B gives the percent change in a given firm's operating margin from 1985 to 1994. Entries marked 'above' or 'below' are those whose values are not meaningful, either because of negative or zero values for the benchmark (average or median of comparison firms) or for Times Mirror (TM). TM's 9.6% revenue decline in 1994 reflects the pending sale of its cable operations. All data are drawn from company annual reports.

A. Revenue growth rates (%)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1985–1994 Growth rate
Dow Jones	7.8	9.0	15.8	22.0	5.3	1.9	0.3	5.4	6.3	8.2	8.0
Gannett	12.7	26.8	11.1	7.3	5.6	– 2.8	– 1.5	3.4	5.7	5.1	7.1
Knight-Ridder	3.9	8.6	8.9	5.9	9.7	1.8	– 2.9	3.2	5.2	8.1	5.2
New York Times	13.4	12.3	8.0	3.5	4.0	0.4	– 4.1	4.1	13.9	16.7	7.0
Tribune Co.	8.0	4.7	7.0	5.7	7.0	– 3.4	– 18.3	4.6	5.0	10.5	2.7
Washington Post	9.6	12.6	8.3	4.0	5.6	– 0.4	– 4.1	5.1	3.3	7.7	5.1
Average	9.2	12.3	9.9	8.1	6.2	– 0.4	– 5.1	4.3	6.6	9.4	5.9
Median	8.8	10.7	8.6	5.8	5.6	0.0	– 3.5	4.4	5.5	8.2	6.1
Times Mirror	5.5	– 0.4	7.0	5.6	5.6	3.3	– 0.3	2.2	0.3	– 9.6	1.8
Relative to Average	60%	below	71%	70%	90%	above	above	50%	5%	below	31%
Relative to Median	63%	below	97%	97%	99%	above	above	49%	6%	below	30%

B. Operating margins (%)

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1985–1994 % change
Dow Jones	23.3	23.2	22.5	21.9	19.9	13.3	14.0	15.4	16.4	17.1	−26.6
Gannett	22.8	21.2	21.7	21.0	22.1	20.3	17.4	18.9	20.5	22.2	−2.6
Knight–Ridder	13.3	14.3	15.0	13.0	14.1	12.9	10.8	12.0	11.6	12.5	−6.0
New York Times	15.3	17.4	17.2	14.8	9.6	7.3	5.5	5.0	6.3	9.0	−41.2
Tribune Co.	12.5	13.2	11.8	15.5	16.9	11.7	17.0	17.7	18.6	18.8	50.4
Washington Post	18.9	18.8	19.5	17.1	21.7	19.6	14.0	16.0	16.0	17.0	−10.1
Average	17.7	18.0	18.0	17.2	17.4	14.2	13.1	14.2	14.9	16.1	−6.0
Median	17.1	18.1	18.4	16.3	18.4	13.1	14.0	15.7	16.2	17.1	−8.1
Times Mirror	16.2	17.6	18.7	16.2	15.3	10.6	8.7	10.2	10.1	8.8	−45.7
Relative to Average	92%	98%	104%	94%	88%	75%	66%	72%	68%	55%	762%
Relative to Median	95%	97%	102%	99%	83%	81%	62%	65%	62%	52%	564%

Table 2
Newspaper operating margins and corporate overhead for The Times Mirror Company and six comparison media firms: 1985–1994.

Panel A gives the operating margin for newspaper operations, defined as newspaper revenue minus newspaper cost of goods sold minus newspaper selling and general administrative expenses, divided by newspaper revenue. Panel B gives total corporate overhead as a percent of total company revenue. The far right column gives the percent change in a given firm's newspaper operating margin (Panel A) or corporate overhead ratio (Panel B) from 1985 to 1994. An entry marked 'n.d.' indicates the data were not disclosed by the firm for the year in question, while an entry marked 'n.m.' indicates the data are not meaningful. All data are drawn from company annual reports. The Washington Post Company allocates corporate overhead to its business segments, which implies that its newspaper operating margin is understated relative to those of the other firms. Times Mirror reports "corporate and other", which implies that its corporate overhead ratio is not strictly comparable to those of the other firms.

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1985–1994 % change
A. Newspaper operating margins (%)											
Dow Jones	25.4	24.1	20.9	15.8	14.1	11.7	11.3	14.6	16.7	16.0	– 37.0
Gannett	23.8	22.4	23.2	22.5	23.5	22.2	19.7	21.3	22.8	23.4	– 1.7
Knight–Ridder	16.9	17.8	17.7	15.6	17.4	16.3	13.6	14.9	14.8	16.4	– 3.0
New York Times	17.8	19.6	19.9	16.8	13.1	10.3	7.3	6.2	8.0	10.3	– 42.1
Tribune Co.	12.9	14.8	13.1	17.0	18.4	10.9	19.3	19.8	21.8	23.1	79.1
Washington Post	20.6	22.1	22.4	20.6	24.3	20.8	13.9	17.8	17.8	18.7	– 9.2
Average	19.5	20.1	19.5	18.0	18.5	15.4	14.2	15.8	17.0	18.0	– 2.3
Median	19.2	20.8	20.4	16.9	17.9	14.0	13.8	16.4	17.3	17.6	– 6.1
Times Mirror	17.2	19.2	18.9	15.6	15.0	8.3	6.7	6.5	7.1	9.4	– 45.3
Relative to average	88%	95%	97%	87%	81%	54%	47%	41%	42%	52%	1970%
Relative to median	90%	92%	93%	93%	84%	59%	49%	40%	41%	54%	743%

B. Corporate overhead to total revenue (%)

Dow Jones	n.d.	n.d.	n.d.	n.d.	n.d.	n.d.	0.9	0.9	0.9	0.9	n.d.
Gannett	2.3	2.4	2.3	2.3	1.8	1.8	1.9	1.9	1.8	1.8	− 21.7
Knight–Ridder	1.4	1.4	1.5	1.6	1.7	1.8	1.6	1.5	1.5	1.6	14.3
New York Times	0.9	0.9	1.0	0.8	0.8	0.8	0.8	1.0	1.0	1.2	33.3
Tribune Co.	1.0	1.0	1.3	1.1	1.0	1.1	1.3	1.3	1.3	1.2	20.0
Washington Post	n.d.	n.d.	n.d.	n.d.	n.d.	n.d.	n.d.	n.d.	n.d.	n.d.	n.d.
Average	1.4	1.4	1.5	1.5	1.3	1.3	1.3	1.3	1.3	1.3	11.5
Median	1.2	1.2	1.4	1.3	1.3	1.4	1.3	1.3	1.3	1.2	17.2
Times Mirror	1.8	1.7	0.6	− 0.3	0.4	1.9	2.2	2.1	2.1	2.1	16.7
Relative to average	129%	117%	37%	n.m.	28%	142%	171%	161%	164%	154%	145%
Relative to median	150%	138%	40%	n.m.	28%	135%	172%	162%	165%	167%	97%

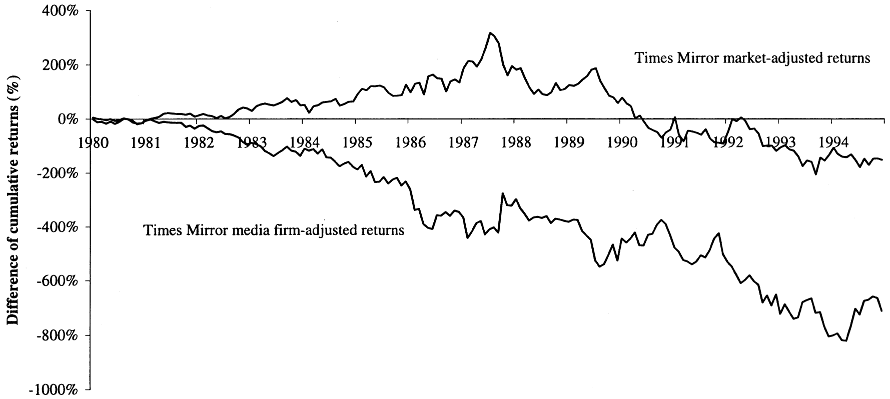

Fig. 2. Common stock returns of the Times Mirror Company versus the CRSP value-weighted market index and an equal-weighted portfolio of six comparison media firms: 1980–1994. The figure plots the cumulative rate of return on Times Mirror common stock minus the cumulative rate of return on two benchmarks from the beginning of 1980 through year-end 1994. The first benchmark portfolio is the CRSP value-weighted market index and the second is a portfolio with equally weighted investments in six media firms: Dow Jones, Gannett, Knight-Ridder, New York Times, Tribune Co., and Washington Post. All rate of return data are drawn from CRSP, and include both dividends and share price changes.

cumulative return minus the contemporaneous return on the Center for Research in Security Prices (CRSP) value-weighted index. The media firm-adjusted return is TM's cumulative return minus the contemporaneous return on a portfolio with equal investments in the six comparison firms. For roughly the first half of the 1980s, TM's stock returns are near those of both the CRSP market index and the comparison media firms, staying a bit above the former and a bit below the latter. From the middle to late 1980s, TM's stock performance exceeds that of the market index, but falls below that of the other media firms. From the late 1980s through 1994, TM's returns are inferior to those of both the market index and the comparison firms. Thus investors began to view TM as a poor performer relative to other newspaper companies around the mid-1980s and, by the late 1980s, also saw TM as performing poorly relative to the market as a whole.

2.4. *Questionable strategic decisions by prior management*

TM's poor operating and stock price performance reflects a number of questionable strategic decisions by pre-Willes management. These decisions drew criticism from a variety of outside observers, and we summarize these criticisms briefly here (see also the Appendix chronology).[5] In 1984, TM intro-

[5] Sources for statements in this section are: WSJ, May 29, 1986, 3; New York Times, September 21, 1987, IV-1; WSJ, February 7, 1989, A1; Forbes, April 12, 1993, 46; and WSJ, July 17, 1995, A1.

duced the New York City edition of its Long Island newspaper, Newsday, which subsequently incurred ten years of losses totaling $100 million or more, before being closed abruptly in 1995 by Mark Willes. In 1986, TM purchased the Baltimore Sun and Evening Sun at a price that, according to the Wall Street Journal, "raised eyebrows among analysts who follow publishing stocks". Regarding that purchase, Forbes reported in 1993 that "Today, the Sun's annual operating profits of about $25 million don't come close to returning a decent profit on the final $650 million investment. Circulation has declined 11%, advertising lineage 37% since 1986" and "it remains doubtful whether the results will ever justify the cost". TM closed the Evening Sun in 1995.

During the early to mid-1980s, according to the Wall Street Journal, TM was "drubbed by competition in Dallas and Denver, where it sold the Dallas Times Herald in 1986 and the Denver Post in 1987 after years of losses". These losses reflect TM's questionable strategy of purchasing daily newspapers in major metropolitan areas with multiple papers during a period of consolidation, which left most such areas with only one daily newspaper. Regarding the sale of TM's Dallas and Denver papers, the New York Times says that "Admitting defeat in Dallas and Denver gave Times Mirror a reputation for being unable to turn-around struggling newspapers". In 1986, TM purchased Broadcasting and related magazines for $75 million, which it sold in 1991 for $32 million in a transaction cited by the Wall Street Journal as one that "raised questions" about the pricing of asset sales and divestitures done by pre-Willes management. Nor were acquired newspapers in distant cities the only money losers for TM. In 1992, the firm closed the San Diego edition of the L.A. Times, which Forbes estimates lost "nearly $100 million" over its 14-year history.

In 1993, TM sold four television stations, which the buyer re-sold less than one year later (to a Ronald Perelman company) for around $700 million or a profit of some $150-200 million, earning what the Wall Street Journal termed an "enormous return" on its short-term investment. This return was so large that the Chandlers became concerned: the Wall Street Journal quotes Jeffrey Chandler as saying that "the family phone lines were humming for a week" after the re-sale price was disclosed, which disclosure occurred just two weeks before the 1994 cable transaction announcement. It seems likely that the Chandlers' concerns over the profit foregone in the television station sale served to sensitize the family to the adverse developments that followed the cable transaction (see Section 4.2 for details).

Finally, a number of journalists pointed out that, while TM's management was absorbed in various acquisitions and divestitures, the firm's flagship L.A. Times was increasingly being supplanted by local newspapers in its own back yard, particularly in Orange County and to a lesser extent in the San Fernando Valley. The Wall Street Journal, for example, says that "as for the local competition, time and again top executives have overlooked or underestimated it". The many questions raised in the financial media about major strategic

decisions made by pre-Willes management suggests that TM's poor operating and stock price performance, documented above, reflects poor managerial decisions, and not simply economic events beyond managerial control (e.g., the regional recession of the early 1990s).

3. Debt and dividend pressures at Times Mirror before the 1995 CEO change

Although TM's operating performance began to decline in the late 1980s, and its stock had underperformed the industry since the mid-1980s, the board did not bring in Mark Willes until 1995. This aspect of the TM case, combined with the evidence in Section 2.4, supports Jensen's (1993) hypothesis that boards of directors are generally slow in dealing with poor managerial performance.[6] In Jensen's view, boards' inherent slowness implies that debt and/or dividend pressures are often required to force desirable changes in management and major cost-cutting initiatives. We next show that debt pressure played no material role in the events that led to the hiring of an outsider as CEO (Section 3.1), but that TM's historically generous dividend policy did put ongoing pressure on old management to increase total cash flow (Section 3.2).

3.1. TM's debt obligations before the CEO change

Table 3 reports leverage data for 1980–1994 which show that TM maintained low leverage and investment grade debt ratings for at least 15 years before the 1995 CEO change. Moreover, with the exception of the bond ratings, every leverage measure reported in the table actually improves over the two years before TM hired Mark Willes. The ongoing low leverage and the short-term improvement therein indicate that debt-related pressure was not a key factor in the 1995 CEO change.

Panel A of Table 3 shows that TM's bonds maintained investment grade ratings throughout 1980–1994. TM's A2 rating in 1993-1994 is one notch below Moody's rating for the prior eight years, but indicates that Moody's still viewed

[6] One possible reason for the delay is that at the time TM's board viewed the firm's poor performance as primarily due to the regional recession in Los Angeles, thus beyond managerial control. While regional problems may help explain TM's poor performance relative to the comparison firms in the early 1990s, it cannot be the entire explanation for at least three reasons. First, TM's stock had underperformed relative to the comparison firms since the mid-1980s, or well before the inception of the regional recession (Section 2.3). Second, TM's operating performance was consistently below that of the average comparison firm since at least the mid-1980s (Section 2.2). Finally, the questionable managerial decisions that we discuss in Section 2.4 primarily concern firms owned by TM outside the Los Angeles area, and many occurred in time periods before the regional recession.

Table 3
Financial leverage of the Times Mirror Company: 1980–1994.

The table presents eight measures of the financial leverage position of the Times Mirror Company. The Moody's debt rating is at year-end and is obtained from Moody's Bond Record. Total debt equals the sum of long term debt and short term interest bearing debt. Long term debt, short term debt, and total assets are measured in book value terms. Total capital equals the market value of equity plus the book value of long and short term debt. The interest coverage ratio is calculated as (1) earnings before interest, taxes, extraordinary items, discontinued operations, and accounting changes in a given year divided by (2) interest expense in that year. All data, except the Moody's ratings, come from company annual reports.

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
A. Bond ratings															
Moody's debt rating	Aa	Aa	Aa3	Aa3	Aa3	A1	A1	A1	A1	A1	A1	A1	A1	A2	A2
B. Dollar amounts of debt															
Long term debt ($millions)	447	478	541	513	446	721	836	878	877	892	1,068	978	1,114	795	246
Total debt ($millions)	462	503	552	590	584	937	901	887	882	1,089	1,235	1,091	1,215	1,132	892
C. Debt proportions															
Long term debt/total assets	0.26	0.25	0.25	0.22	0.18	0.27	0.29	0.28	0.25	0.23	0.26	0.24	0.26	0.17	0.06
Total debt /total assets	0.27	0.26	0.26	0.25	0.23	0.35	0.31	0.28	0.25	0.28	0.30	0.27	0.28	0.25	0.21
Total debt/total capital	0.25	0.24	0.21	0.10	0.17	0.20	0.18	0.09	0.17	0.19	0.26	0.22	0.23	0.21	0.18
D. Interest expense and coverage															
Interest expense ($millions)	24	49	52	44	54	58	60	53	58	55	76	77	75	85	69
Interest coverage ratio	10.5	6.3	5.8	9.1	8.3	8.9	12.4	10.4	10.4	10.0	5.0	3.1	2.6	4.5	4.6

TM's bonds as a respectable quality credit before Mr. Willes' arrival.[7] Panels B and C show that, while the dollar amounts of long term and total debt increased over 1980–1992, debt as a proportion of total assets and capital remained roughly constant over this period. Moreover, debt declined both in absolute and relative terms in 1993 and 1994, when TM's leverage also fell relative to that of the comparison firms.[8] Panel D shows that, with the possible exception of 1991–1992, interest coverage remained reasonably high (above 4.5 and up to 12.4) over 1980–1994, so that at no point did TM face the serious prospect of an interest payment shortfall. Nor was TM close to a debt covenant violation: the 1994 annual report indicates that TM's consolidated debt is one-third the amount permitted under TM's most restrictive covenant, while its consolidated net worth is 157% of the required amount.

The high bond ratings and low leverage ratios indicate that TM followed a conservative debt policy, consistent with Jensen and Meckling's (1976, fn 52) prediction that controlling stockholders favor low leverage because financial distress can cost them control. It is also consistent with the evidence in DeAngelo and DeAngelo (1985, p. 40) that controlled firms tend to have low debt ratios. Because of controlling stockholders' incentive to limit debt, firms like TM present an ideal forum to test whether dividend policy can itself effectively pressure management to improve operating performance. The data presented next show that TM's dividend policy did exert pressure on old management, but that management was able to circumvent this pressure for many years by tapping non-operating sources of cash.

3.2. Dividend pressure before the CEO change

TM followed an aggressive payout policy over 1980–1994, particularly just before the 1995 CEO change. We use the Lintner (1956) model to assess the extent to which TM paid higher dividends over 1980–1994 than it would normally have paid, given the firm's realized earnings and its historical payout policy. We also use this approach to assess TM's actual dividends relative to the level the firm would have paid had its earnings performance kept pace with that

[7] Moody's Bond Record indicates that "Bonds which are rated A possess many favorable attributes and are to be considered as upper-medium-grade obligations. Factors giving security to principal and interest are considered adequate, but elements may be present which suggest a susceptibility to impairment some time in the future". The 2 in the A2 rating indicates that the rated debt is in the middle of the ratings distribution for the A category; A1 indicates that the firm is in the high end of the ratings distribution for the A category.

[8] From 1985–1993, TM's ratio of long term debt to total assets is slightly higher, but not markedly different from that for the mean and median comparison firm. In 1990, for example, TM's long term debt ratio is 26% versus 23% for the median comparison firm. By 1994, all firms had reduced their leverage, but TM's reduction was larger so that TM's ratio was 6% in that year, versus 16% for the median comparison firm.

of the six comparison firms. We find that, even though old management paid abnormally high dividends given TM's realized earnings, stockholders still had reason to be disappointed because TM's dividends remained well below the level the firm would have paid had its earnings performance simply matched that of the median comparison firm.

The basic Lintner model relates the current year's dividend change to a constant term, last year's dividend, and this year's earnings (all measures are on a per share basis). Fama and Babiak (1968) and others find that the Lintner model generally does a good job explaining dividend decisions. Fama and Babiak obtain the best dividend predictions when the model is specified with earnings defined as earnings before extraordinary items (EBEI), the constant term is set equal to zero, and last year's EBEI is included as an explanatory variable. Thus, we use EBEI and consider four model specifications, which alternately include and omit a constant term and lagged earnings.

Panel A of Table 4 presents parameter estimates for these four specifications of the Lintner model based on earnings and dividend data for 1958–1979. All fitted models do a good job explaining TM's dividend decisions (with adjusted R^2's between 83.9% and 88.5%), and the magnitudes of the estimated parameters are empirically plausible. For example, Model 1's dividend coefficient implies a speed of adjustment coefficient of 0.26 – i.e., TM typically responded to an earnings increase by adjusting dividends about one-quarter of the way each year to its long-run target payout level. The dividend and earnings coefficients in Model 1 jointly imply that TM's target payout ratio over 1958–1979 is about 55% of earnings, since 0.11/0.26 equals 0.55 (see Fama and Babiak, 1968 for why this ratio of coefficients estimates the firm's target payout ratio).

Panel B of Table 4 reports TM's actual dividends relative to the level predicted by the Lintner model for each of the years 1980–1994, given the firm's realized earnings. Panel C reports comparable figures assuming that TM's earnings performance matched that of the median comparison firm. In Panel B, we use the Panel A parameter estimates to predict dividends in a given year conditional on TM's realized earnings. For example, actual 1980 dividends are 110.1% of those predicted by 1980 earnings, 1979 dividends, and the Model 1 parameter estimates. Similarly, actual 1981 dividends are 121.1% of those predicted by Model 1, given TM's actual 1981 earnings and 1980's predicted, not actual, dividends.[9]

[9] The iterative nature of this procedure implies that the firm's earnings history from 1980 through any subsequent year T enters into the prediction of dividends for year T, and therefore into the estimated excess dividend for that year. For example, predicted 1981 dividends are based on predicted 1980 dividends used as an input to the Lintner model. And since predicted 1980 dividends are a function of 1980 earnings, predicted 1981 dividends also depend on 1980 earnings, even for model specifications in which lagged earnings do not enter explicitly. Similarly, predicted 1982 dividends are based on predicted dividends for 1981, and the latter figure depends on both 1981 and 1980 earnings. Therefore, predicted 1982 dividends are a function of earnings for 1982, 1981, and 1980, and so on.

Table 4
Actual versus predicted dividend payments by The Times Mirror (TM) Company: 1980–1994.

Panel A gives estimates of four variants of the Lintner model that prior research (Fama and Babiak, 1968) has shown to yield unsurpassed dividend predictions. These estimates are generated from annual dividends and earnings per share data for TM over 1958–1979, as reported by Compustat. We use the Panel A estimates to generate predicted levels of dividends based on realized future earnings in 1980, 1981, etc. Panel B reports the ratio of actual dividends to dividends predicted by each fitted model, given realized earnings for TM. Panel C reports the ratio of actual to predicted dividends, given industry adjusted earnings for TM, defined as the level of earnings per share that TM would have attained had its actual 1979 earnings grown in subsequent years at the median rate of the six comparison firms analyzed earlier in the paper.

A. Lintner model estimates for Times Mirror over 1958–1979

	Coefficient estimates (t-statistics):				Adjusted R^2
	Constant	Lagged dividend	Current earnings	Lagged earnings	
Model 1	—	– 0.27 (– 2.40)	0.11 (4.36)	—	88.5%
Model 2	—	– 0.30 (– 1.87)	0.10 (4.04)	0.01 (0.30)	87.9%
Model 3	– 0.01 (– 1.82)	– 0.23 (– 2.08)	0.10 (4.56)	—	84.6%
Model 4	– 0.01 (– 1.79)	– 0.27 (– 1.75)	0.10 (4.20)	0.01 (0.41)	83.9%

Year	Model 1	Model 2	Model 3	Model 4
B. Ratio of actual to predicted dividends given realized earnings for Times Mirror				
1980	110.1%	110.2%	107.7%	107.8%
1981	121.1%	121.8%	116.5%	117.5%
1982	136.0%	137.2%	128.9%	130.6%
1983	118.5%	120.3%	111.8%	114.3%
1984	123.2%	124.7%	115.8%	118.1%
1985	125.9%	127.1%	117.5%	119.6%
1986	103.0%	104.2%	97.0%	99.0%
1987	109.4%	109.3%	101.4%	102.0%
1988	112.1%	113.2%	103.3%	105.2%
1989	118.7%	120.0%	108.1%	110.4%
1990	141.4%	143.7%	125.9%	129.7%
1991	172.6%	178.4%	148.8%	156.8%
1992	214.4%	227.6%	179.0%	195.5%
1993	215.0%	231.1%	181.5%	202.1%
1994	229.5%	244.7%	193.4%	214.3%
C. Ratio of actual to predicted dividends given realized industry adjusted earnings for Times Mirror				
1980	104.5%	104.6%	102.4%	102.6%
1981	109.4%	109.8%	105.6%	106.2%
1982	114.0%	114.7%	108.7%	109.6%
1983	97.1%	97.9%	92.0%	93.2%
1984	97.6%	98.4%	92.1%	93.2%
1985	94.5%	95.0%	88.6%	89.6%

Table 4 (*continued*)

Year	Model 1	Model 2	Model 3	Model 4
1986	90.7%	91.1%	84.6%	85.5%
1987	86.7%	87.2%	80.4%	81.5%
1988	85.4%	86.0%	78.9%	80.0%
1989	82.0%	82.7%	75.5%	76.7%
1990	84.6%	85.3%	77.1%	78.4%
1991	87.5%	88.6%	78.4%	80.3%
1992	88.4%	90.4%	78.4%	81.4%
1993	83.8%	86.0%	74.3%	77.7%
1994	75.9%	77.8%	67.7%	70.7%

For every year over 1980–1994, Panel B shows that Times Mirror's actual dividends exceed the dividends implied by realized earnings and Models 1 and 2. Models 3 and 4 show the same pattern of excess payouts over the full period, with the trivial exception of 1986 (when actual dividends are 3% below those predicted under Model 3, and 1% below those predicted under Model 4). Under all four models, excess dividends are generally moderate during the 1980s, with the ratio of actual to predicted dividends reaching a high of 136–137% in the recession year 1982 (under Models 1 and 2).

The estimated level of excess dividends increases substantially in 1990, and thereafter rises to truly dramatic levels under all four models. Under Model 1, for example, the ratio of actual to predicted dividends increases from 118.7% in 1989 to 141.4% in 1990, and continues to increase in every subsequent year, reaching a peak of 229.5% in 1994. In 1992–1994, the ratio of actual to predicted dividends exceeds 200% for eight of the twelve estimates in Panel B, with the smallest value a still substantial 179.0% (Model 3 in 1992). These data indicate that, throughout the early 1990s, TM's actual dividends exceed, by a wide margin, those implied by the Lintner model and the firm's current earnings. This finding suggests that old management felt pressure to pay generous dividends despite the firm's continued poor performance.

Although old management increased dividends well beyond those justified by TM's earnings, stockholders nonetheless had reason to view these payouts as disappointing. Panel C of Table 4 reports TM's actual dividends as a percent of the dividends the firm would have paid had its earnings performance simply matched that of the median comparison firm.[10] For all models and all years beginning in the mid-1980s, TM's actual dividends are well below their

[10] We calculate TM's hypothetical industry-adjusted earnings for 1980 by multiplying actual 1979 earnings by one plus the 1980 earnings growth rate for the median comparison firm. TM's industry-adjusted earnings for 1981 equal 1980 industry-adjusted earnings times one plus the growth rate for the median comparison firm over 1981. And so on for later years.

predicted amounts. Under Model 1, for example, the 1994 ratio of actual to predicted dividends is 75.9%, implying that stockholders received 24.1% less than they would have, had TM's earnings performance kept pace with the industry. Beginning in 1983, all data in Panels B and C fit this pattern, with stockholders receiving less, and in later years much less than they would have, had old management been able to increase TM's earnings at the median industry rate.

In three of the four years before the 1995 CEO change, TM's dividend payout ratio exceeds 100%, and it also substantially exceeds the payout ratios of the six comparison firms. Table 5 reports 1985–1994 cash dividends as a percent of EBEI (Panel A) and cash dividends plus common stock repurchases as a percent of EBEI (Panel B) for TM and the six comparison firms. The far right column of Panel A reports that TM's dividend payout ratio is 60.1% for the median year over 1985–1994, which is 169% of that for the median comparison firm. The far right column of Panel B indicates that payout ratios, which include stock repurchases, also tend to be higher for TM than for the other firms. Most alarmingly, TM's dividend payout ratio grows from less than 45% during 1985–1989 to over 100% in three of the four years since 1990. Table 5 also shows that persistent payout ratios in excess of 100% are unique to TM in the early 1990s. Payout ratios in excess of 100% are, of course, simply not sustainable in the long term.

Table 6 reports the cumulative cash payout deficit for TM over 1980–1994, given its actual cash flow from operations and actual investment and asset disposal decisions. These data show that TM's total annual equity payouts, calculated as dividends plus stock repurchases, generally exceed its free cash flow, calculated as cash flow from operations minus outlays for capital investment and acquisitions. In fact, total equity payouts usually exceed free cash flow by a wide margin. Net cash flow after equity payouts but before asset sales is negative in 12 of the 15 years in the table. In all three years in which TM avoided a net cash flow deficit (1991, 1993, and 1994), dividends were frozen at their 1990 level, although they had increased substantially during the 1980s. And capital expenditures in those three years averaged \$264 million, versus \$418 million for the other 12 years in the table.

The most striking finding in Table 6 is that, from 1980 to 1994, the cumulative net cash flow deficit before asset sales grew to \$2.4 billion, reflecting TM's continued high equity payouts and investment outlays.[11] Through a series of asset sales that began in 1982, by year-end 1994 old management was able to

[11] While Table 5 indicates that TM's equity payouts were high relative to those of the comparison firms, its investment outlays as a percent of total assets do not differ significantly from those of the median comparison firm during Mr. Erburu's tenure as CEO. Specifically, we calculate the ratio of cash outlays for capital expenditures and acquisitions to the prior period's total assets, both for TM and the six comparison firms. We use a t-test to compare the time series for TM to that for the median comparison firm, and the difference is not significant (p-value = 0.62).

reduce the cumulative net cash flow deficit to $740 billion, a number that is nonetheless substantial for a firm whose 1994 net cash flow before asset sales is just $53 million. [The cumulative deficit as of 1994 is $2.8 billion when we include cash outflows for all other investments (beyond outlays for capital expenditures and acquisitions) and, after asset sale proceeds, the net deficit is $1.1 billion.] In essence, old management sold assets to help fund continued high dividends that were not warranted given TM's recent operating performance, yet it was still unable to avoid running up a large cumulative net cash flow deficit.

3.3. Chandler family control and TM's dividend payouts

By 1994 this cumulative deficit, combined with TM's continued poor operating performance and ongoing capital expenditures, made a dividend cut desirable and, arguably, imperative. In controlled firms such as TM, a dividend reduction would likely have severe consequences for management, reflecting the costs it imposes on controlling stockholders who can fire management and who have limited ability to create "homemade dividends" by selling shares while preserving control. A dividend reduction would have especially undesirable consequences for the Chandlers, whose trusts cannot sell their TM shares until after the death of the last family member who was alive in 1938.[12] Consequently, a dividend cut would likely force the Chandlers to reduce their personal consumption, thereby posing a more concrete threat to their welfare than a deterioration in TM's operating income or a decline in the firm's stock price.

By 1994, the Chandlers, along with TM's other stockholders, had already foregone dividend increases for four years. Table 7 reports 1980–1994 data on Chandler family stock ownership (columns (1) and (2)), total dividends (column (3)), and dividends paid the Chandlers (columns (4)–(7)). Column (1) shows that, until TM's 1987 dual class recapitalization, the family held an identical percentage of voting rights and dividends from their holdings of approximately 31–32% of the firm's common stock.[13]

[12] If Chandler family members are prevented by contract from selling their shares, their ability to borrow using those same shares as collateral is limited, since presumably the lender also could not sell the shares if the borrower defaults.

[13] From the mid- to late-1980s, the Chandlers and TM took a number of actions to consolidate the family's control. In 1985, TM issued 3.1 million new common shares (4.3%) to its ESOP and repurchased 10.4% of its shares. In 1986, shareholders approved a proposal to both change TM's state of incorporation from California to Delaware and to add anti-takeover amendments. In 1987, they approved the creation of two classes of common stock with differential voting rights. TM reclassified its common stock as class A and distributed to all current holders, one for one, a share of new class C common stock, with ten votes per share. Class C common stock is transferable only among shareholders' families and other closely affiliated parties. If class C shares are sold to others, they revert to class A common shares. Thus, over time, as non-Chandler stockholders sell shares and the Chandlers do not, the Chandlers' voting percentage increases.

Table 5
Cash payout ratios for The Times Mirror Company and six comparison media firms: 1985–1994.

Panel A gives each firm's dividend payout ratio defined as cash dividends paid on common stock in a given year divided by earnings before extraordinary items (EBEI). Panel B gives each firm's total cash payout ratio defined as common stock dividends plus repurchases in a given year divided by EBEI. The far right column gives the each firm's median payout ratio over 1985–1994. Payout ratios marked 'n.m.' are not meaningful because earnings are negative. All data are drawn from company annual reports.

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1985–1994 median
A. Dividends as a percent of earnings (%)											
Dow Jones	36.2	29.2	30.5	29.0	22.9	71.7	106.3	65.0	54.1	46.0	41.1
Gannett	46.9	49.0	46.6	44.4	43.8	51.1	63.8	52.1	47.4	41.8	47.1
Knight–Ridder	34.7	35.6	38.1	42.9	35.2	44.6	53.8	52.0	51.9	45.6	43.7
New York Times	20.1	20.3	20.5	22.7	56.4	79.3	69.3	n.m.	768.8	27.3	27.3
Tribune Co.	28.7	14.4	35.3	27.3	26.2	n.m.	43.5	45.7	33.8	30.0	30.0
Washington Post	11.3	14.3	8.8	7.5	11.9	27.8	42.0	38.9	32.1	28.7	21.1
Average	29.6	27.2	30.0	29.0	32.7	54.9	63.1	50.7	164.7	36.6	35.1
Median	31.7	24.8	32.9	28.2	30.7	51.1	58.8	52.0	49.6	35.9	35.6
Times Mirror	38.7	23.7	39.7	35.7	43.3	76.9	169.4	244.6	84.6	110.0	60.1
Relative to average	131%	87%	133%	123%	132%	140%	268%	482%	51%	301%	171%
Relative to median	122%	96%	121%	127%	141%	150%	288%	470%	171%	307%	169%

B. Dividends plus common stock repurchases as a percent of earnings (%)

Dow Jones	36.2	35.0	46.4	30.1	25.5	75.3	106.3	89.0	86.9	111.3	60.8
Gannett	46.9	49.0	46.6	54.6	52.2	82.8	286.5	52.1	47.4	127.6	52.1
Knight–Ridder	286.4	36.6	61.9	178.0	108.5	131.7	53.8	52.0	79.3	125.8	93.9
New York Times	26.4	27.5	44.5	92.3	146.0	155.5	69.3	n.m.	4937.1	136.4	92.3
Tribune Co.	28.7	40.5	125.7	59.7	155.5	n.m.	43.5	45.7	33.8	51.0	45.7
Washington Post	129.1	14.3	8.8	7.5	66.0	121.3	48.3	44.7	47.1	79.8	47.7
Average	92.3	33.8	55.7	70.4	92.3	113.3	101.3	56.7	871.9	105.3	65.4
Median	41.6	35.8	46.5	57.2	87.3	121.3	61.6	52.0	63.4	118.5	56.5
Times Mirror	232.4	24.3	50.8	36.4	44.3	90.4	169.4	244.6	84.6	110.0	87.5
Relative to Average	252%	72%	91%	52%	48%	80%	167%	431%	10%	104%	134%
Relative to Median	559%	68%	109%	64%	51%	74%	275%	470%	134%	93%	155%

Table 6
Cumulative net cash flow deficit ($millions) for The Times Mirror Company: 1980–1994.

Free cash flow is defined as cash flow from operations minus investment outlays. Investment outlays are cash flows for capital expenditures and acquisitions, taken from the cash flow statement. Net cash flow (NCF) before asset sales equals free cash flow minus cash dividends and repurchases, while "bottom line" NCF adds the cash proceeds from asset sales. Each cumulative NCF amount is simply the running total, beginning with the 1980 amount. Cash flow from operations is calculated net of interest charges because the table is designed to assess the ability of the firm's ongoing operations to generate cash payouts to equityholders, and interest must be paid before cash is distributed to equityholders. All data are drawn from Times Mirror annual reports. Rounding error accounts for the few minor addition discrepancies in the numbers.

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Cash flow from operations	206	255	256	344	343	410	223	366	452	445	407	441	399	426	486
Investment outlays	−379	−216	−230	−364	−361	−373	−775	−424	−480	−538	−414	−223	−462	−275	−295
Free cash flow	−172	39	26	−20	−18	37	−552	−59	−29	−93	−7	218	−63	151	191
Payouts:															
Dividends	−52	−61	−68	−69	−82	−92	−97	−106	−118	−129	−139	−139	−139	−139	−139
Repurchases	0	0	0	0	0	−459	−2	−30	−2	−3	−24	0	0	0	0
Total payouts	−52	−61	−68	−69	−82	−551	−99	−135	−121	−132	−163	−139	−139	−139	−139
NCF after payouts but before asset sales	−224	−22	−42	−89	−101	−514	−651	−194	−149	−225	−170	79	−202	13	53
Cumulative NCF deficit before asset sales	−224	−246	−288	−377	−477	−991	−1,643	−1,837	−1,986	−2,211	−2,381	−2,303	−2,504	−2,491	−2,439
Asset sale proceeds	0	0	23	62	87	108	552	103	145	16	9	66	62	125	340
Cumulative proceeds	0	0	23	86	173	281	833	936	1,082	1,097	1,106	1,173	1,234	1,360	1,700
Cumulative NCF deficit	−224	−246	−265	−291	−305	−710	−810	−900	−905	−1,114	−1,275	−1,130	−1,270	−1,132	−740

Table 7
Chandler family voting rights ownership in and estimated dividends received from The Times Mirror Company: 1980–1994.

Times Mirror proxy statements are the source for the stock ownership data. Annual reports are the source for total dividends paid to stockholders. Dividends received by the Chandler family in each year are estimated as the firm's total common stock dividends for the year in question times the proportion of all common shares held by the family as reported in the proxy statement issued after the end of the fiscal year. Voting rights and dividends prior to 1987 reflect the single class of voting common stock that was outstanding, and thereafter reflect the firm's introduction of dual classes of common stock (one class with ten votes per share and the other class with one vote per share). The inflation adjusted dividend amount in a given year equals the unadjusted dividend amount divided by one plus the percentage increase in the Consumer Price Index since 1980.

	(1) Chandler family vote percentage	(2) Chandler family dividend percentage	(3) Total dividends to all stockholders ($000s)	(4) Estimated dividends received by the Chandler family ($000s)	(5) Chandlers' inflation adjusted dividends (1980 constantdollars)	(6) Growth since 1980 in Chandlers' inflation adjusted dividends	(7) Change since 1990 in Chandlers' inflation adjusted dividends
1980	31.5%	31.5%	$51,522	$16,229	$16,229	—	—
1981	31.4	31.4	61,110	19,189	17,618	8.6%	—
1982	31.2	31.2	68,311	21,313	18,848	16.1	—
1983	31.0	31.0	68,606	21,268	18,122	11.7	—
1984	30.7	30.7	82,446	25,311	20,729	27.7	—
1985	32.8	32.8	91,806	30,112	23,760	46.4	—
1986	32.8	32.8	96,705	31,719	24,734	52.4	—
1987	38.7	32.8	105,793	34,700	25,913	59.7	—
1988	45.9	32.5	118,336	38,459	27,507	69.5	—
1989	48.8	32.5	129,144	41,972	28,690	76.8	—
1990	51.0	32.5	138,779	45,103	29,016	78.8	—
1991	52.5	32.0	138,792	44,413	27,746	71.0	– 4.4%
1992	54.0	32.0	138,846	44,431	26,958	66.1	– 7.1
1993	54.8	31.1	138,878	43,247	25,523	57.3	– 12.0
1994	56.8	31.1	138,901	43,129	24,793	52.8	– 14.6

A comparison of columns (1) and (2) reveals that the Chandlers' vote percentage exceeds their dividend percentage beginning in 1987 and, by 1990, the family held a majority of the votes. Column (2) shows that the family continued to receive some 31–32% of TM's total dividends over the entire 1980–1994 period.

Column (3) of Table 7 shows that TM's total dividends increased steadily from $51.5 million in 1980 to $138.8 million in 1990, but remained stalled at roughly the latter amount through 1994. Likewise, Chandler family dividends increased steadily from $16.2 million in 1980 to $45.1 million in 1990, where they languished through 1994 (column (4)). The picture appears even more grim when we adjust the Chandler family dividends for realized inflation. Column (5) indicates that the Chandlers' dividends grew to only $24.8 million (in 1980 constant dollars) in 1994, rather than the $43.1 million (in nominal dollars) reported in column (4). Column (6) shows that the Chandlers' dividends, adjusted for inflation, grew just 52.8% from 1980–1994, rather than the 165.8% nominal growth implied by the data in column (4).

Table 7's most striking finding is that, since TM's dividends remained essentially constant in nominal dollars from 1990–1994, Chandler family dividends actually decreased in real terms by nearly 15% in the early 1990s (column (7)). From 1985–1994, TM's dividends also fell behind those of the six comparison firms (whose data are not shown in the table): TM's 10-year dividend growth rate of 51.3% is less than half the 109.4% growth rate for the median comparison firm over 1985–1994 (mean, 129.3%). In fact, TM's 10-year dividend growth rate is lower than that of any comparison firm. These data reinforce our earlier interpretation, supported by the data in Table 4, that TM's stockholders had good reason to view their recent dividends as inadequate.

And despite $1.7 billion in asset sales, TM's management had run up a $740 million cumulative net cash flow deficit over 1980–1994 (see Table 6). It seems reasonable to assume that, at this point, management faced intense pressure from TM's controlling stockholders to preserve their dividends, and the evidence presented next confirms this view. The theoretical ideal, of course, is that management would respond by improving operating performance to generate the necessary cash. However, what TM's management actually did was to negotiate the firm's largest-ever asset sale, the $2.3 billion divestiture of TM's cable operations, which in 1993 had contributed 12.7% of TM's revenues and a full 36% of its operating income. As we next discuss, this transaction was structured to preserve the Chandlers' dividends while substantially cutting those to other stockholders, and to provide TM with a $1.3 billion cash infusion. Thus, in one fell swoop, management was able to circumvent any immediate dividend pressure, and to raise substantial funds for new investment.

4. TM's free cash flow problem: The 1994 cable transaction

TM's June 1994 agreement to sell its cable television business created a classic free cash flow problem. The events set in motion by this transaction galvanized TM's board which, within a month of the initial announcement, had decided to consider outside CEO candidates to replace the soon-to-retire Robert Erburu. This broadened search process ultimately led to the hiring of Mark Willes, although the incumbent CEO had tapped two internal candidates for the job. As we describe in Section 5, Mr. Willes generated substantial value for TM's stockholders by distributing rather than re-investing much of the proceeds from the cable transaction and, more generally, by re-focusing the firm on its core newspaper operations.

4.1. Objectives of TM management and the Chandler trusts in the cable transaction

TM agreed to transfer its cable television business to Cox Enterprises in exchange for (1) $1.36 billion cash paid to TM, and (2) common stock in the new Cox Cable Communications, which would combine Cox's and TM's cable businesses, for all TM stockholders except the Chandlers. The family would receive a new class of TM preferred stock that, unlike the Cox shares issued to other stockholders, would pay immediate dividends. TM also disclosed plans to cut its common stock dividend by 67–80%, conserving some $70–$80 million yearly. (As a comparison, TM's 1993 investment outlay for capital expenditures and acquisitions was $275 million, as shown in Table 6.) Finally, TM announced old management's intent to use most of the cash proceeds from the asset sale and the dividend savings for new investment.[14]

The cable sale solved three difficulties for old management. First, it relieved TM of a business that required large and growing capital outlays (cable operations accounted for 53.4% of capital expenditures in 1993, up from 42% in 1992, 29.5% in 1991, and 16.8% in 1990). Second, the transaction provided a large cash infusion to fund investments in new technology related to TM's publishing businesses. Third, because TM received an attractive price, the cable sale seemingly provided "cover" for management to reduce total dividends without reducing the Chandlers' receipts – i.e., by imposing the full dividend cut on the minority stockholders.

Table 8 provides some evidence on the interests and objectives of TM management and representatives of the Chandler trusts as they negotiated the cable transaction. The table lists 10 key events that occurred over the five

[14] The remaining cash would be used to pay down TM's long term debt. As a means of addressing free cash flow problems, debt paydowns are inferior to equity payouts, which eliminate any possibility that management will waste the distributed cash. Debt paydowns reduce the possibility of immediate wastage, but free up future cash, because of reduced interest obligations, for possible future wastage.

Table 8
Key events preceding the sale of Times Mirror Company's cable television assets.

The table lists key events leading up to Times Mirror's (TM's) June 1994 agreement to sell its cable television assets to Cox Communications. Page numbers in parentheses refer to the location in TM's proxy statement (dated December 16, 1994) that describes each noted development. The Wall Street Journal is the source for the June 6, 1994 entry. We have added italics to highlight particularly relevant points.

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1. January 1994: Management's desire to pursue new opportunities in the publishing business leads it to begin exploring the possibility of *recommending a dividend cut* to TM's board (p. 37).

2. January 1994: Management approaches certain trustees of the Chandler Trusts to discuss a possible cable TV transaction. The trustees express a willingness to explore such a transaction provided that it would (1) give fair value to all stockholders, (2) would not require the trusts to make a taxable sale of securities, and (3) would "*maintain the Chandler Trusts' income level*". (p. 37).

3. February 1994 and later: Management refines proposals for a cable transaction in discussions with potential cable bidders and the Chandler Trusts. The envisioned deal structure would provide the Trusts with TM preferred stock (and other stockholders with securities of equivalent value in the cable firm). It would also *allow TM to cut its dividend and provide funds for new investment in publishing*. (p. 38).

4. February 16, 1994: A management presentation to the board's Executive Committee (which includes Chandler trustees) discusses (1) the status of negotiations with potential cable transaction partners and (2) the "level of dividends paid by Times Mirror in relation to other public publishing companies". (p. 39).

5. March 3, 1994: TM's full board decides to hold further discussions with possible cable buyers. A special committee of directors is appointed to negotiate on behalf of non-Chandler stockholders. (p. 39)

6. April 4, 1994: Representatives of the Chandler Trusts propose that the cable transaction provide the trusts with a new class of TM participating preferred stock that would receive "increased dividends based upon a percentage participation in the net income of New Times Mirror". (p. 41). They eventually agree to accept preferred stock with a fixed dividend plus some additional shares of common stock. (p. 42).

7. May 2, 1994: At a board meeting, Morgan Stanley reports on current cable asset valuations and makes a "presentation regarding changing Times Mirror's dividend policy by *reducing the dividend …*" (p. 40).

8. June 1, 1994: The board trims the set of potential buyers to Cox and another (unidentified) party and discusses a cut in TM's dividend. Management indicates that "it would be *appropriate to reduce the dividend level by between* $66\frac{2}{3}$*% and 80%* below the current level …" (p. 44). On the next day, the board decides to pursue a deal with Cox. (p. 45).

9. June 3, 1994: A national newspaper carries a report of the impending cable deal, prompting TM to issue a press release indicating that a definitive agreement is expected to be signed by Monday, June 6. (p. 45).

10. June 6, 1994: The *Wall Street Journal* reports that Cox will acquire TM's cable operations. "In an unexpected and related step, Times Mirror said it plans to slash its dividend to one-fifth to one-third of the current 27 cents a quarter per share, conserving cash for investment in new information

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Table 8 (*continued*)

businesses. While payouts for current Times Mirror holders thus will be sharply reduced, trusts held by the Chandler family of Los Angeles are to receive dividends from a newly created class of stock". (*WSJ*, p. A3, col. 2) A front page feature story (subtitled "A Two-Man Race for CEO") spends considerable time profiling *two insiders involved in a leadership race to replace the soon-to-retire Robert Erburu*. The story closes with a passage about one of the CEO candidates: Growing philosophical, Mr. Schlosberg muses on the eventual decision by the company's directors. "They've probably made up their minds", he says. "Curt and I are old guys, 50. We aren't going to change". (*WSJ*, p. A1, col. 6).

months prior to the transaction announcement, and is based on old management's description of these events (as reported in TM's proxy statement of December 16, 1994, and the Wall Street Journal report of the deal announcement). The table shows that old management was concerned with raising funds for new investments in TM's publishing businesses (see table entries 1, 3, and 10) and believed that a dividend cut was an important means of raising those funds (see entries 1, 3, 4, 7, 8, and 10).

The Chandler trusts were amenable to management's proposals, provided the transaction was structured to at least maintain the Chandlers' dividends (see entries 2 and 6). The Chandlers' focus on preserving their dividends is understandable, since they cannot sell their shares. However, it is far removed from the theoretical ideal that the role of large block stockholders is to closely monitor management to ensure it follows value-maximizing policies (Shleifer and Vishny, 1986). The Chandler trusts' negotiating stance suggests that, at this point, TM's controlling family gave management wide latitude on corporate strategy, as they sanctioned both new technology investments and a dividend cut for minority stockholders.

Although historically the Chandlers have been famously private about family affairs, some family members have recently indicated that a passive, dividend-focused orientation accurately portrays the Chandlers' attitude toward TM at the time. In articles published after Mark Willes was hired, the media reported:

> "As long as the paper was doing well financially and as long as the dividends were growing it was just a whole bunch of rich people clipping coupons", Jeffrey Chandler, 53, the owner of two radio stations (and Philip Chandler's son), said in a recent interview (New York Times, November 27, 1995, D1).

> "There is not a family mandate to be involved", says Otis's son Harry Chandler, one of the few family members still at the company. "Most in the family were content so long as [the company] continued to grow and they collected the dividend" (WSJ, July 17, 1995, A1).

Table 8 suggests that old management believed it had wide discretion over corporate strategy, provided it maintained the Chandlers' dividends. Management's arguments for a dividend cut (entries 1, 3, and 7) justified the

reduction on grounds that TM's dividend policy was out of line with its peers, and not based on TM's poor performance. The unstated reason why TM's dividend policy was out of line is that its subpar earnings and stock price performance made its payout ratio and dividend yield high, due to low denominators. More generally, TM's proxy statement contains no indication that old management was forced to confront the firm's poor operating performance, or what that performance might imply for the profitability of the new investments it planned to fund with the proposed dividend cut and cable proceeds.

4.2. Wall Street and minority stockholder reactions to the cable transaction

The initial announcement of the cable transaction occurred on Friday June 3, 1994, when TM disclosed that it had nearly finalized an agreement to sell its cable business to Cox. While the firm announced no details, the identity of the business to be sold revealed that this would be TM's largest-ever asset sale, and TM's stock price rose $3.75, or 11.7%, to close at $35.75. On Saturday, the L.A. Times and the New York Times reported that the transaction was valued at $2.3 billion, would create the nation's third largest cable firm, and that analysts believed that Cox was paying "top dollar" for TM's cable business. In these reports, CEO Robert Erburu indicated that the asset sale proceeds would allow TM to invest in new technology businesses that would enhance the firm's strategic position as a provider of news content.

On Monday June 6, TM's stock price fell $3.00, or 8.4%, to close at $32.75, erasing all but $0.75 of Friday's gain. This share price decline incorporates the market's reaction to Mr. Erburu's weekend disclosure of TM's reinvestment plans. This price reaction conforms to the findings of Lang et al. (1995) that retention of asset sale proceeds is generally not good news for stockholders.[15] Monday's share price decline also reflects information initially reported that day in national newspapers that the cable transaction provided for differential treatment of TM's controlling and minority stockholders, and that the latter would suffer an immediate 67–80% dividend reduction. In contrast, the Chandlers would receive shares of TM preferred stock that would pay them the same or increased dividends; moreover, they owned sufficient TM stock to approve the cable transaction, and had already pledged to vote for approval.[16]

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[15] The TM case also conforms to (1) Lang et al.'s finding that asset sales tend to follow a period of poor performance, and (2) Schlingemann et al.'s (1998) finding that asset sales by firms that are increasing their "corporate focus" tend to be divestitures of divisions with large capital outlay requirements.

[16] As a condition of the deal, Cox required the Chandler family to pre-commit to vote their shares for approval. The reason given for the differential treatment of Chandler stockholders was that their trusts would be required to sell any non-TM stock, triggering a large tax liability. But see the Section 5.3 discussion of the 1997 transactions between TM and the Chandlers, which enabled the family to circumvent their trust provisions at least to some degree, and see the postscript.

On June 9, TM's minority stockholders filed suit to enjoin the transaction, alleging that its terms favored the Chandlers. At issue was the family's insulation from the dividend cut and its participation in the negotiations, from which minority stockholders had been excluded. The minority, moreover, not only had insufficient votes to block the transaction, but also received no appraisal rights. All litigation was settled in October 1994, when TM agreed to exchange, for common stock, up to $350 million of a new preferred stock with dividends guaranteed for three years (albeit at a much lower level than TM's common stock had paid before the transaction).[17] TM management also promised not to cut the common stock dividend for the next three years.

Fig. 3 provides evidence that investors viewed old management's plans to reinvest the cable proceeds as a serious misallocation of TM's free cash flow. The figure plots the price and time of all trades in TM common stock on February 2, 1995, using data from Francis Emory Fitch. On that day, TM's first announcement was the firm's 1994 fourth quarter and full year earnings. The earnings announcement went out over the Dow Jones newswire at least three times before trading opened (at 9:00, 9:06, and 9:13 a.m. E.S.T.). TM's earnings were within the range of analysts' expectations and, accordingly, TM's share price remained stable at around $23 for the next several hours. (The $23 price level is below the $32.75 price that prevailed just after announcement of the cable transaction, primarily because of the 'ex-dividend' day price decline associated with the distribution of Cox shares to TM's minority stockholders.)

Later the same day, Robert Erburu and other senior managers met with analysts, and provided details of their plans to invest in new electronic products and services. The executives indicated that expenses and start-up costs related to these expansion plans would reduce 1995 earnings by as much as $40 million after taxes. They also left open the possibility that TM would make substantial new investments through acquisitions.[18] These disclosures met a punishing reaction on Wall Street. Fig. 3 shows that TM's share price began to slide around 1 : 00 p.m., and had plummeted by mid-afternoon. Overall, TM's shares fell 13.4% on February 2, and half-again as much on February 3, for a remarkable 19.3% drop in equity value over the two-day period. The stock market's verdict on old management's reinvestment plans was abundantly clear. The 19.3% share price decline, coupled with the earlier 8.4% decline when management first disclosed plans for a large dividend cut and an aggressive new

[17] The preferred stock was issued through a heavily oversubscribed exchange offer to minority stockholders, wherein TM received three and one-third times the number of common shares sought. The oversubscription suggests that minority stockholders' had little confidence in management's ability to increase future dividends on TM's common stock.

[18] The disclosures attributed in this paragraph to TM's management are based on: TM's press release about Mr. Erburu's speech to analysts, which went out over the Business Wire at 2:41 p.m. E.S.T., and on WSJ, February 3, 1995, B14.

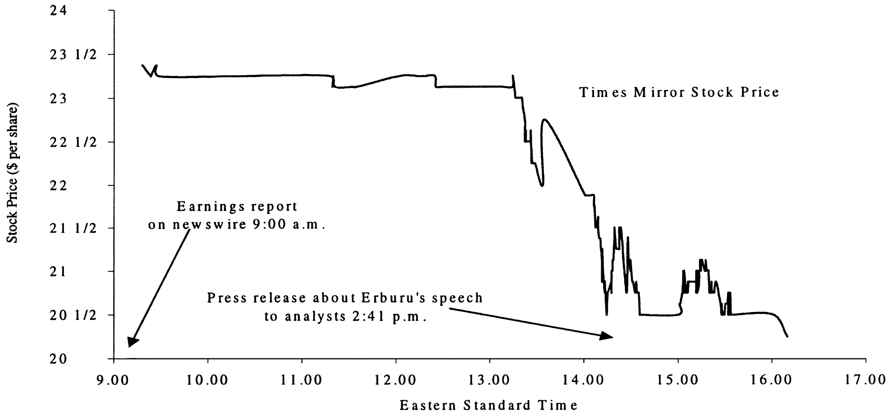

Fig. 3. Share price behavior on February 2, 1995 for the Times Mirror Company. The figure plots data obtained from Francis Emory Fitch on the dollar price and time of all trades in the common stock of the Times Mirror (TM) Company on February 2, 1995. A report of TM's fourth quarter 1994 earnings was carried on the Dow Jones Newswire (at 9:00 a.m., 9:06 a.m., and 9:13 a.m. Eastern Standard Time) before trading opened on the NYSE. The reported earnings were within the range of analysts' expectations and, accordingly, there was essentially no share price response to this disclosure. The share price decline later in the day captures the market's response to disclosures by Robert Erburu (TM's then-CEO) and other senior executives in a meeting with analysts in New York City. The press release about Mr. Erburu's speech to analysts went out over the Business Wire at 2:41 p.m. Eastern Standard Time (i.e., at 14.41 hours).

investment program, indicates that investors viewed these plans with strong disfavor.

4.3. Events leading up to the 1995 CEO change

Corporate boards are traditionally secretive about the processes they follow when choosing a CEO, particularly when the new CEO is an outsider whose selection is a rebuff to incumbent managers (Warner et al., 1988; Weisbach, 1988; Gilson, 1989). The TM case fits this pattern, since there are no on-the-record statements by board members describing the details of the process that led to the choice of Mark Willes as CEO. The ostensible reason for this silence, according to a Wall Street Journal source, "a person close to the family", is that "Mr. Erburu wrested a pledge that the four family directors and other board members wouldn't disclose the process of selecting the 54-year old Mr. Willes ..." (WSJ, July 17, 1995, A1).

Nevertheless, some individuals close to the family and company have discussed aspects of the CEO selection process off the record with reporters. These discussions indicate that a significant early step occurred in June 1994, the month the cable transaction was disclosed, when the board expanded the CEO

search to include outside candidates. The CEO search was previously a contest between two insiders who had worked closely with Robert Erburu to set the company's strategy. The expansion of the search was not only a rejection of Mr. Erburu and his two internal candidates, but also a sign that the board might seriously want to change TM's strategic course. The same sources also indicate that Chandler family representatives played an active role in selecting a new CEO who would substantially improve TM's profitability.

Four observations suggest that the events set in motion by the cable transaction galvanized the Chandlers to take a more active role to alter TM's strategic direction. First, the board expanded the search the same month the cable transaction was announced. Second, in choosing Mark Willes, the board rejected the succession plans of the old CEO, a rejection that would not have occurred had Mr. Erburu maintained the support of TM's controlling family. (After rejecting Mr. Erburu's two candidates, the board also reportedly turned down Mr. Erburu's offer to stay on past retirement until the board selected a replacement.) Third, and probably most important, old management's disclosures of its plans for the cable proceeds produced clear signals that the stock market believed those plans were value-destroying, and this rejection came on the heels of a report in the Wall Street Journal that TM's stockholders may have foregone hundreds of millions of dollars on an asset sale made just one year earlier.[19] Fourth, the cable transaction angered minority stockholders due to their dividend cut and to the differential treatment it accorded the Chandlers.

When they negotiated this treatment, representatives of the Chandler family had relied on old management's intentions to provide payment of equal value to all stockholders (see items 2 and 3 of Table 8). And the proxy statement for the cable sale and press interviews with Mr. Erburu read as though old management believed a dividend reduction would be acceptable to the minority, provided they received securities that investment bankers valued as equal to those received by the Chandlers. Remarkably, old management seemed to give little weight to the negative reactions that might accompany a dividend cut for minority stockholders. The family paid for this naiveté by being labeled greedy in a public forum, a portrayal far from that of a socially responsible newspaper dynasty, such as the Sulzbergers at the New York Times. This portrayal cannot have pleased the Chandlers, and may have helped motivate them to actively seek a more dramatic management change than that proposed by soon-to-retire CEO Robert Erburu.

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[19] See 'Donaldson Lufkin to See Huge Return on Sale of Stake in Television Stations', WSJ, May 26, 1994, A3. Although the article discusses a number of factors that might help rationalize the large discrepancy between the price DLJ received and the price TM had received one year earlier, the Chandlers were nevertheless concerned (see Section 2.4).

5. The 1995 CEO change and its aftermath

On May 2, 1995, TM announced that Mark Willes would replace Robert Erburu as CEO and President on June 1 and would become Chairman on January 1, 1996, when Mr. Erburu would retire. Four days before Mr. Willes' official start date, TM announced it would close the Baltimore Evening Sun in September. In July, TM closed New York Newsday on one day's notice, laying off some 700–800 employees. The two newspaper closings and the additional, unprecedented layoffs of some 350 employees at the L.A. Times (about half the total planned cuts and layoffs) served as dramatic indicators that the new CEO planned to implement swift, radical change. Also in July, TM announced the authorization to repurchase 10% of its common stock, the first in a series of repurchases of common and preferred stock.

5.1. Stock price and operating performance under TM's new CEO

Table 9 reports two-day rates of return on TM's common stock associated with key announcements about Mark Willes' plans, beginning with the May 2, 1995 report of his hiring. For simplicity, announcement returns are not adjusted for general market or industry price movements. (Adjusted returns give a virtually identical picture because market and industry index price movements over two-day intervals are generally near zero.) The table also reports two adjusted return measures of TM's cumulative abnormal stock performance. The first, CAR1, is the cumulative return on TM's stock from the close of trading on May 1 through each subsequent announcement date, minus the cumulative return on the CRSP value-weighted market index over the same interval. The second, CAR2, is the cumulative return on TM's stock minus the cumulative return on an equally-weighted portfolio of the six comparison firms.

The stock market reacted favorably to the news that TM had hired Mark Willes, and to his plans to revive the firm. Table 9 indicates that TM's stock rose 4.1% at announcement of Mr. Willes' hiring. It rose an additional 11.9% (one-day return) the following day, as Mr. Willes' remarks indicated that he might close unprofitable newspapers, repurchase stock, and not reinvest the proceeds from the cable transaction. By the May 26 announcement that TM would close the Baltimore Evening Sun, the firm's shares had risen by a cumulative 25% (CAR1 = 24.5% and CAR2 = 25.7%). Although TM's shares declined by a small amount (− 1.1%) in response to that closure, the stock price increased substantially on July 17 (10.4%) when TM announced it would cease publishing New York Newsday. The market also responded favorably (up 7.4%) on July 20 when TM announced plans to repurchase stock, with news of these plans evidently dominating the simultaneous disclosure that second quarter earnings had declined by 43%.

By July 20, TM's stock had gained more than 50% abnormal appreciation since Mr. Willes' hiring (CAR1 = 52.8% and CAR2 = 57.4%), indicating that investors supported his strategy of curtailing low return investments and distributing cash. Table 9 announcement returns are modest for the four events occurring between September and December 1995, perhaps because prior disclosures made their 'surprise' element small. In any case, investors continued to endorse Mr. Willes' actions with substantial additional abnormal returns over the latter part of 1995 and all of 1996. The cumulative abnormal return from Mr. Willes' hiring through year-end 1995 is about 70% (CAR1 = 67.7% and CAR2 = 72.5%), and reaches about 135% by year-end 1996 (CAR1 = 132.9% and CAR2 = 140.2%). This return remains roughly the same through year-end 1997, at 157.5% relative to the CRSP index and 124.9% relative to the comparison firms. The fact that TM substantially outperformed the comparison firms after Mr. Willes' hiring is especially striking, since TM had underperformed these firms for many years before he was hired (see Fig. 2).

One reason for the favorable stock market reaction to Mark Willes' policies is the large magnitude of TM's equity payouts in the first $2\frac{1}{2}$ years of his tenure as CEO. Table 10 provides data on TM's cash inflows and outflows in 1995–1997, and in total over the three-year period. These data show that, over 1995–1997, TM generated almost $1 billion cash flow from operations which, after deducting $644 million in investment outlays, left the firm with $317 million in free cash flow. Investors received payouts of a much greater $2.1 billion over the three year period, i.e., they received all of TM's free cash flow and all the cash proceeds from asset sales of some $1.8 billion ($1.3 billion from the cable transaction alone). The $2.1 billion payout over 1995–1997 dwarfs the total payout of $417 million over the three years before Mr. Willes was hired (not shown in the table, but calculated from data in Table 6).

TM's favorable stock price performance under Mark Willes also reflects improvements in operating efficiency. For TM and for the median comparison firm, Table 11 reports operating margins, corporate overhead ratios, and revenue growth rates before 1995 (pre-Willes, first two columns) and for 1995–1997 (remaining columns). Because of difficulties interpreting margin differences before and after the 1994 cable divestiture, we report and emphasize newspaper operating margins. TM's newspaper margin shows marked improvement under Mr. Willes and, by 1997, is close to that of the median comparison firm (17.4% versus 18.8%). On the other hand, TM's corporate overhead ratio has not improved under Mr. Willes, although we hesitate to place much weight on this observation because TM's overhead ratio includes the results of miscellaneous operations (see Section 2.2). And while newspaper revenue has grown under Mr. Willes, TM's total revenues declined in both 1996 and 1997. Overall, Mr. Willes has improved operating performance via cost containment, but TM's performance through 1997 remains below that of its industry peers. Importantly, Mr. Willes has been CEO for too short a period to determine

Table 9
Stock price performance for the Times Mirror Company for key dates following the hiring of Mark Willes as Chairman, President, and CEO.

The table summarizes the stock market reaction to key financial press reports following the hiring of Mark Willes as Chairman, President, and CEO of Times Mirror (TM). Announcement descriptions are paraphrased, or are direct quotes, from Wall Street Journal reports. The announcement date stock return refers to the raw rate of return on TM's stock over the business day prior to and the day of the Wall Street Journal report of the announcement summarized in the far right column. To avoid double counting of two day returns on adjacent dates, the announcement return for 5/3/95 is the one day rate of return for that date. CAR1 equals (1) the cumulative return on TM common stock from the closing price on 5/1/95 through the closing price on the day in question minus (2) the cumulative return on the CRSP value weighted index over the same period. CAR2 equals (1) the cumulative return on TM common stock minus (2) the cumulative return on an equal-weighted portfolio of the comparison sample of six media companies described elsewhere in the paper. All stock return data are taken from CRSP. Entries that are not applicable are marked n.a.

Date	Announcement date return	Cumulative abnormal return from 5/1/95: CAR1 and CAR2	Description of announcement
5/2/95	4.1%	4.8% 5.0%	Hiring of Mark Willes announced.
5/3/95	11.9%	16.3% 17.5%	There has been strong speculation that TM might close New York Newsday and repurchase stock. TM had previously said it planned to reinvest much of the $1.36 billion raised from the earlier sale of its cable TV business. In comments yesterday, Mr. Willes appeared to suggest a substantial rethinking of that strategy.
5/26/95	− 1.1%	24.5% 25.7%	TM will cease publishing the Baltimore Evening Sun. The news didn't surprise analysts who had long expected TM to stop publishing the evening edition in Baltimore.
7/17/95	10.4%	37.6% 42.5%	TM will cease publishing New York Newsday. Plans for a multimedia future are on hold, as TM recently cut outlays for new technology investments by at least $10 million.
7/20/95	7.4%	52.8% 57.4%	TM reveals a 43% decline in second quarter earnings and plans to repurchase 10% of its stock.
9/27/95	− 1.7%	46.7% 49.5%	TM has repurchased preferred stock from an unnamed institutional holder.

10/25/95	0.0%	48.3% 52.4%	Willes announces a third quarter loss on large restructuring charges. TM expects to complete the repurchase of 12.8 million shares and will request board authorization for further buybacks. Debt to capital, which will be about 12% at year end, will be increased to 25–30%.
11/29/95	2.0%	61.2% 60.6%	TM will repurchase up to 3.25 million shares of its series B preferred stock.
12/8/95	0.7%	69.3% 71.6%	Directors authorize the repurchase of 12 million shares over the next three years. This represents a slowing of the pace of buybacks, since 12.8 million shares were repurchased this year.
12/29/95	n.a.	67.7% 72.5%	Cumulative abnormal return through year-end 1995.
12/31/96	n.a.	132.8% 140.2%	Cumulative abnormal return through year-end 1996.
12/31/97	n.a.	157.5% 124.9%	Cumulative abnormal return through year-end 1997.

Table 10
Net cash flow ($millions) for The Times Mirror Company: 1995–1997.

Free cash flow is defined as cash flow from operations minus investment outlays. Investment outlays are cash flows for capital expenditures and acquisitions, taken from the cash flow statement. Net cash flow (NCF) before asset sales equals free cash flow minus cash dividends and repurchases, while "bottom line" NCF adds the cash proceeds from asset sales. Cash flow from operations is calculated net of interest charges because the table is designed to assess the ability of the firm's ongoing operations to generate cash payouts to equityholders, and interest must be paid before cash is distributed to equityholders. In 1997, Times Mirror (TM) transferred cash and real property with a total value of $475 million to a limited liability corporation (LLC) that was jointly owned by TM and the Chandler family. The Chandlers contributed TM securities to the LLC. The LLC largely allocates the income from TM's contribution to the Chandlers and the dividend income from the Chandlers' contribution to TM, thus enabling TM to largely treat the Chandler-contributed TM shares as reacquired. We treat TM's entire $475 million contribution as 1997 stock repurchases. Additionally, we treat the $226 million real property component of that contribution as an asset sale, since the substance of this portion of the transaction from TM's perspective is that the firm sold the property for cash and used the proceeds to repurchase Chandler shares. All data are drawn from TM's 1997 annual report. Rounding error accounts for any minor addition discrepancies in the numbers.

	1995	1996	1997	Total
Cash flow from operations	250	360	349	959
Investment outlays	– 215	– 165	– 264	– 644
Free cash flow	35	196	86	317
Payouts:				
Dividends	– 97	– 80	– 85	– 262
Repurchases	– 355	– 588	– 939	– 1,882
Total payouts	– 452	– 668	– 1,024	– 2,144
NCF after payouts but before asset sales	– 417	– 472	– 939	– 1,828
Asset sale proceeds	1,308	190	295	1,793
Net cash flow	891	– 282	– 644	– 34

whether he will be able to grow the firm's revenues, hence profits, consistently over the long term. In this respect, the jury is still out on the success of his turnaround effort at TM (As it turns out, this issue will likely ever be resolved; see the Postscript below.)

5.2. *What accounts for TM's radical shift in corporate strategy under Mark Willes*?

Differences in equity holdings cannot explain why Mark Willes radically altered TM's strategy, since Mr. Willes and Robert Erburu owned virtually identical percentages of TM's equity, holding 0.3% versus 0.2% respectively. In the years around the CEO change, moreover, both executives received a substantial fraction of their total pay in incentive-based compensation (bonuses and the reported present value of stock option grants). In 1993–1994, 63% of Mr. Erburu's total pay was incentive based, versus 84% for Mr. Willes in 1996–1997.

Table 11
Operating performance statistics before and after the 1995 management change at The Times Mirror Company.

This table summarizes operating performance statistics before and after the 1995 management change at The Times Mirror Company (TM). Revenue growth rate and operating margin definitions are detailed in Table 1, which gives a more complete picture of performance prior to the management change. Newspaper operating margins and corporate overhead ratio definitions are detailed in Table 2. All data are taken from company annual reports. The 1985–1994 median and 1994 revenue growth rates for TM differ from those reported in Table 1 in that the current numbers are restated to exclude the firm's cable television operations, which were sold in early 1995. The restated figures give a better picture of the prior management's performance with the assets that TM held when Mark Willes took over in mid-1995.

	1985–1994 median	1994	1995	1996	1997
Operating margins					
Times Mirror	13.0%	8.8%	5.2%	10.7%	13.9%
Median comparison firm	17.1%	17.1%	14.6%	15.9%	18.6%
Newspaper operating margins					
Times Mirror	12.2%	9.4%	10.0%	14.7%	17.4%
Median comparison firm	17.1%	17.6%	13.8%	15.6%	18.8%
Corporate overhead to total revenue					
Times Mirror	1.8%	2.1%	2.1%	1.8%	2.5%
Median comparison firm	1.2%	1.2%	1.3%	1.5%	1.4%
Revenue growth rates					
Times Mirror	3.3%	3.5%	2.7%	− 1.4%	− 2.4%
Median comparison firm	6.1%	8.2%	5.4%	8.2%	8.1%
Newspaper revenue growth rates					
Times Mirror	2.7%	4.2%	− 0.3%	1.1%	5.6%
Median comparison firm	4.7%	5.9%	5.4%	6.5%	7.8%

It is understandable that Mr. Willes' compensation was heavily tilted toward incentive pay given TM's strong performance and the fact that the board had hired him to turn the firm around. What is remarkable is the large fraction of Mr. Erburu's pay that was incentive based in 1993–1994, given TM's poor operating and stock price performance in those years (see Figs. 1 and 2).

Despite these performance difficulties, TM's board rewarded Mr. Erburu with substantial incentive compensation for his service during these last two of his 32 years at TM. Mr. Erburu received incentive payments (option grants and bonuses) totaling $625,000 in 1992, $1,192,000 in 1993, and $1,854,000 in 1994, which are large sums relative to his respective base salaries of $875,000, $875,000, and $923,000. The board justified these incentive payments based on Mr. Erburu's contributions over his entire career even though TM's current

performance was poor, a situation which the board explicitly blamed on factors beyond Mr. Erburu's control (but see fn 6). In its decision to grant Mr. Erburu a bonus for 1993, for example, the board

> was strongly influenced by the contribution Mr. Erburu has made during his career with the company; his role as a representative of the company in the industry, its community and in national affairs; the progress the company is making in diversifying its operations into non-advertising based businesses; and the company's efforts to moderate the severe impact of the recent recession on the most significant operating units of the company (proxy statement dated March 21, 1994, pp. 24–25).

Perhaps the board rewarded Mr. Erburu for his loyal service because he was nearing retirement. Another factor may be Mr. Erburu's relationship with the Chandlers, most notably Otis Chandler, with whom he worked for two decades, and who was TM's Chairman during Mr. Erburu's first five years as CEO. Whatever the reason, according to all documents we examined,[20] the board made no negative statements about Mr. Erburu and, in fact, rewarded him financially despite TM's protracted performance problems.

Mr. Willes' base salary was roughly equal to Mr. Erburu's, but his incentive pay was much larger at $4,035,000 in 1996 and $4,807,000 in 1997. Agency theory typically views incentive contracts as exogenous to managers, i.e., as imposed on them by boards seeking to motivate specific types of behavior. This view is far from descriptive in the current case. When Mr. Willes was hired, he deliberately sought a pay package that emphasized performance-linked payoffs. According to TM's 1996 proxy statement,

> The committee's initial consideration in setting the compensation of Mr. Willes was incenting him to leave his position of Vice Chairman at General Mills … .*Mr. Willes proposed* that his compensation, and that of other company executives, be determined on a leveraged basis that was heavily weighted toward performance to align executives' interests with those of stockholders. The committee adopted this approach … . (proxy statement dated March 29, 1996, emphasis added).

Since Mr. Willes himself proposed a performance-sensitive pay package, his mindset going into the job evidently was to unlock substantial value for stockholders, and he wanted a pay package that would reward him accordingly. If so, the negotiated compensation arrangement reflects Mr. Willes' orientation toward stockholder value, and is not reasonably viewed as an incentive scheme imposed on him by the board to elicit a radical shift in TM's corporate strategy.

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[20] We inspected TM's annual reports, forms 10-K, and proxy statements for all years 1980–1995, and all articles over the same period indexed in the WSJ, the New York Times, and the Los Angeles Times.

Donaldson's (1990, p. 128) clinical study reinforces this interpretation, since it indicates that Mr. Willes was hired previously as CFO of General Mills to bring an external capital markets perspective to that firm's financial management.

Jensen (1993, p. 847) argues that a manager's personal values, experiences, and orientation affect his or her willingness to make painful restructuring decisions. Mr. Willes' value orientation and background may explain why he was able to initiate layoffs at TM's flagship L.A. Times and outright closings of other journalistically prominent newspapers, decisions that Mr. Erburu was apparently unwilling or unable to make during his tenure. Bagdikian (1997) documents the ongoing tensions between journalists and stockholders over the extent to which the profit motive should govern news operations. Not surprisingly, Mr. Willes – who, unlike Mr. Erburu, is an outsider with no journalism background and who came to TM with a reputation as a financial disciplinarian – has been a lightning rod for criticism from journalists for these very decisions.[21] Mr. Erburu's failure to implement the downsizing decisions for which Mr. Willes later received widespread media criticism may reflect not only Mr. Erburu's insider status and journalism background, but also possibly his reputation as a 'statesman' within the newspaper industry and a related unwillingness to jeopardize long-standing relationships in his final two years before retirement.

5.3. Payout policy under Mark Willes

Large stock repurchases were an important element of Mr. Willes' turnaround strategy. Repurchases are, of course, tax-favored relative to dividends and can sometimes be superior signals about future profitability (see, e.g., Ofer and Thakor, 1987; DeAngelo et al., 2000). For TM, stock repurchases are problematic because the Chandler trusts cannot sell their TM stock, and thus cannot participate. In addition, as became evident with the 1994 cable sale, the Chandlers desired greater, not lesser, cash distributions than implied by their 31% dividend percentage ownership. Under Mark Willes, TM satisfied the Chandlers with two 1997 capital restructurings that were tailored to meet the family's preferences for specific cash distribution attributes. These restructurings, together with the repurchases targeted at minority stockholders, saved personal income taxes for all of TM's stockholders. The minority gained because repurchases are tax-advantaged relative to dividends, and the Chandlers gained

[21] See, among many other articles, "Demolition Man: Mark Willes Tore Down the Traditional Wall Between Editorial and Advertising. Will that Save the L.A. Times?" by Ken Auletta, The New Yorker, November 17, 1997, pp. 40–45. Auletta quotes Benjamin Bradlee, the former executive editor of the Washington Post as saying "He (Willes) alarms me because in his vision of civic journalism what's good for the community and what's good for the advertiser are an inch apart. He has no commitment to the pursuit of the truth. I say this when I never met the man, but he worries me. He doesn't feel like he's trespassing if he gets into a newsroom".

because the 1997 restructurings diversified and otherwise altered the risk-return structure of their holdings without triggering capital gains taxes.

In the first 1997 capital restructuring, a wholly owned subsidiary of TM was merged with Chandis Securities Company, a firm owned by one of the Chandler trusts. The merger allowed the family to dispose of all the Chandis-held shares of TM's class A preferred stock, which paid a fixed 8% dividend and had been issued in the 1994 cable transaction, along with the Chandis-held shares of TM's reduced voting common stock. In exchange, the Chandlers received two new issues of TM participating preferred stock that initially paid a 5.8% dividend, but beginning in 2001 could receive higher dividends of up to 8.4%, depending on the dividends paid on common stock. Thus, the effect of the first 1997 capital restructuring was to give the Chandlers the dividend participation rights they had initially sought (and failed to acquire) in the 1994 negotiations with TM over the cable transaction (see Section 4.1 and especially item 6 of Table 8).

In the second 1997 capital restructuring, TM and the two Chandler trusts formed a limited liability corporation (LLC), to which the trusts contributed their remaining class A preferred stock and some additional shares of TM's reduced voting common stock. TM contributed nearly $250 million in cash, which would be used to purchase a diversified portfolio of securities. TM also contributed $226 million in real property, including corporate headquarters, which was leased back to the company. TM will receive most of the dividend income from the TM securities contributed to the LLC by the Chandlers, effectively lowering its net dividends, and will treat 80% of the contributed securities as treasury stock, i.e., as repurchased shares, thereby increasing its reported earnings per share. The Chandler trusts will receive most of the income from the LLC's diversified portfolio and real estate. This transaction enables the Chandlers to receive regular cash disbursements plus depreciation deductions, and to diversify their holdings without actually selling TM shares (thereby circumventing their trust provisions and avoiding capital gains taxes).[22]

6. Summary and implications of the Times Mirror case

Times Mirror, controlled for 100 years by the Chandler family, experienced poor operating performance beginning in the late 1980s and continuing through the mid 1990s. During this time, management accommodated the Chandlers' desire for cash dividends despite TM's continued poor earnings. Management funded these dividends in part by selling assets, culminating in the 1994 sale of

[22] While the 1997 restructuring reduced the family's TM stockholdings, and thereby weakened their monitoring incentives, such reduction was not large. According to the 8-K dated August 8, 1997, "the direct equity interest of the Chandler trusts in the Company has been reduced from 39.28% to 33.59% and their voting power has been slightly reduced to 68.70% to 67.32%".

TM's cable operations, which had contributed more than one-third the firm's operating profit. Wall Street initially reacted favorably to the cable sale, but subsequently punished TM's share price when it learned of management's plans to reinvest much of the $1.3 billion proceeds in new technology. Shortly thereafter, TM's board hired Mark Willes, an outsider with a cost-cutting reputation, as CEO. In the first $2\frac{1}{2}$ years of his tenure, TM's abnormal share appreciation was 157.5%, reflecting investors' approval of his decisions to restructure operations and distribute free cash flow.

The TM case is puzzling because (i) the new CEO was able to unlock substantial stockholder value by imposing rigorous financial discipline on corporate decisions, yet (ii) the board had allowed poor performance to persist from at least the late 1980s until 1995, when it hired a value-oriented CEO. In seeking to understand this puzzle, we identified five themes that help explain TM's governance and policy decisions around the time of the CEO change. In what follows, we briefly discuss these themes and relate them to the findings of prior clinical studies and to several theoretical propositions in corporate finance.

1. *TM's dividend policy reflects the cash distribution preferences of the controlling family.*

Our evidence indicates that TM's payout policy was strongly influenced by the preferences of the Chandler family, whose personal consumption was effectively tied to TM's dividend payout via trusts that restrict the sale of the family's TM shares. In the negotiations that proceeded the 1994 cable transaction, Chandler family representatives consistently stressed the importance of maintaining the family's payouts, even should TM's management decide to reduce the dividend paid on TM's common stock (which it immediately did, by some 67–80%). The 1994 cable transaction and two 1997 capital restructurings effected under Mark Willes gave the Chandlers differential payouts that were not made available to TM's minority stockholders. These observations indicate that payout policy is not a matter of indifference, as argued by Miller and Modigliani (1961), but rather is sometimes tailored to meet the preferences of controlling stockholders, possibly placating them to ensure that "sleeping dogs lie" (Warther, 1993).

2. *In theory, pressure to pay dividends disciplines managers to improve operating performance (Rozeff, 1982; Easterbrook, 1984; Jensen, 1986). At TM, management was able to circumvent this pressure for many years by tapping non-operating sources of cash to fund continued high dividends, i.e., TM's substantial financial flexibility reduced the disciplinary effectiveness of dividend policy.*

Non-operating sources of cash – most notably the proceeds from asset sales, but also cash balances and new borrowing – enable managers to circumvent the

disciplinary pressure theoretically imposed by both dividend and debt payments. This implication is closely related to the point made by Weiss and Wruck (1998, p. 84) in their clinical study of Eastern Airlines, that asset liquidity can reduce corporate debt capacity by increasing the scope for value-reducing future investments. Asset sales can be positive NPV actions when viewed in isolation, but damaging on net if they delay the day of reckoning over poor performance. They can also be damaging because they provide funds that facilitate investment in negative NPV projects (Jensen, 1986; Weiss and Wruck, 1998). TM's cable transaction fits the latter scenario in that Wall Street viewed the asset sale per se as a value-enhancing development, but strongly objected to old management's plans for reinvestment. TM's cable sale and the Eastern Airlines case both fit the general pattern documented by Lang et al. (1995) and Schlingemann et al. (1998) that asset sales are viewed favorably by investors only when the selling firm does not retain the cash proceeds.

Although financial flexibility weakens the disciplinary effectiveness of both dividend and debt policy, two factors suggest that debt contracts provide a superior disciplinary technology. First, as Jensen (1986, Section I) points out, interest payments are legal obligations that managers cannot avoid as easily as they can avoid paying dividends. Second, debt covenants can directly constrain managers' ability to use asset sale proceeds to fund new projects. Nonetheless, as the Eastern Airlines case illustrates, the prospect for distortionary reinvestment of cash remains, even in the presence of debt contracts and under bankruptcy court supervision.

3. *Shleifer and Vishny (1986) posit that large block stockholders play an important role in disciplining corporate management. Yet the presence of a controlling stockholder failed for many years to ensure that TM's management followed value-enhancing strategies. As a practical matter, monitoring effectiveness seems to reflect board culture (Jensen, 1993), as well as the degree of board independence from operating management.*

The Chandler family had majority control, board representation, and no family members currently in top management with jobs to protect, yet it allowed TM's poor operating performance to persist for an extended period. One possible reason is provided by Jensen (1993, p. 863) who argues that boards tolerate poor performance for extended periods because board culture values "politeness and courtesy at the expense of truth and frankness." Although we cannot rule out the possibility of private disagreements between Mr. Erburu and TM's board over his performance, we find no public evidence of such conflicts. On the contrary, during Mr. Erburu's last few years as CEO, TM's board set his incentive pay to reward him for contributions during his 32 years at TM that were not reflected in the firm's current operating performance. One possible reason is that the board did not want to publicly "rock the boat" as Mr. Erburu was scheduled to retire soon. Another reason is that Mr. Erburu's treatment

reflects the length of his relationship with TM's directors, such as Otis Chandler, with whom he worked on TM's acquisition strategy for two decades beginning in 1961.

The ineffectiveness of large block monitoring at TM prior to 1995 contrasts markedly with the apparent effectiveness of such monitoring in the O.M. Scott (Baker and Wruck, 1989) and Safeway/Kroger (Denis, 1994) clinical studies. For both Scott and Safeway, measurable improvements in corporate performance were generated in part through post-leveraged buyout (LBO) monitoring by independent financial experts with large equity stakes and board representation. As Anders (1992, pp. 81–83) describes, LBO experts such as Kohlberg, Kravis, and Roberts closely monitor the performance of operating management and are "unlikely to tolerate a laggard CEO for a protracted period", i.e., the post-LBO board culture is one that frankly confronts performance problems. In addition to differences in board culture, the superior effectiveness of managerial monitoring by boards dominated by LBO specialists plausibly reflects both (i) the absence of personal ties between operating management and the board, and (ii) the firm's substantial debt, which increases the urgency with which operating management perceives the need to improve cash flow.

4. *At TM, managerial decisions were not shaped simply by managers' equity ownership and incentive pay, but also reflected their personal values, experience, and orientation.*

Mark Willes and Robert Erburu had similar equity stakes and, in the years around the CEO change, the board awarded both executives substantial incentive pay above their (similar) base salaries. Yet Mr. Willes generated large wealth gains for stockholders by radically restructuring operations that Mr. Erburu largely left untouched, and by paying out cash that Mr. Erburu had earmarked for new investments. Perhaps Mr. Erburu failed to adopt Mr. Willes' approach because TM's board rewarded him with generous incentive pay despite the firm's protracted poor performance (thus undermining the explicit contractual link between pay and performance), or because his industry ties clouded his ability to see what needed to be done. For his part, Mr. Willes deliberately sought performance-sensitive compensation, suggesting that he joined TM with a stockholder value orientation. [Donaldson (1990, p. 128) documents Mr. Willes' value orientation and cost-cutting experience at General Mills.] Thus, Mr. Willes' compensation contract is not appropriately viewed as an arrangement exogenously imposed on him by TM's board to elicit specific desired behavior.

Dial and Murphy's (1995) clinical study of General Dynamics also supports the view that a manager's personal orientation is an important determinant of his or her willingness to restructure operations. They document that, shortly after the end of the Cold War, General Dynamics hired as CEO an outsider who increased stockholder wealth by radically downsizing the firm. The behavior of

General Dynamics' new CEO differed from that of other CEOs in the defense industry, whose equity stakes were approximately the same (Dial and Murphy, 1995, Table 8). Like Mark Willes, General Dynamics' new CEO came to the job with a stockholder value orientation and sought pay-for-performance compensation that would motivate top executives to restructure the firm and distribute cash to stockholders. Dial and Murphy's evidence, like ours for TM, suggests that managerial decisions do not simply reflect equity ownership and incentive contracts, but also a manager's mindset, personal values, and experience.

5. *The TM case illustrates how ineffective governance processes are sometimes transformed into effective processes because unplanned events unfold in a way that clarifies the need for action.*

Perhaps the most striking aspect of the TM case is that the firm's performance problems were not resolved because monitoring agents – i.e., the board and the controlling Chandler family – quickly identified a performance problem and acted immediately to repair it. Rather, the performance problems persisted for many years until a series of events, precipitated as byproducts of the cable divestiture, galvanized the board to bring in an industry outsider as CEO to bring greater financial discipline to the firm.

The stage was set for the 1995 CEO change by the controlling family's ongoing desire for dividends and old management's policy of paying dividends above the level sustainable given TM's persistent poor operating performance. A related factor was that old management wanted to invest in new technology, but had generated inadequate internal resources to do so. These factors led to the 1994 sale of TM's cable assets – a transaction that was structured to solve several problems in one fell swoop. Specifically, the cable sale would enable old management to maintain the Chandlers' dividends while cutting those to minority stockholders, to avoid the large capital expenditures required by the cable business, and to raise substantial cash for new technology investments. However, the transaction backfired on old management because TM's stock price reaction clearly demonstrated Wall Street's strong disapproval of old management's future investment plans and, secondarily, because the Chandler's differential dividend treatment angered minority stockholders. Since long-time CEO Robert Erburu was nearing retirement age, the board was able to shift to more value-oriented leadership without visible rancor. Had Mr. Erburu not been scheduled to retire, the board's long history of tolerating poor performance makes one question whether the board would have further delayed the day of reckoning.

All indications are that, before the cable transaction, TM's old management had the support of the controlling Chandler family and the board. This situation changed after events that followed the cable transaction made it obvious that TM's strategy was flawed, and these events ultimately led to the 1995 CEO

change. Wruck (1994) documents that improved organizational efficiency at Sealed Air Corporation was effected via a crisis generated by a highly leveraged restructuring. But Sealed Air's management deliberately induced that firm's crisis to motivate employees, whereas TM's old management did not deliberately create a crisis, and certainly did not seek the radical changes that followed the cable transaction. The TM case illustrates one reason why, as Jensen (1993) claims, the corporate governance process often operates ponderously. Sometimes individuals can only initiate (or accept) radical change after receiving a 'wake up' call, and sometimes that call only comes as an unplanned side-effect of other events that clarify the necessity for change and/or the path such change should take.

Postscript: As this article goes to the printers, the Times Mirror Company has agreed to be acquired by Tribune Co. The Chandlers will receive a large equity stake in the merged firm and will have substantial board representation and oversight of the L.A. Times. The latter condition enabled the family to circumvent trust provisions that were widely believed to have prevented them from selling their TM shares. Tribune Co. initially approached Mark Willes, who rebuffed the inquiry on the grounds that the Chandler trusts precluded a sale. Tribune Co. then approached the Chandlers directly and negotiated the merger. Mr. Willes only learned of the negotiations two weeks before announcement and was, according to the L.A. Times, "totally surprised" since he was "under the impression that under the terms of the Chandler family trust, the paper could not be sold or merged". Mr. Willes will have no role at the merged firm. He apparently lost the Chandlers' support in part because the family had become increasingly concerned with his focus on newspapers to the exclusion of "new" media, an area in which Tribune Co. excels. Also, Mr. Willes' standing suffered following a scandal at the L.A. Times over a breach of journalistic ethics that was sufficiently serious that Otis Chandler broke a silence of many years to condemn Mr. Willes' stewardship.

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Appendix A

Chronology of major events for the Times Mirror Company and the Los Angeles Times: coverage primarily from 1980 to 1997

This chronology was compiled primarily from articles in the Wall Street Journal, the New York Times, and the Los Angeles Times, some of which we have cited verbatim, and secondarily from articles in various other newspapers and financial publications.

1882–1884: General Harrison Gray Otis purchases the Los Angeles Times shortly after its founding.

1917: Harry Chandler, son-in-law of General Harrison Grey Otis, becomes publisher of the L.A. Times.

1938: The Times Mirror Company is the first daily newspaper company to go public, as a company official sells some of his shares. The firm itself has never made a primary equity offering in which capital was infused via the sale of common stock.

1944: Norman Chandler, Harry Chandler's son, becomes publisher of the L.A. Times.

1960: Otis Chandler, Norman Chandler's son, becomes publisher of the L.A. Times.

1964: The Times Mirror Company is listed on the New York Stock Exchange.

1980: Otis Chandler, the last family member to hold a top management position at Times Mirror, resigns as publisher of the L.A. Times. Mr. Chandler, age 52, will become Chairman of Times Mirror. Robert Erburu, age 49, widely seen as a steward for the Chandler family and currently President of Times Mirror, will become CEO. Otis Chandler is widely credited with turning a financially profitable but provincial newspaper into a world-class news organization.

Times Mirror purchases the Denver Post at a price that "flabbergasted" some newspaper observers, who believe it is 50–100% too high, according to the Wall Street Journal. The L.A. Times had previously quoted a source in Denver who describes the Post as troubled by "bad morale, a lousy union contract, an antiquated plant, shrinking circulation and terrible profits". Times Mirror management calls the Denver Post "one of America's truly fine newspapers". According to the Wall Street Journal, a group that had dropped out of the bidding opined that "Anybody that buys the Post is in for a great many problems. It is going to take an awful lot of money to get it back on its feet". Otis Chandler later acknowledges to the New York Times that "It's been written that we underestimated the competition in Denver. If we'd had more time, perhaps we would have been more aware that we were going to have a very rough fight. But there were other bidders for the paper and we didn't realize how far the Post had slipped".

1984: Times Mirror introduces the New York edition of Newsday, its Long Island newspaper.

1985: Mr. Erburu will add the Chairman title in January 1986. Mr. Chandler will resign as Chairman but will remain a director and will become Chairman of the Executive Committee.

Times Mirror issues 3.1 million new common shares (4.3%) to its ESOP and repurchases 7.5 million shares (10.4%), raising the percent held by officers and directors and affiliated (Chandler) interests from about 32% to 40%.

The Wall Street Journal runs a feature article on how, since it purchased the Hartford Courant in 1979, Times Mirror has made disastrous changes that have created staff and community relations problems for the paper. According to a Courant columnist, "To survive here, you have to have the attitude of a French bureaucrat. You can't pay attention to who's running the government because every few years it's someone different". Management of the Courant is overseen by David Laventhol, a TM group vice president.

1986: David Laventhol, age 52, Senior Vice President for Eastern Newspapers and Chairman of Newsday becomes President of Times Mirror. Robert Erburu will remain Chairman and CEO. Mr. Laventhol was Executive Editor of Newsday when it was acquired by Times Mirror in 1971.

TM shareholders approve changing the state of incorporation to Delaware from California and anti-takeover amendments.

Times Mirror sells the Dallas Times Herald to William Dean Singleton for $110 million in cash and notes, which analysts describe variously as a "reasonable" or a "low" price. According to the Wall Street Journal, the Times Herald recently "has gone through several years of turmoil, in which it has had four editors, five people to fill the managing editors' slots (it currently has two), lost two popular columnists, and had turnover rates as high as 40%". Analysts view TM's ownership of the Dallas Times Herald and the Denver Post as especially risky, as both newspapers have strong competitors and recently such competition has left most cities with only one major daily. Mr. Singleton is widely known for turning around troubled newspapers. His strategy for the Dallas Times Herald is "to stop changing strategies".

TM purchases the Baltimore Sun and Evening Sun for $600 million, or $400 million net of asset sales. The Sun's major newspaper competitor had announced one day earlier that it was ceasing publication. The price paid for the Baltimore papers "raised eyebrows among analysts who follow publishing stocks", according to the Wall Street Journal, although observers allowed the newspapers would add "journalistic luster" to TM's operations. The Evening Sun is seen as particularly prestigious because it was edited by H.L. Mencken early in the century. TM will spend an additional $250 million on new facilities and equipment for the Baltimore papers, whose combined 1992 operating profits of $25 million "don't come close to returning a decent profit on the final $650 million investment", according to a later Forbes article.

1987: Shareholders approve the creation of two new classes of common stock. The current common stock will now be called class A common and will continue to have one vote per share. The new class B common has one-tenth of a vote and will be issued in future acquisitions, although none has been issued to date. The new class C common has ten votes, is convertible to class A common, and only

retains its voting advantage upon sale or transfer if traded among certain Chandler family members and closely affiliated parties.

The L.A. Times will make the largest capital expenditure in its history, some $385 million, to upgrade and move its printing operations out of its downtown Los Angeles complex. It will also upgrade printing facilities for the Orange County and San Fernando Valley editions.

Times Mirror sells the Denver Post, which it purchased in 1980 for a then-present value of $84 million, to William Dean Singleton for $95 million with "generous financing", or a present value of about $70 million according to analysts. The New York Times indicates that "Admitting defeat in Dallas and Denver gave Times Mirror a reputation for being unable to turn around struggling newspapers. The company was so eager to extricate itself from Dallas and Denver that it agreed to sell both newspapers to Mr. Singleton, a cost-cutting newspaper entrepreneur, at what analysts termed very favorable prices for the buyer". Mr. Erburu himself admits that "There's no question that we cleaned up some mistakes".

1988: Richard T. Schlosberg 3d, publisher and CEO of the Denver Post, becomes President and Chief Operating Officer of the L.A. Times.

1989: Mr. Laventhol adds the post of publisher and CEO of the L.A. Times. Mr. Laventhol is the primary supporter of New York Newsday, which is said to have lost at least $100 million from its inception in 1984 through 1990, and up to $150 million through 1995. Mr. Laventhol's journalistic background pleases TM journalists, who view him as "one of us" as opposed to a "corporate type". Earlier in the year, C. Shelby Coffey 3d becomes editor of the L.A. Times, following a 17-year reign by William Thomas. This appointment is seen as unusual, as Mr. Coffey is a relative outsider, having been with the newspaper for less than two years.

In March TM closes Sports Inc., a magazine it launched just 15 months prior, because the publication attracted insufficient advertising dollars to show a profit.

1990: Newspaper retail advertising goes into a deep, industry-wide slump, primarily due to the financial difficulties of retailers. TM foregoes a dividend increase for the first time since 1983. The firm is trying to cut costs by hiring freezes and by avoiding significant acquisitions.

1991: TM sells its Broadcasting and related magazines, for which it paid $75 million in 1986, in what analysts called a "disaster purchase", for $32 million. Industry-wide, retail advertising drops even further from its 1990 low, a decline described by analysts as the "worst period for advertising since World War II".

The L.A. Times offers early retirement to 300 employees, having eliminated another 300 jobs through attrition over the past year. The company reiterates its goal to avoid layoffs as much as possible. Because of insufficient advertising revenues, TM halts distribution of the L.A. Times in 10 central California counties and in Reno, Nevada, Phoenix and Tucson, Arizona, and

Salt Lake City, Utah. It also drops its afternoon edition because of declining readership.

1992: Times Mirror reports a fourth quarter loss for 1991 because the notes it received when it sold the Denver Post in 1987 could not be paid on time. The related earnings charge causes TM to report its first quarterly loss since its 1964 listing on the New York Stock Exchange.

The L.A. Times shutters its 14-year old San Diego edition and offers employee buyouts designed to reduce its work force by 7%. The San Diego edition is said to have run up losses of almost $100 million since its inception. The L.A. Times is facing intense competition from local dailies in Orange County and the San Fernando Valley. It has also been hurt by a deepening regional recession and by the Los Angeles riots.

1993: For the 1992 calendar year, Times Mirror announces its first annual loss since its 1964 NYSE listing. Pressed for cash given the decline in advertising revenues, the L.A. Times is considering the sale of its signature downtown complex across from Los Angeles City Hall, which it has occupied for more than 55 years. Much of the space is apparently in disrepair, and is described by some employees as a "dump where the plumbing does not work and they (the employees) are harassed by beggars and transients on the street".

In December, David Laventhol, who is suffering from Parkinson's disease, resigns as President of Times Mirror and publisher of the L.A. Times. Mr. Laventhol will be replaced in the first position by Mr. Erburu and in the second by Richard T. Schlosberg 3d, and will hold the new position of Times Mirror editor at large. After Mr. Laventhol's resignation, two TM executives are in competition to replace Mr. Erburu, currently 63 years old, when he retires in a few years. They are Mr. Schlosberg and Curtis A. Hessler, both age 49 and both named executive vice presidents at the time of Mr. Laventhol's resignation.

At the L.A. Times some 2,000 positions, about 25% of the work force, have been eliminated since 1990.

1994: In May, Donaldson, Lufkin and Jenrette agrees to sell four TV stations, which it bought less than a year ago from TM for $300-plus million, to Ronald Perelman's New World Entertainment for around $700 million.

In June, Times Mirror agrees to sell its cable operations for $2.3 billion to Cox Enterprises. The price paid is said to be "top dollar" for the only TM division to show profit increases over the past five years. Shareholders other than the Chandler family will receive one share in new Times Mirror for each share in the old company plus $10.45 worth of shares in the new cable company, which will combine TM's cable operations with those of Cox. Cox will hold a controlling stake in the new cable company. Chandler family shareholders, which number about 100, will receive additional Times Mirror common stock plus a new issue of nonvoting Times Mirror preferred stock in lieu of a share in the new cable company. The new TM preferred stock will enable the family to maintain its level of dividends in the face of a proposed dividend cut on

the common stock to between 1/5 and 1/3 its current quarterly payout of $0.27 per share.

Minority shareholder lawsuits ultimately force TM to offer non-family stockholders the opportunity to exchange their TM common stock for another preferred stock that converts back to common in three years if not redeemed by the company in the interim. In the exchange offer to distribute this latter preferred stock, TM receives three and one-third times the number of common shares it was seeking.

The $1.36 billion cash inflow from the cable transaction poses a classic free cash flow problem, as many of TM's investment decisions have been demonstrably poor, and Mr. Erburu's plans for the cash are "to pursue plans in new technology". The Wall Street Journal indicates that TM was already "one of the first to invest – and lose – millions of dollars in what turned out to be a slow, expensive system to electronically transmit text to readers' homes, a service it abandoned in 1986".

1995: The company completes the merger of its cable operations with Cox Communications in February. In May, Times Mirror names an outsider, Mark H. Willes, the Vice Chairman of General Mills, President and CEO. Mr. Erburu, whom he replaces, will retire on January 1, 1996 at age 65.

Mr. Willes is described as a cost cutting financial and marketing expert with no prior experience in the media business. The New York Times cites senior officials at Times Mirror as indicating that Mr. Willes "was hired by a board of directors restive about the company's poor financial performance and was given a clear directive to improve profits. People who have talked to board members said Mr. Willes' primary sponsors on the board were members of the founding family of the Los Angeles Times, the Chandlers". Mr. Willes' appointment coincides with the disclosure of sizable circulation declines at the L.A. Times (down 4%, the fifth largest loser among major dailies) and New York Newsday (the top of the list with a circulation decline of 7%).

Mr. Willes closes the Baltimore Evening Sun and New York Newsday and announces that TM will cut 1,000 additional positions (700 at the L.A. Times), including layoffs. The firm formerly cut only via attrition and buyouts. The New York Times describes the situation in the L.A. Times newsroom: "There're literally people sitting at their desks, staring into space, waiting to be tapped on the shoulder", said a reporter, speaking on the condition that his name not be printed. "It is so grim because you are all in the same room, and you are in front of your friends and someone is going to come by and say, "Hey, let's have a chat", and everyone's going to know what happened".

In July, TM announces that it will use some of the proceeds from the Cox merger to repurchase 10% of its common stock. Mr. Erburu had planned to invest these proceeds in a variety of multimedia projects. In contrast, Mr. Willes plans to cut investment in TM's non-newspaper businesses and focus on growing the newspapers from within.

In September, TM buys back more than 3.8 million of its series B preferred shares from an unidentified institutional holder, and in November, it announces a Dutch auction repurchase of its series B preferred stock. The series B preferred stock had been issued to non-family stockholders as part of the settlement of shareholder lawsuits that challenged the fairness of the Cox Communications deal to TM's non-Chandler stockholders. Also in September, Curtis A. Hessler, one of Robert Erburu's two candidates to succeed him as Times Mirror CEO, leaves the firm.

1996: In May, Times Mirror raises its quarterly dividend on common stock from 6 to 10 cents a share. In June, the L.A. Times cuts its newsstand price in half, to 25 cents a copy, after having just raised it in January 1995 from 35 to 50 cents. The reduction was apparently motivated by the desire to keep average daily circulation from falling below one million copies. According to Mr. Willes, "If the Los Angeles Times does not do well, nothing can overcome that". In July, TM announces that it will exit college publishing and consolidate its legal information business. In September, the company announces that it will sell its Harry N. Abrams art book publishing unit. In October, TM reports an upturn in circulation at the L.A. Times for the first time in five years and announces plans to repurchase 12 million common shares, or 12% of the common stock outstanding. In December, TM announces that it repurchased 10.5 million shares for about $440 million in 1996 and plans to repurchase about $420 million more in 1997.

1997: In March, TM announces that it plans to redeem a year early the remaining series B preferred stock for common stock. All of the remaining series B stock is held by non-Chandler stockholders. In May, TM raises its quarterly dividend on common stock from 10 to 15 cents a share.

In August, TM enters into two transactions with the Chandler trusts that increase and diversify the family's cash payouts from Times Mirror.

In September, Richard T. Schlosberg 3d retires, and is replaced in his role as publisher of the L.A. Times by Mark Willes. Mr. Schlosberg's departure is unexpected, although some sources indicate that there was speculation that some sort of shakeup at the flagship paper was in the works. Although Mr. Schlosberg denies it, there is also speculation that he resigned under pressure. Mr. Schlosberg and Curtis A. Hessler, who resigned four months after Mark Willes' arrival, were the two candidates chosen by former CEO Robert Erburu to succeed him.

In October, Shelby Coffey 3d, the editor of the L.A. Times, resigns unexpectedly. The Washington Post, quoting anonymous sources, says Mr. Coffey resigned rather than work with Mark Willes who, as the new publisher, is making a series of sweeping changes at the newspaper. In what is believed to be a first for a large metropolitan daily, the L.A. Times will organize its business side around editorial sections rather than around business functions, thereby integrating the business and journalistic sides to an unprecedented degree. This

integration alarms many commentators inside and outside the newspaper, who fear it will impair the editorial independence and journalistic integrity of the paper.

Separately, Times Mirror announces the repurchase of as many as 10 million common shares in its ongoing stock repurchase program.

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