TEAM *INTERNATIONAL®*
14203 Vistawood
San Antonio, TX 78249
Tel: (210) 641-7733
www. teaminternational.net

Leading from Behind…And Then There Was Mervyns

The sheep had gone wild, or were on steroids, or maybe they were just wolves in sheep's clothing!

~Noel Osborn, "Leading from Behind"

Last month I finished an article entry for this website, suggesting that, especially in normal times, we should be helping our leaders learn to "lead from behind" . As leaders, the lesson goes, we should be guiding our people ahead as they do their work, assuming they are doing good work, and we should behave like experienced shepherds who know how to give the right direction, motivation, and guidelines, and then letting our employees take the initiative and provide the creativity to move the organization forward.

But now there's the case of Mervyns, brought to disaster in late 2008 by a group of leaders who entirely wrecked a formerly successful firm, causing it to fall into bankruptcy and liquidation. As reported in the December 8, 2008, issue of *BusinessWeek*, more than 18,000 people have been dis-employed without severance, many of these even losing weeks of accrued vacation pay. So where were the leaders in this case? Were they out front leading the massacre? Were they behind and not knowing where the lead sheep were going? And how did the whole flock get turned into mutton-chops?

Here's an overview of the story: Mervyn's (once spelled with an apostrophe) was founded in 1949 by Morris Mervyn and grew to be a midsize chain with some 50 stores in 3 states. In 1978, Morris, then 58 years of age, sold the company to Target (at the time named Dayton Hudson) for a cool $300 million. Retail analysts believe that Target bought, and subsequently neglected the Mervyns brand, using its revenue surplus to build the Target franchise.

Then, in 1994, Target sold the company, now with over 250 stores and 30,000 employees, to a combination of private equity titans Cerberus/Sun Capital/Lubert-Adler for $1.2 billion, receiving a nice capital gain over the purchase price some 16 years earlier. But here is where the shepherds leading the flock went wild: they had promised to revive Mervyns; but instead of doing so, they stripped off the company's real-estate assets, and held them separately – and then the holding companies for the real-estate, also property of the equity titans, nearly doubled the rents to Mervyns. This left Mervyns saddled with $800 million in debt, while the owners of the private equity combination sucked out more than $400 million in cash for themselves.

So what was management doing all this time? Former J.C. Penney executive Vanessa Castagna was recruited to be the first CEO after the buyout from Target. She initially believed the owners wanted to turn Merwyns around. But higher leasing costs, and the distributions sucked out by the equity firms drained operating incomes. Castagna found it harder and harder to work the finances, and she left in 2007, after two years on the job.

Castagna was replaced by the equity owners with Richard Leto, formerly an executive at Kohl's. Leto saw the handwriting on the wall and advised the owners to sell the company. But the equity partners were focused on profits on the real-estate side of the business. As sales continued to fall, Leto was also dismissed before he had completed a year on the job. He was replaced on an interim basis by one of his VPs, and then the equity owners (now reduced to Sun Capital and Lubert-Adler) brought in the 4th CEO in 12 months, John Goodman, a well-regarded former president of the Dockers brand at Levi Strauss.

By then the story was almost over. Very soon Goodman found himself in extremis, and vendors/creditors were refusing to sell to the company. However, the creditors themselves offered Goodman a last-ditch solution: sue the private equity owners who had run the company into the ground! As CEO, they reminded him, Goodman had a fiduciary interest in the company's value; and now, as CEO, he was being asked to sue the very owners who had hired him a few months earlier.

As the news spread of the pending bankruptcy, and as firings began, there was panic. Goodman was still shopping Mervyns to potential buyers. But the deal breaker was the new rent payments, and the equity landlords wouldn't agree to lower them to save the business. Finally Sun and Luber-Adler, unable to dig themselves out of their own mess, decided that liquidation was the only answer. Here is the press release they issued to *BusinessWeek:*

"When it was acquired, Mervyns was struggling. Significant improvements were achieved, but *financial headwinds* (my emphasis) and the challenging retail environment proved insurmountable." Financial headwinds, indeed! The only headwinds present was the foul-stinking breath of the equity mongrels who chewed up the company, filled their own bellies with the flesh they devoured, and left the sheep disemboweled and strung along the road called unemployment.

Sorry, does that sound like a too-strong continuation of the metaphor? And does the metaphor of the shepherd and his flock fail us in the Mervyns case? Here we see that the leaders, in the personage of a succession of talented and experienced CEOs, tried their best to guide and shepherd the company. But the poor sheep were infiltrated by wolves in sheep's clothing who were bent on killing the very flock they had infiltrated. The metaphor may still hold, but it leads us towards a very different leadership model. Have a look at Figure 1, a rendition of the old Hershey-Blanchard situational leadership model. In this new context, there is now a 4th quadrant to consider -- where we are taken into negative task behaviors, i.e. where we are pulling our organization into unsustainable losses, and where we are also in negative relationships -- one part of the organization slapping up against the other, each losing trust with the other, into a downward spiral of hate and discontent. Wow, what a scenario we discover in that place in the model! That's not how it's supposed to work in a capital-building, human-resource-developing, business-sustaining society.

So what went wrong here, who's to blame? To be sure, the direct blame falls to the equity owners who exploited Mervyns and misused its capital. Some fault may be accrued to Morris Mervyn himself, now 88; and he is reported to have walked out of Mervyns for the last time in tears, with his wife's voice ringing in his ears: "Maybe you shouldn't have sold the company."

However, rather than just trying to attach blame, perhaps we can understand the Mervyns case in the context of the economic development of our age. Is this an essential failure of the capitalist system?

I am an economist by training, and I have been re-reading Robert Heilbroner's classic text, *The Making of Economic Society*, in which he traces the history of capitalism across the "rise and development of the market system".

At the end of the 19th century and the beginning of the 20th century, there was rapid growth in the U.S. economy. Leading that growth was a class of entrepreneurs with names like Carnegie in steel, Harriman in railroads, Rockefeller in oil, and J.P. Morgan in finance. These entrepreneurs supplied a strategy of industrial growth that changed the economy from a collection of small regional business-owners to a complex of large national organizations operating across state lines – "big business", as we now know it. As a group, these business leaders became known as the "robber-barons", and Heilbroner describes them as "bold, aggressive, acquisitive, competitive." They were also abusive of their economic power, and were wont to set up trusts to protect themselves from competition, especially among each other. Nevertheless, the U.S. economy grew as never before, led by the formation of giant enterprises such as Ford and General Motors, General Electric, and U.S. Steel, and government attempted to set rules for growth that would protect the economy from abuse.

Fast forward a hundred years and we see another huge burst in the U.S. economy, with GDP growing at a rapid rate and a new type of economic giant emerging in the form of the super-sized financial institution – think Citigroup, Bank of America, and J.P.MorganChase. Also think of their leaders – Sandy Weill, Kenneth Lewis, and Jamie Dimon. Here are the new barons in the U.S. economy, the deal-makers, the financial wizards, and the architects of new ways to finance growth and create wealth.

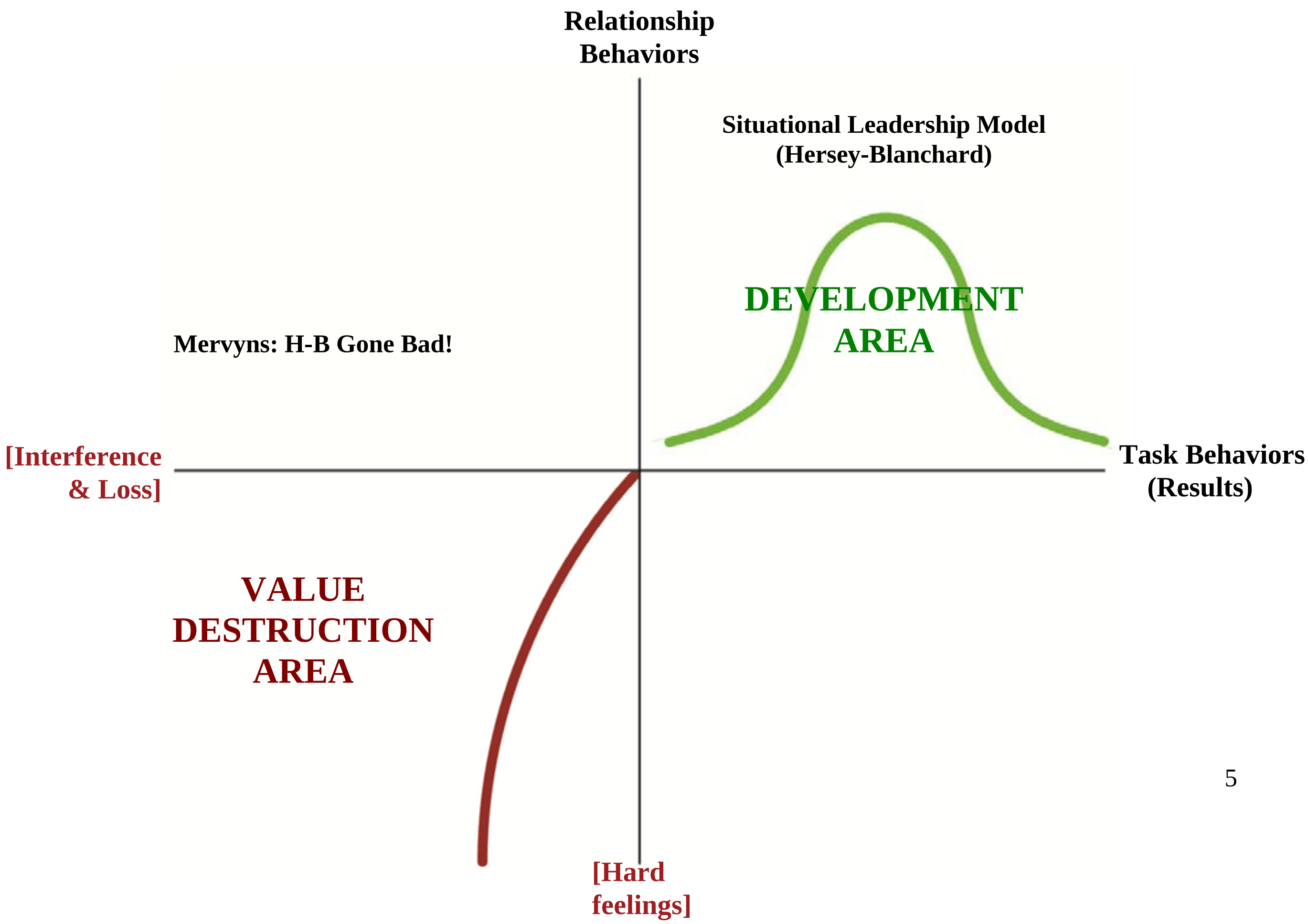
In just the last few months, we have seen a need to intervene in the workings of this new phase of capital formation, in the form of bail-outs and loans to keep the economic edifice from tumbling down through the cracks that have developed in the creative structures financing our growth. This will certainly produce a new framework for economic development, where government becomes an active player, not only in setting out the rules for growth, but also as a creditor and even part-owner of the organizations it seeks to control.

If the era of Franklin Roosevelt was known as the New Deal, perhaps the new era of Barack Obama will be the epoch of the Big Deal. You can bet that a lot of new economics will be written and re-written, as we track the development of the interaction of the players in this new scenario.

Hopefully other companies like Mervyns will survive the onslaught of the deal-makers, and more care will be given to the principles of authentic and moral leadership which drive real and permanent wealth creation for <u>all</u> participants…

Figure 1

In the H-B Situational Leadership model below, the usual area for study is in the NE Quadrant, where leaders proceed along a development curve, swapping task behaviors (getting the job done) with relationship behaviors, where followers are empowered and motivated to seek their own solutions. In the Value Destruction Area in the SW Quadrant, followers are badly managed, or even treated poorly, results are reduced, and relationships are destroyed.



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 ~T. Noel Osborn, Ph.D.