In turbulent, commitment-intensive industries: 1) firms cannot plan; 2) adaptive strategies can become expensive as markets and technologies shift; and 3) waiting to resolve uncertainty can forfeit first mover advantages.

**Turbulence:** rapid, discontinuous, and unpredictable change in multiple factors important to a firm’s long term performance, such as technology and regulation

**Commitment:** significant, irreversible investments with long lead times

**Research question:** After controlling for other factors that influence strategy, how does organizational structure affect risk taking behavior, specifically, a firm’s propensity to expand horizontally, idle, or divest assets in a turbulent, commitment-intensive environment?

**Options**

- **Expand horizontally:** committing more resources in a turbulent environment equates to risk taking
  - Acquisitions as special case: zero NPV expected
- **Idle**, i.e., invest just enough to maintain competitive position
  - Note: idling may be risky in a business with increasing returns to scale
- **Divest assets:** reduce shareholders’ exposure to risky business, using cash to buy back shares; diversify; pay down debt
Definitions

- **Owner-manager:** >20% of equity; or >5% of equity + >50% of votes; or LP
- **Focused firm:** cable systems represent at least 90% of revenue
- **Exit:** sale of all assets in focal line of business (but not necessarily liquidation of going concern); >50% of equity exchanged (for cash and/or buyer's stock)

Past Empirical Research

- Most studies found a positive relationship between management equity ownership and risk taking behavior
  - Wright et al. (1996) reported a non-monotonic relationship; speculated this was due to owner-managers' undiversified wealth (Fama & Jensen, 1983)
  - Lane, Cannella, & Lubatkin (1998) failed to replicate Amihud & Lev
- Two studies found a negative relationship between diversification and risk taking behavior
  - Hoskisson & Hitt, 1988; Baysinger & Hoskisson, 1989

To explore these questions, I studied the U.S. cable TV industry using a multi-method research design.

Cable TV is well-suited for studying the relationship between organizational form and risk taking in a turbulent, commitment-intensive context.

- Cable is commitment-intensive: plant upgrades are costly and irreversible; acquisitions are visible and irrevocable
- Turbulence increased since the 1980s, allowing for longitudinal tests
- Heterogeneous participants, offering variance on predictors
- Acquisition -- the only route for horizontal expansion since franchising was completed in the early 1980s -- provides a readily measured dependent variable

In the cable industry, turbulence increased during the 1990s.

- **1984-89:** Lower turbulence
  - 1984 deregulation
  - Competitive threats fade
- **1990-96:** High turbulence
  - HLT restrictions
  - Phone company and satellite competition
  - 1992 deregulation; 1996 deregulation

Market valuations reflected this increased turbulence. Cable system private market values peaked in 1990, and cable company stock prices have been flat since then.
In the face of increased turbulence, owner-managed focused firms increased their share of total cable industry subscribers. Why?

A multinomial logistic regression model was fit to 1986-1995 data for 201 companies serving 98% of cable customers (pseudo $R^2 = .20$).

I employed the Bower-Burgelman strategy process model to analyze the data collected during my field interviews.

Relative to a focused firm, a diversified company exhibits an increasing propensity to exit and expand with increasing turbulence.

Product Market Context Findings

- Largest firms were optimistic about their competitive prospects, and saw a need for increased scale
- Medium-sized firms with greater near-term exposure to competition also believed they needed 3 to 5 million subs; less exposed firms were not concerned about "critical mass"
- Relative profit performance influenced expansion, but not exit

**Product Market Context Findings**

- Largest firms were optimistic about their competitive prospects, and saw a need for increased scale
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- Relative profit performance influenced expansion, but not exit
Companies in more competitive markets uniformly viewed national scale to be essential. Companies in less competitive markets held a contrary view of "critical mass.

**ARGUMENT COUNTER-ARGUMENT**
- **Endgame:** a handful of integrated giants offering branded, bundled services
- **No-one can afford full national coverage; giants will seek affiliates to extend their reach**
- **Large companies secure programming discounts**
- **Such overheads unlikely to exceed 1% of sales for a 1 million sub cable company**
- **Need critical mass to absorb staff overheads for new technologies**
- **Can piggyback on Cable Labs and largest players' efforts**
- **This is truly valuable, but: 1) cable is still a good business without this upside; and 2) possible that big wins have been exploited**

Exit odds were higher for medium-sized cable companies with systems in markets perceived likely to evolve more quickly into competitive battlegrounds.

**TOP 50 MSOs IN 1990: % EXITING BY 1997, BY SCALE AND % OF SUBS IN LARGE SYSTEMS**

<table>
<thead>
<tr>
<th>Market Size</th>
<th>Medium-Sized</th>
<th>Large-Sized</th>
</tr>
</thead>
<tbody>
<tr>
<td>COMPETITIVE MARKETS</td>
<td>68% exit (N=22)</td>
<td>SCALE ADVANTAGES 17% exit (N=4)</td>
</tr>
<tr>
<td>LESS COMPETITIVE MARKETS</td>
<td>36% exit (N=18)</td>
<td></td>
</tr>
</tbody>
</table>

Comcast is still active; Continental sold. Why?

**COMCAST CONTINENTAL**
- **Cable Assets, 1994**
  - Com: 3.4 million subs; #4 MSO
  - Cont: 4.2 million subs; #3 MSO
- **Equity Ownership**
  - Roberts family (father/son team) controlled voting stock, owned 5% of economics
  - Hostetter owned 25% of economics and 32% of votes
- **Debt**
  - Com: 6.8X cash flow
  - Cont: 8.7X cash flow
- **Cable Outcome**
  - Com: Still active
  - Cont: Sold to US WEST, 2/96
- **CEO Personal Wealth**
  - Roberts: family stock worth about $450 million
  - Hostetter: US WEST stock worth over $1 billion

Comcast grew by issuing equity.

- **Roberts:** "We faced a difficult choice in the 1980s between two paths. The first path, taken by Hostetter, focused on personal equity ownership. Ames took out his own credit card to buy out Dow Jones, which owned 25% of Continental in the early 1980s. He’s much more of a risk taker than we are, and he made much more money."

"The second path involved really growing the company. Somewhere along the road - I'm not sure it was a conscious decision - my father decided he wanted this to be a family business. A business worth more than cash. To be viable, you have to be bigger, and that meant issuing equity."
At Continental, Hostetter sought to maximize his personal share of the company’s equity.

- **Hostetter:** “You’re diluting yourself when you issue equity in the public market for eight times cash flow and apply it to acquisitions at ten times. I’ve never understood the mindset of companies like Comcast that finance themselves in that manner. Our strategy from the beginning has been to maximize shareholder returns. The way you did that involved related risks. For us, that meant leverage, leverage, leverage!”

Owner-managed focused firms varied widely in their willingness to use debt and equity.

The balance between perceived need for capital and projected capital availability influenced exit odds.

Owner-managers’ risk preferences varied widely. Some were cautious; others seemed almost reckless.

- “When the oil business went down, a lot of our friends went bankrupt. They all had a lot of debt, based on supposedly predictable cash flows from oil” (Fred Nichols, President, TCA)
- “If the entrepreneur goes bust, so what? The bank pays the price” (Jerry Kern, deal lawyer and TCI director)
- “I’ve never been hurt by the deal I didn’t do” (Frank Batten, Chairman, TeleCable)
- “If you don’t buy it, you won’t own it” (Jerry Lenfest, CEO, Lenfest)

The balance between perceived need for capital and projected capital availability influenced exit odds.

Owner-managers’ personal priorities drove outcomes.

- “I can’t imagine getting more pleasure from doing anything else. We have a wonderful team, making a contribution to the lives of 2,100 employees. After 30 years, I have a lot of friends in the cable business. We’ve all made more money than we ever could have dreamed possible. But it’s more than that. We’re part of history, proving that TV is not a ‘vast wasteland.’”
- “I sold my company once, dispersed all those people. It was tough. People say you can’t fall in love with bricks and mortar. That’s true; you have to make rational business decisions. But in a way, most cable entrepreneurs are like the corner shopkeeper. This is what we do!”

Jeff Marcus, CEO of Marcus Cable
Among owner-managed firms focused, the existence of a family dynasty reduced the odds of exiting to zero.

- “It’s not about getting rich. It’s about enriching life by extending the family, being in a place where you can create value through wits and guile, challenging the marketplace.”
  
  Leonard Tow, CEO, Century

COO Alan Spoon described portfolio strategy at The Washington Post Company:

- “Staying in cable is strictly a financial decision. Like everyone else running a media company, I’m looking for wonderful opportunities to absorb a lot of free cash flow. Now, cable is a cash crocodile; we’ve been spending a lot to get ready for satellite competition. So far, it looks like a good investment.”

- “But if you believed that you needed 2 to 5 million subs to be competitive – and I don’t – then you’d completely transform the character of a typical media company. We’d unbalance our portfolio if we saw a great opportunity, but not if it meant starving the newspaper or Newsweek for capital. That’s our heart and soul.”

Institutional strategy was critical in TeleCable’s decision to sell.

- Owner-manager seen to be a prudent value investor
  
  “It’s hard to say exactly when, but the day will come in a community of any size when there are two video competitors, probably both with phone company ownership. So, do you sell now, or bet on a slow evolution toward competition? Sure, we could have hung around five more years, but are you that greedy?”
  
  (Dick Roberts, CEO)

- Commitment to operating excellence constrained choices
  
  “You can move to the Ozarks, like the Washington Post, to try to escape the plague. That’s the last place the phone companies will attack. But that’s not the business we got into. We are outstanding and very profitable operators, but we’ve achieved these results by investing in marketing, equipment, and people. You simply can’t support our cost structure in rural systems.”
  
  (Al Ritter, CFO)

Despite intense criticism, Jerry Levin, Time Warner’s agent CEO, remained committed to cable and to a strategy of vertical integration.

- “Why cable? I guess it’s something in our genes. Time Inc. was always an idea company, all the way back to Luce. He got into video through The March of Time newsreels.”

- “I have always believed in cable, and I still believe in cable, despite Wall Street’s current view. Along with Malone and many of the other CEOs of cable companies, I’ve seen the industry pass through three crises [1975; 1982; and present] and emerge stronger each time.”

- “I had a sense of mission about Time Inc. It was the kind of business that I thought had meaning, that satisfied my soul. I believed with a kind of messianic zeal that I could figure out what it needed.”
  
  (In BW, 12/95)

Structural Context Findings

- In committing their firms to expansion, owner-managers and agents both faced considerable downside, but the upside opportunity for owner-managers was much greater

- Agents felt pressure to justify decisions; owner-managers had more discretion

- Focused firm CEOs had deep, first-hand industry knowledge. Diversified company CEOs, with less information, estimated a greater variance for outcomes

“Sure, a hired manager is more conservative. He has to be: he realizes that if he makes one slip, he’s out the door.”

John Malone, CEO of TCI
To a much greater extent than an owner-manager, an agent CEO has to justify his actions to other parties. In the face of turbulence, this is very difficult to do.

- Agent is obliged to explain decisions to investors; Board; division managers
- Belief: Staying in cable will entail redoubling our bet in a risky game that we (as a medium sized player without telecommunications experience) don’t really know how to play
- Belief: Redoubling our bet in cable will jeopardize implicit commitments with other divisions, putting our organizational "truce" at risk
- Observed facts: 1) We can sell now for a big gain; 2) others are selling, and the Street seems to like the results
- Dilemma: How can I justify a decision to risk the resources with which I have been entrusted, when I cannot with confidence explain how our strategy will evolve in this turbulent environment?

Agents felt a stronger need to justify their strategies

- “It was a wonderful age. If you were managing a public company [during the 1970s], you didn’t have to explain anything to anybody. People from that time have no idea what it is like today.” (Nick Nicholas, agent CEO, Time Warner)
- “Our strategic decisions are unfettered by committee … we can move quickly, and I can step up and pay a big price without anyone second guessing me. In a big company run by professional managers, who really wants to make the decision? Who wants to be held accountable if the deal doesn’t work?” (Gerry Lenfest, owner-manager, The Lenfest Group)

Compared with their focused firm counterparts, diversified firm CEOs had less understanding of industry dynamics. Hence, they estimated greater outcome variance, and were less likely to expand.

**Estimated Payoff to Firm**

- **Focused Firm CEO**
- **Diversified Firm CEO**

**Estimated Payoff to Firm**

**Are we observing rational behavior?**

- **H1**: Agent CEOs were excessively risk averse due to concerns about their job security.

Contrary evidence
- Exits did not generate criticism or complaints from investors
- Trusts clearly are conservative
- Agent CEOs appeared to be quite secure in their positions
- Agent CEOs tended to dismiss H1 in interviews
**H2:** Entrenched owner-managers in focused firms were victims of “groupthink.” Inconsistent with minority investors’ preferences, they expanded recklessly, due to their emotional commitment to cable.

**Support**
- Bear market for cable stocks; protests from minority investors
- Highly directive leadership; lack of norms of methodological rigor: conditions Janis (1982) says encourage bolstering behavior

**Contrary evidence**
- Sophisticated investors are backing new cable LPs
- Evidence that most entrepreneurs “shopped their firm” (e.g., TCI negotiated a sale). With groupthink, managers typically consider one option.
- Lack of evidence of groupthink behaviors in interviews (e.g., illusion of invulnerability; illusion of unanimity; poor information search; selective bias in processing information)

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**Generalizability**

- Impact of structure will be most readily apparent when product and capital market forces are not overwhelming
  - Measured pace of cable consolidation due to: 1) scale economies that favor expansion by mid-sized firms; and 2) limited competitive pressures, until recently
  - Bank lending policies allowed persistence of owner-managed focused cable companies (less reliance on internal cash flow; external equity)

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**Mintzberg & Waters (1982) on the entrepreneurial mode of strategy formation:**

“No other mode of strategy making can provide so clear and complete a vision of direction, yet also allow the flexibility to elaborate and rework that vision. The conception of strategy is an exercise in synthesis, which is best carried out in a single informed brain. That is why the entrepreneurial mode is at the center of the most glorious corporate successes.”

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**Normative implications**

- The heroic view of the CEO as architect of strategy has fallen out of fashion: “this model is no longer interesting to strategy researchers, even as the strawman” (Ghoshal & Bartlett, 1994)
- However, the heroic CEO seems to be alive and well in industries that create, transport, and process information (e.g., Gates, Ellison, Malone, Murdoch, Redstone)
- First mover advantages drive the rapid pace of events in these information industries; companies cannot afford the time required to formulate strategy through a bottom-up process that relies on political sponsorship
- This research suggests that compared to other organization types, owner-managed focused firms may be more willing and better able to deal with the risks inherent in high velocity environments

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**Owner-Managers Can Mediate Product, Capital Market Forces**

- Bottom-up process can be “captured” by strong product and capital market forces (Christensen; Sull)
- Owner-managers can mediate these forces:
  - Take responsibility for risks that middle managers might avoid
  - Have credibility when selling strategy to capital markets; absorb stock price erosion if markets do not like the strategy

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**Requirements For Top-down Model More Readily Met In Focused Firms**

- Access to heavy flow of “real-time” information
- Expertise to separate signal from noise and synthesize strategy
Potential Limitations Of Top-down Model

• Vulnerability to cognitive biases and defensive avoidance behaviors
  – Groupthink (Janis)
  – Escalation of commitment (Staw)
  – Success-induced biases (March)
• Can drive away talented managers