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The short happy life of Celiant Corporation: Did managerialism at Lucent Technologies divert shareholder wealth to private equity investors?

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ABSTRACT

Proponents of private equity investment in corporate ventures assert that private equity creates shareholder wealth by alleviating agency costs, improving venture governance, and allocating resources more efficiently. Critics claim private equity expropriates wealth from public company shareholders to private investors and managers. We use managerialism as a framework to examine these competing claims in the context of the power amplifier business at Lucent Technologies. Lucent spun off this business in 2001 into a company called Celiant Corporation, and then sold Celiant in a series of transactions in 2001 and 2002. We estimate that Lucent contributed assets to Celiant worth $330 million, but that the spin-off and sale of Celiant generated only $91 million for Lucent's shareholders. The apparent loss of over $200 million of shareholder wealth is consistent with a scenario in which Lucent managers and private equity investors used their superior information for personal gain.

1. Introduction

Much practitioner and academic attention has focused on the financial and strategic benefits of private equity investment (e.g., Sahlman, 1990; McKnight, 2001; Folta and Janney, 2004; Allen and Hevert, 2007). Private equity can help alleviate agency costs created by the separation of management of the enterprise from its ownership. Proponents of private equity financing assert that private equity investors provide more effective monitoring of the organization than other investors. This monitoring improves corporate governance and provides a level of control over corporate managers that is not normally available to public companies. These benefits allow the organization to focus on the rapid development and successful commercialization of new technologies. Thus, private equity can provide a more suitable governance structure than a traditional corporate structure for the commercialization of new technologies.

Despite the possibility of more effective monitoring, questions remain about the role insiders play in facilitating private equity investments. Critics of private equity financing assert that private equity allows wealth expropriation from shareholders to private investors and managers. The possibility of expropriation occurs because some agents responsible for managing the ventures have personal stakes in those ventures. These agents, with their informational advantage, may have

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the opportunity to influence private equity investments that work to their advantage. As Michael Kinsley describes in an editorial in *The Washington Post*:

> Private investors buy a company from its public stockholders. They have a letter from an investment bank saying the price is a fair one. They usually have the support of management, or they actually are the management. The public stockholders have little choice. But time and again—surprise, surprise—the investment bank turns out to be wrong. The company is actually far more valuable! (And any bank that can't be counted on to get this wrong will not be in this profitable line of work for long.) Soon the company is sold at a large profit, either to another company or back to the public. (Kinsley, 2006)

Hence, private equity investment involves a trade-off between the purported superior strategic structure of private equity, and the risk that shareholder wealth will be unduly transferred to managers and the private equity investors. We examine this trade-off in the context of corporate venturing at Lucent Technologies, using a theoretical framework for managerialism described in Rowlinson et al. (2006).

Our research question examines whether private equity ventures derive real economic value from the competitive advantages gained from improved monitoring and the efficient management of the assets purchased, or whether the ventures gain value from an exploitation of managerial control over those assets, at the expense of the shareholders who were the original owners of those assets. We use case study methodology to examine this question in the context of Lucent Technologies, which attempted to incubate new technologies within a corporate venture unit. Our analysis suggests that Lucent sold corporate venture assets to private equity investors for hundreds of millions of dollars below fair value.

We analyze Lucent's power amplifier business. Until 2001, Lucent designed and manufactured the power amplifiers used in the base stations of its telecommunications cell sites. Between 1997 and 2001, Lucent incubated many of its internally developed technologies in an internal corporate venture unit called the New Ventures Group (NVG). In June 2001, Lucent spun off its power amplifier business into a company called Celiant Corporation, selling approximately 50 percent of Celiant to the private equity firm of Pequot Capital Management and to a high-profile private investor. Although NVG did not manage Celiant at the time of its initial spin-off, later in 2001 Lucent transferred its interest in Celiant into NVG and subsequently sold 80 percent of the entire NVG portfolio to Coller Capital, a London-based private equity firm. In 2001, Lucent managers associated with Celiant and with NVG received significant equity incentives in Celiant.

In February 2002, Andrew Corporation acquired Celiant for $470 million. The transactions involving Celiant generated less than $100 million for Lucent's shareholders, but we estimate that the tangible and intangible assets contributed by Lucent to Celiant had a fair value of as much as $330 million as of June 2001. These events suggest an expropriation of wealth from Lucent's shareholders of nearly $250 million for the Celiant assets alone, but there is evidence that Lucent sold at least one other venture in the NVG portfolio for much less than fair value. The sales of the two ventures may suggest a pattern of selling corporate venture assets for below fair value.

The corporate history of Celiant resembles the process described by Michael Kinsley, and possibly illustrates a corporate venture failure in which inadequate corporate governance and monitoring allowed corporate venture managers to utilize their superior information and their control over company assets for personal gain. As such, we believe Celiant provides an example of radical managerialism as described in Rowlinson et al. (2006) whereby managers use their power to pursue their personal interests, while legitimizing their actions by drawing upon the popular managerial concepts of entrepreneurship and venture capital.

While researchers who evaluate corporate venturing activities are usually limited by the availability of venture-specific information, we obtain detailed information about Celiant from Andrew Corporation's filings with the Securities and Exchange Commission. Also, Lucent's corporate venture strategy was described at length in several contemporary academic and business press articles to which Lucent managers contributed with interviews or as coauthors. Finally, our analysis benefits from the proximate time between Lucent's spin-off of Celiant and Andrew's acquisition of Celiant, and from the materiality of the acquisition to Andrew.

In the next section of the paper, we use managerialism to frame our research question. In Section 3, we discuss the history of the New Ventures Group and its role within Lucent. Section 4 describes the managerial incentives in place in the New Ventures Group. In Section 5 we estimate the amount of wealth that may have been transferred from Lucent's shareholders to private equity investors and to a small group of NVG and Celiant managers. Section 5 also includes an analysis of Celiant's value chain to assess the alternative explanation that Celiant actually generated $300 million of value during the nine months that it operated Lucent's former power amplifier business. Section 6 provides concluding remarks.

2. Managerialism and its implications for corporate venturing

The separation of ownership from control is a dominant feature of modern corporations. According to Michael Jensen: "Understanding the behavior of the corporate organization requires a deep knowledge of its governance and the factors that determine the distribution of power among corporate managers, shareholders, and directors" (Jensen and Warner, 1988, p. 227). Managerialism is the idea that managers, rather than owners, have come to dominate corporations (Rowlinson et al., 2006, p. 682). Rowlinson et al. (hereafter RTW) constructs a framework using managerialism to classify and characterize various theories of the firm. In this section, we show how the arguments offered by proponents and critics of corporate venturing and private equity can be understood in the context of the RTW framework.