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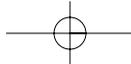
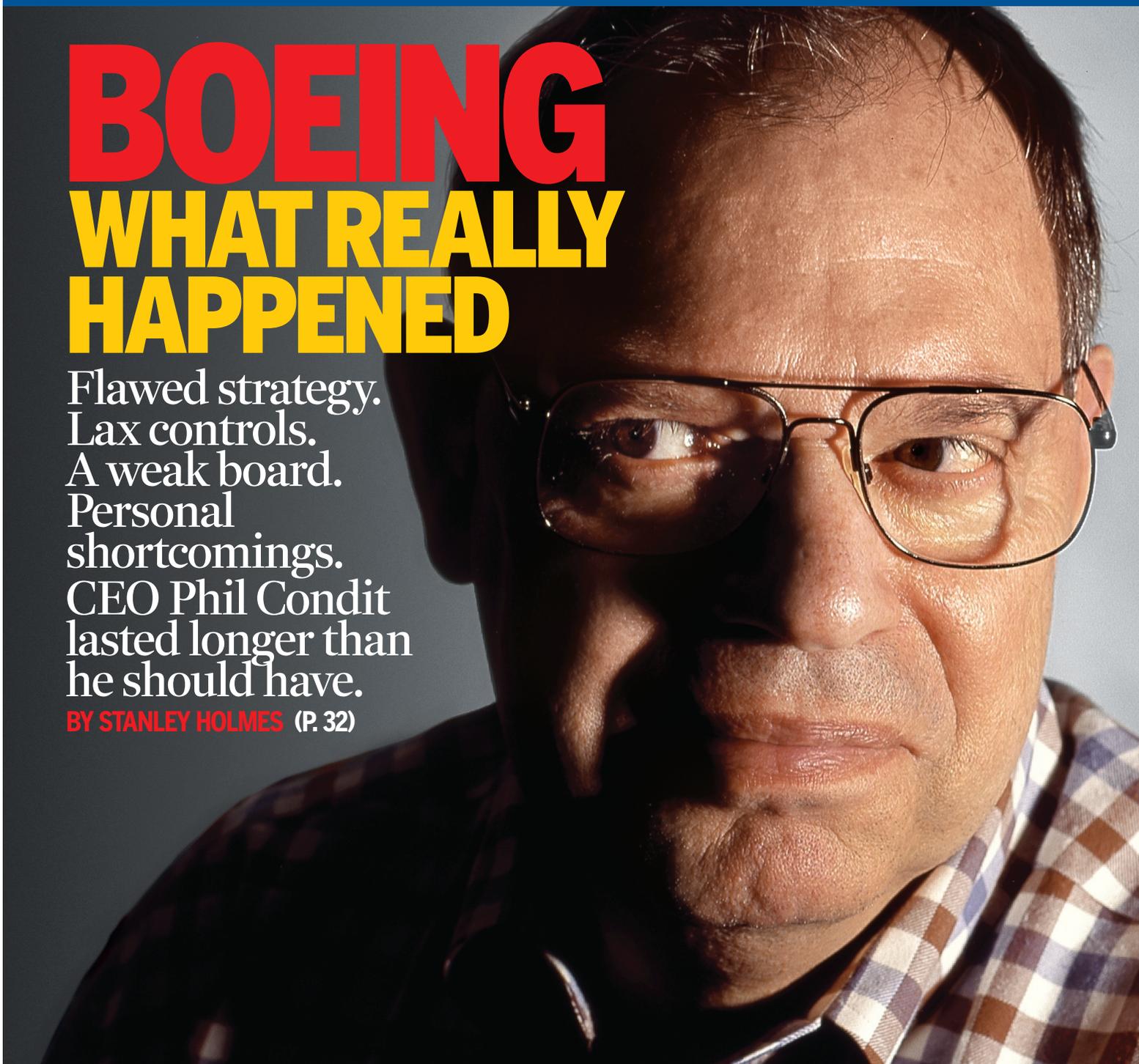
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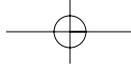
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BOEING **WHAT REALLY** **HAPPENED**

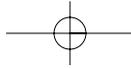
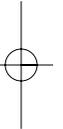
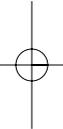
Flawed strategy.
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A weak board.
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shortcomings.
CEO Phil Condit
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BY STANLEY HOLMES (P. 32)





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EXECUTIVE SUITE

BOEING

WHAT REALLY HAPPENED

Flawed strategy. Lax controls. A weak board. Personal shortcomings. CEO Phil Condit lasted longer than he should have. **BY STANLEY HOLMES**

THE REALLY SURPRISING thing about Philip M. Condit's resignation as chairman and chief executive officer of Boeing Co. was not that his seven-year tenure ended so abruptly on Dec. 1, but that it lasted so long. Recent allegations of questionable conduct by a Boeing executive involved in negotiating an \$18 billion deal with the Pentagon was only the latest mishap in a series of ethical lapses and managerial blunders that marred Condit's tumultuous reign from the start.

Condit's resignation has been portrayed as the selfless gesture of a leader who put the company's interests before his own. In fact, Condit had survived an array of crises before this latest upheaval, and the chairman had no inten-

tion of bailing out this time, according to people who are close to the company. But with its crucial defense business in jeopardy, a board that had overlooked missteps before finally took firm action. The CEO had to go. Under pressure from the board, Condit offered his resignation. According to an old friend who talked to him on Monday night, the CEO was distraught. Condit and Boeing insist his exit was voluntary.

A BOLD VISIONARY

THE STORY OF Philip Murray Condit, 62, is the tale of a manager promoted beyond his competence and blind to his own shortcomings. The skills that made him a brilliant engineer—obsessive problem solving and an ability to envision elegant design solutions—were of less use in an executive position. Al-

though always a bold visionary, Condit was frequently indecisive and isolated as a CEO—in stark contrast to his predecessors. Starting with founder William Boeing, the company has been led by a succession of strong, commanding leaders who enjoyed near-total autonomy, displayed unwavering devotion to a culture of engineering and manufacturing excellence, and led modest personal lives. Condit may have enjoyed a similar degree of latitude, but he was further removed from the company's operations. He also developed a reputation as a womanizer, often with Boeing employees, and an appetite for the high life. In a hiatus between one of his four marriages, Condit took up residence in the Boeing suite at Seattle's Four Seasons Olympic Hotel, where he had the suite remodeled at company expense to add a

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bedroom, say some people who are familiar with the matter.

His troubles started almost as soon as Condit moved into the CEO's office. Within a year, he had steered Boeing into a manufacturing crisis that took Wall Street—and the board—by surprise and ultimately caused the company to take a \$2.6 billion write-down. Last year, in a telling coda, Boeing paid \$92.5 million to shareholders who accused the company of using accounting tricks to hide the damage prior to the crucial merger with McDonnell Douglas (BW—May 20, 2002). Even worse, through most of his tenure, Condit badly misread the rising threat from Europe's Airbus. And some of the acquisitions he made to diversify away from commercial aircraft were plagued with integration problems. This year alone, Boeing has taken more than \$1 billion in deal-related write-offs. Company officials point out that "in the midst of the worst downturn in the history of commercial aviation," Boeing is profitable in all its businesses. However, revenues have been declining since 2001 and will slip to an estimated \$49 billion this year with estimated earnings of \$790 million. The result: Boeing's stock has fallen 6.5% under Condit—while the Standard & Poor's 500-stock index rose 61.8%. "That was a difficult record to run away from," says Richard Turgeon, research director of Victory Capital Management, which owns 2 million Boeing shares. "It was unacceptable."

CLOSE TO THE EDGE

EQUALLY DAMNING was the heavy damage done to Boeing's reputation on Condit's watch. A company that had long been a paragon of American industrial excellence has ensnared itself in one scandal after another in recent years. "Under Condit, engineering skills and ethics seemed to lose sway over senior management," says Loren Thompson, a defense analyst at the Lexington Institute in Arlington, Va. "Condit booked a huge amount of defense business by allowing his subordinates to play business close to the edge." Boeing has said that there is no evidence linking Condit to the scandals.

The decision to steer the company more deeply into defense contracting represented a historic shift. The most crucial step in that process was the 1997 acquisition of McDonnell Douglas. Not only did that deal make defense contracting a much bigger part of Boeing's mix but the smaller McDonnell also had an outsize effect on the Boeing culture.

The Troubled Reign Of Phil Condit

Since Condit took over in April, 1996, Boeing has been under constant fire in Washington, on Wall Street, and in the courtroom.



Factory Fiasco Boeing lost control of its commercial airplane plants in 1997 by trying to pump out a record number of airplanes. The chaos forced Boeing to stop two assembly lines so workers could catch up. That cost the company more than \$2.6 billion and forced its first annual loss in half a century. In 2002, Boeing paid \$92.5 million, without admitting guilt, to settle a shareholder lawsuit alleging it had papered over the mess.

Loose Talk Controversy swirls around a deal to sell refueling planes to the Air Force. Documents revealed that a Pentagon official, Darleen Druyun, may have tipped Boeing off about a lower Airbus bid. CFO Michael Sears was ousted over allegations that he discussed a Boeing job for Druyun. She took the job and was also fired. The deal has been frozen.



Troubled Buys

Boeing has a spotty acquisition record. The purchase of the Hughes satellite and Jeppesen flight-information businesses resulted in more than \$1 billion in write-downs. Even though investors were generally happy with the McDonnell Douglas deal, it created a culture clash.



Boeing, the jewel of its hometown of Seattle, had always prided itself on treating employees—from designers to line workers—as family. But the values most esteemed at McDonnell were the ability to schmooze with Washington power brokers and win the contract. Building planes sometimes seemed to take second place.

And with McDonnell came a new No. 2 exec, Harry C. Stonecipher. The decisive, brutally candid Stonecipher was the temperamental opposite of the aloof, nonconfrontational Condit. Many inside the company came to view him as an en-

forcer. The relentless bottom-line focus Stonecipher brought to bear during his stint as president antagonized many managers on the Boeing side of the house. Condit's 2001 decision to move the company headquarters to Chicago completed the cultural uprooting, leaving many of those left behind in Seattle feeling a bit like unloved stepchildren.

Condit had been steeped in the Boeing culture for more than 30 years. He caught the eye of Boeing's top brass almost as soon as he arrived at the company in 1965, fresh out of Princeton with a master's degree in aeronautics. Early in



Feisty Rival Condit miscalculated the determination of Airbus to spend \$13 billion on developing a massive new passenger jet, the 555-seat A380. Today, Airbus has more than 120 orders in hand for the A380 and has seized the lead from Boeing in commercial-jet deliveries.

Women Problems? Boeing faces a sex-discrimination class action, set to come to trial in April, 2004. The lawsuit, filed in a federal court in Seattle, alleges that top company officials knowingly underpaid Boeing's female employees and denied them promotion, in order to "enrich the corporation" at their expense. The suit was brought by 38 women who represent a cross-section of Boeing's female employees.



Rocket Ban In July, the Pentagon punished Boeing for possessing documents from rival Lockheed Martin that helped win rocket contracts. Boeing has been indefinitely banned from bidding on military satellite launches, and the Pentagon has transferred \$1 billion of future business to Lockheed.

his career, he solved a vexing problem by calculating the force of the vortex created when jumbo jets take off. This allowed the Federal Aviation Administration to develop rules for safe spacing between jumbos and smaller aircraft, rules still in effect today. It was that problem-solving skill that attracted the attention of Thornton A. "T" Wilson, then Boeing's chairman and CEO, who took the engineer under his wing. "It was clear that young Condit was a standout engineer and person," recalls Granville Frazier, a retired Boeing senior exec and longtime friend who first met Condit in the mid-1960s.

Later, Condit's design leadership on the 757 and 777 programs positioned him to take over the top job. But although he won great praise for his engineering prowess, some say both programs were riddled with problems that resulted from poor management. On the 777, for example, Condit made some inspired design breakthroughs, most notably switching to software that allowed Boeing to go directly from a design on the computer screen to the factory floor, avoiding expensive mockups. But Condit wildly overshot his initial budget. The plane was budgeted for \$6 billion in development

costs but ultimately cost \$12 billion, say close observers. "We were milking money from the 767 and the 737, and that money was going right into the 777," said one former high-ranking Boeing exec. "Even though it's a wonderful machine, on a stand-alone basis, the 777 is not a commercial success." Boeing declined to discuss development costs, saying they are proprietary.

Once he reached the top spot, Condit's shortcomings as a manager became more worrisome. Within a year of taking office, Condit overreached in trying to step up airliner production even as the company was shifting to a more automated manufacturing system—the equivalent of replacing the engine on a race car as it wheels around the track at 200 mph. Boeing's massive Seattle assembly lines nearly broke down in 1997, a year after he assumed office. By the time order was restored, the company had lost most of its credibility on Wall Street—a humiliation that seared the new CEO. In a meeting on Aug. 5 of that year—with more than two dozen senior execs in the board room of Boeing's then-headquarters in Seattle—Condit complained about the embarrassment he had suffered while trying to soothe angry investors on the East Coast, recall execs present at the meeting. He had been called a liar by shareholders fed up with broken promises, the production fiasco, and a slumping stock. With tears welling, Condit vowed he would never suffer such indignity again. In a talk this year to plant workers, Condit took responsibility for the stumble, saying: "I give myself a very poor grade. It happened, and so it's my responsibility. There's my F."

THE FALL GUY

BUT CONDIT'S PROBLEMS were far from over. By the spring of 1998, with earnings struggling, global markets in a nosedive, and the stock under pressure, investors were calling for Condit's head and pressuring directors to do something. Condit saved his own position, but others were not so lucky. On a Saturday in early September, he called Ron Woodard, then president of the commercial airplane division, and asked him to come to the office. Condit told Woodard this hurts me more than it hurts you—and fired him. Woodard became the fall guy for the manufacturing collapse. "He told me he had a real close brush with the board, and he was almost dumped two months before," Woodard told *BusinessWeek*.

But if there was any lingering sense of

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shame, it didn't deter Condit from his taste for lavish living. In the early '90s, he built a massive medieval-style mansion outside Seattle, replete with a custom miniature train that chugged from room to room, delivering drinks to guests. Condit hosted elaborate parties that often included poetry readings and evenings of Camelot themes, featuring characters from King Arthur.

That extravagance soon began filtering into a company culture that had been based on modesty, fiscal restraint, and the singleminded pursuit of building big airplanes. Former CEOs Bill Allen and T. Wilson both eschewed the trappings of corporate privilege. Wilson lived in the same middle-class house during his whole career at Boeing. When Condit succeeded Frank Shrontz as CEO in 1996, Boeing had three small corporate jets, and senior execs were required to fly commercial airlines to stay in touch with their customers. Now, Boeing has a fleet of corporate jets, including a 737 for Condit, done up in English-library style.

RAISED EYEBROWS

CONDIT'S PERSONAL life was similarly prone to excess, and it began to raise eyebrows within the company and among directors. After his second marriage, to a Boeing secretary, broke up in 1990, Condit embarked on a relationship with a Boeing receptionist, Laverne Hawthorne. They dated for about six months—until Condit got promoted to president in 1992. About the same time, the company's customer relations department downsized, and Hawthorne was issued a pink slip. She told *BusinessWeek* that she immediately went to see him in his office and reminded him of promises he had made to her. As Hawthorne recalls it, she looked him in the eye and said: "One of us in this room has balls, and it certainly isn't you." Then she stormed out. Hawthorne declines to say whether she filed a wrongful-termination suit against Condit or received a settlement from the company,

but several Boeing executives say both happened. "There was a lawsuit and a settlement," said one Boeing exec. Condit declined to comment.

As Condit's airplane factories were imploding in 1997, so was his third marriage. That's when he moved into the suite at the Four Seasons. Condit had married Jan Condit—his first cousin—in

ior. Piggott did not return calls seeking comment. Said one Boeing lawyer to a senior Boeing executive: "We have another Bill Clinton on our hands."

SEALED COURT FILES

BOEING HAS OTHER WOES relating to women. A class action alleging widespread pay discrimination against women is now pending in federal court in Seattle. The suit alleges that top company officials knowingly underpaid women and denied them promotion to "enrich the corporation" at their expense, says plaintiffs' lawyer Mike Helgren. Boeing says that allegations are without merit. The documents in this suit have been sealed by the court. *BusinessWeek* has asked to have them unsealed. That motion is pending.

Although Condit often trumpeted his visionary strategic skills, they failed him when it counted most. As late as 1996, in a meeting with Boeing's legendary European salesman, Rudy Hillinga, Condit assured him that Airbus would never launch the A380 program. According to Hillinga, Condit said: "I'll give you my personal guarantee, that this time around, Airbus will not succeed." Condit not only underestimated the Airbus threat but also waffled when he needed to respond decisively. Under Condit, Boeing first proposed the 747x, a super-sized 747, and then later the Sonic Cruiser, a high-speed jetliner.

Despite the marketing hype and strong suggestions that Boeing would launch both jetliner programs, Condit did not pull the lever. While Airbus got bigger, Boeing stagnated. The failure to formulate a strategy that could keep up with an emboldened Airbus began to tell as Boeing fell behind in both technology and manufacturing efficiency during the '90s. Boeing, once the manufacturing marvel of the world, now spent 10% to 20% more than Airbus to build a plane. The loss in market share—from nearly 70% in 1996 to roughly 50% today—has marked an astonishing reversal. Boeing



DREAMLINER Much is riding on whether the 7E7 aircraft goes ahead

Turbulence at Boeing

-6.5%

Drop in Boeing's stock price since Condit took over in 1996. Meantime, the S&P 500 rose 61.8%, and the S&P aerospace index is up 20%.

275

Boeing's deliveries of commercial jets in 2003. Airbus will surge into the lead with 300 planes. In 1999, Boeing delivered 620, vs. 294 for Airbus.

\$1.1 Billion

This summer's write-off to account for quality problems and the reduced value of Boeing's satellite and rocket-launch businesses.

Data: Bloomberg Financial Markets, Boeing, Airbus

the early '90s. The two divorced in 1998, and their file is sealed in the King County Superior Court in Seattle. Jan Condit now lives in the mansion.

As Condit rose through the ranks, his private life became more of an issue within the company. Former Boeing Chairman Shrontz had long been concerned and had confronted Condit several times about his personal relationships, say people in the know. Shrontz declined to comment. Former Boeing director Charles M. Piggott, retired chairman of Paccar Inc., had expressed concern to several senior Boeing executives about Condit's behav-

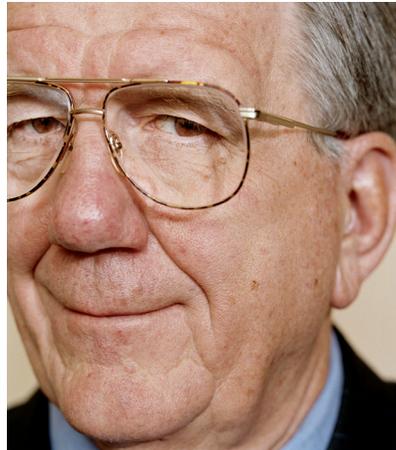
believes that smaller planes and direct flights will prevail against Airbus' A380 jumbo jet, and says it's focusing on profits, "not market share at any cost." But while Airbus is well under way with the A380, Boeing has still not committed to its latest proposal: the superefficient 7E7 jetliner. The company says it will make a decision on whether to go forward by the end of the year. Condit recently told employees: "I would not trade strategies for any amount of money."

Partly to deal with the cyclical nature of the airline business and the rise of Airbus, Condit took steps to diversify his company. Boeing started gobbling up big and small aerospace and information-service outfits. Condit gets high marks for the McDonnell Douglas acquisition. Although the clash in company cultures raised serious management challenges, it let Boeing expand in defense as its commercial business waned. Defense-related sales now account for more than half of the company's revenues, making Boeing the nation's No. 2 defense contractor.

But as Condit got the acquisition bug, some of his forays failed to bear fruit. In late 1999, Boeing bought Hughes Electronics Corp.'s Space & Communications Div. for \$3.75 billion and later paid \$1.5 billion for Tribune Co.'s Jeppesen-Sanderson Inc., the world's largest provider of flight maps and other services for pilots. Boeing hoped to capture more of the higher-margin services businesses and expand Hughes's fledgling satellite services business. Many investors at the time supported Boeing's belief that space, in particular, represented a huge growth opportunity and would add more balance to the volatile commercial airplane business.

SNOWBALLING SCANDAL

BUT CONDIT LATER ADMITTED that he was wrong. He told Everett (Wash.) employees this summer that the space market "did not turn out to be what we thought it was going to be, and we didn't perform." The \$1.1 billion charge was the latest in a series of write-offs related to a collapsing space market as well as to



NEW TEAM

Stonecipher, a former McDonnell exec, is now CEO, and ex-HP boss Platt is chairman

Dept., and the Senate Armed Services Committee are investigating allegations that Boeing acted improperly, or even criminally, in an effort to win at least two multibillion-dollar aerospace defense contracts. A second scandal, dating from 1998,

involved the possession of 35,000 pages of Lockheed Martin Corp. documents during the 1998 competition for a military rocket-launch contract. The Pentagon has indefinitely suspended Boeing from bidding on future rocket contracts pending a review of its ethics. Lockheed Martin is also suing Boeing over the alleged document theft.

Condit was not personally implicated in either of this year's Air Force scandals. But the recent fusillade of embarrassments was too much even for Boeing's famously forgiving board of directors, which had been paying out rope to Condit for years. After Condit resigned, the board awarded the CEO title to one of their own, Stonecipher, 67, who had served for five years as Condit's No. 2 after Boeing acquired McDonnell Douglas. At the same time, the board named director Lewis E. Platt, the former chairman of Hewlett-Packard Co., to the new post of nonexecutive chairman.

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—Loren Thompson, an analyst at the Lexington Institute

execute can be overlooked by a board, scandal can't be. Not when you're a defense contractor. A snowballing ethics problem threatened to imperil the side of Boeing's business that was still growing and healthy: its lucrative government contracts. In the end, that's what did Condit in. The intense scrutiny of Boeing's misconduct is just heating up. On Dec. 2, the Pentagon postponed action on the \$18 billion Air Force deal to acquire 100 Boeing 767 tankers, pending an investigation into the actions that led Boeing to sack Chief Financial Officer Michael Sears and manager Darleen A. Druyun for ethics violations. The Justice Dept., two investigative branches of the Defense

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Stonecipher's mettle will immediately be tested by a momentous decision. By Dec. 15, the board is expected to decide whether to commit to the development of the 7E7 jetliner, which would be Boeing's first new airplane in a decade. The decision will say much about Boeing's commitment to the commercial airplane market. "This is really a pivotal moment," says Richard L. Aboulafia, an aerospace analyst at Teal Group Corp. consultants. "Failure to invest in the 7E7 could mean the beginning of the end for Boeing's storied airplane business."

To many, the ascent of Stonecipher represents the de facto takeover of Boeing by McDonnell Douglas. Condit's most enduring contribution to Boeing's history may be ensuring the transformation of Boeing into a defense contractor with a commercial aviation subsidiary—an ironic legacy for a brilliant aviation engineer. ■

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