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THE SPIRIT OF ENTERPRISE : VIGILANCE AND LUCK

With William Kriegel

President of Sithe/Energies USA Inc. (New York)

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Overview of the meeting

William Kriegel gave the participants food for thought with the tale of two entrepreneurs who, determined to make their fortunes, and frustrated by unrewarding careers in real-estate, decide to try their hands at building and running hydro-electrical power stations. Before long, France becomes too small to hold them, and they head for California to try their luck over there.

In his presentation, William Kriegel shows us all of the steps, the difficulties, the decisions, alliances, failures and elements of luck that contributed to making the company he created into the leading independent producer of energy in the States.

William Kriegel also tells us about the management styles and structures used in his company, which he believes play a critical role when it comes to maintaining their competitive edge.

This is a success story. It has strong flavourings of the Wild West. But the cowboy is a Gaul. This is the tale of an enterprising businessman who, determined to make his fortune, sets out for California to build hydro-electrical power stations and sell electricity to the local electricity companies.

At the beginning, our hero had a tough time, and it was two years before he earned his first fistful of dollars. But in the space of six years he has managed to build a successful company that had a turnover of \$ 120 million in 1989, \$ 200 million in 1990 and an estimated \$ 500 million in 1992. The company is number one in the States of all the independent producers of energy. The company owns 19 working power stations, 4 more are under construction and 10 more are on the way. There are 250 employees, 180 of whom are involved in the day to day running of the power stations, and the other 70 are some of the best qualified managers to be found on the market (MIT, Harvard). Their job is to bring in new contracts and create new projects.

Like all success stories told in the business world, this one never fails to trigger the usual round of questions from those listening. Was the success planned or was it accidental? How much of it was due to luck? What are the secret recipes for success?

He wanted to build a fortune, but he wasn't going to do so in Real Estate

The story really starts in France, William Kriegel was a young, not overly educated salesman, who was learning the basics of the Real Estate trade in his father's company. Through a mutual friend, he was introduced to a young graduate from Polytechnique, who was rather atypical in that he had decided to work in Real Estate.

A common interest unites them both. They are both determined to make their fortunes as quickly as possible. They also believe that the best way to do this is through buying and selling property. Both are of an independent nature and don't particularly feel like working for other people. Thus, the outcome of their encounter in 1978 was the decision to work together to develop their Real Estate activities in Paris.

However, the inflation rate at the end of the 1970's was not the most favourable context for making money in Real Estate. The interest rate was nearing 17 - 18% whereas returns on Real Estate in Paris were around 7 or 8%. Despite some profitable transactions, it didn't take WK or his partner very long to realise that Real Estate was not the place to make a quick fortune at that moment in time.

Having realised this, the two partners decided to get out of Real Estate and try their luck elsewhere.

One day, WK gets a phone call from a friend who tells him that a project to build a hydro electric plant has landed on his desk and that he hasn't got a clue about what to do with it - did it interest WK.? WK. talks it over with his partner who then recalls that he has, after all, a solid engineering background. On the spur of the moment, they decide to get into this new trade which, in fact, is close enough to real estate since after the initial lay out of funds necessary to build a plant, one can cash in on the financial returns for several decades to come. As it happens, rather than seek their fortune through owning real estate, the two partners will try to reach the same goal by owning hydro-electric plants supplying electricity to the EDF.

There were a number of important factors behind WK. and his friend's decision to move into this new trade. Firstly, they considered a legislative point: the EDF is legally obliged to buy its power from independent producers. Secondly, from an economic point of view, the shortest length of a power supply contract is around 15 years and contracting parties make a commitment as regards price. Thirdly, we find a technical factor: hydro-electric power plants

are "factories without workers", heavily reliant on mature technologies and a relatively simple production process powered by a free source of raw material: water.

However, building power stations requires far more cash than real estate. As our two partners didn't have enough funds available, they sought a partnership with an investment bank. The bank accepted to participate in the venture, and made it clear that it would sell its share should the operation be successful.

In 1983, the investment bank actually sells its shares to the Compagnie Générale des Eaux. The founders strike a new agreement with this new partner on the following basis:

- 50/50 sharing of capital with the Compagnie Générale des Eaux
- the founders retain all managerial powers
- neither parties can oblige the other to further investments
- strategic decisions need to be unanimous

France proves to be small market, and the US beckons

After a few years, WK and his partner decide that the French market is too small, and that it is time to extend their activities to other countries. Several options are open to them. Development within Europe was discarded because the markets are too regulated and thus even less favourable to independent producers than France itself. Despite presenting some interesting opportunities, Africa was also rejected as a possibility because of the economical and political uncertainties. In the end, the decision was made to attempt expansion to the US by actually creating a company over there.

But America is not Peru!

Once the decision to go for America was made, WK went and set up in California to start up a company that would be involved in both the construction and exploitation of hydro-electrical power plants. His partner remained in France, in charge of the running and development of their activities there.

It was a tough beginning fraught with many difficulties. W. K. had no previous knowledge of the "way things were done" in the energy producing sector in the US. He was unfamiliar with the local "culture" and his English was shaky. It was not long before he realised that underneath their easy-going exterior, the Americans were hard-nosed businessmen.

"They seem friendly. You think they like you. But all the time they're really sizing you up"

On leaving for the US, WK had in his luggage, a guarantee from COFACE, and a letter of introduction from a previous Governor of California. But the latter had started by warning him that "he would never make it" and had given him the name of a consultant specialised in local referendums on nuclear energy. In turn, WK was put in touch with a lawyer who was to become his principal collaborator.

It was a tough beginning. WK and his lawyer spent the first 8 months prospecting in a part of California where it was in fact impossible to build a power plant because the agricultural landowners, proprietors of the *irrigations districts*, and also very rich and influential, kept the development of all the good projects to themselves.

The obstacles in the American context are multiple. On the one hand, the construction of hydro-electric power plants is very linked to local politics, which necessitates long uphill work with local stakeholders in order to obtain the necessary construction permits. At the same time, care must be taken not to upset the local ecological interest groups. But, getting the permit is not the hardest part. First, you have to get an Electricity Supply Contract from a Utility (local equivalent of the EDF). There are roughly 2000 utilities in the US, and

negotiations with them are notoriously difficult because their clients, constrained by regulations, will only sign a contract once they've done everything possible to avoid doing so. Competition in the sector is fierce, and fast changing regulations make the American context even more complex.

Being stubborn pays off

This description of the difficulties encountered might lead you to conclude that the chances of success are small indeed, or even that they had lost the fight before really getting off the ground. However, the real story is quite the opposite. Within a year and a half, the company founded by WK in the US (Sithe Energies USA) completed its first project. The company's turnover went from 0 to 1 million US dollars in 1987. In 1988 this jumped enormously to 30 million US dollars. We know the rest of the story, as SE is today the leading independent producer of energy in the US.

So, what are the ingredients of such a success story?

The role of certain environmental features in the success

The difficulties encountered on the American market should not hide the fact that the market also presented numerous opportunities, the absence of which would have made William Kriegal's task impossible.

In the US, there is a law that forces the Utilities to buy their electricity from independent companies such as Sithe Energies. This was the basis for William Kriegal's project since it means that there is a substantive potential market for small independent producers, one which is open and where it is still possible to acquire a share of the market

In addition, SE was lucky in that it was able to take advantage of the misfortunes of its competitors, of which the giant General Electric was one. The latter, for example, had based their strategy on an anticipation that both demand for electricity and prices were going to increase simultaneously. However, in the 1980's the opposite happened. Falling oil prices brought down the price of electricity. The drop in profit margins was most harshly felt by the larger corporations who were handicapped by their onerous overheads. The small size of SE and its youth were a distinct advantage. In addition, SE's large competitors were handicapped by the fact that their traditional methods of accounting were not really adapted to dealing with complex activities where several years go by before you see any profit.

A persistent entrepreneur and an understanding financial partner

Ranking high among the reasons for success must be the persistence of the entrepreneur, determined to make his fortune. It was his life-long ambition. Without such persistence, WK would never have had what it took to overcome the many obstacles which he found in his way between the step of prospecting and the final completion of his first project.

But persistence alone would not have sufficed. Something indispensable would still have been missing: patience. Indeed, the American adventure could never have succeeded if the two entrepreneurs had not found an understanding partner in the Compagnie Générale des Eaux who appreciated the difficulties involved in launching this type of venture and who trusted the two men, and above all, who didn't demand short-term results.

A hands-on approach which encouraged learning and the readjustment of his original strategy

Knowing nobody and unfamiliar with the American context, WK felt that he "had arrived, alone, in enemy territory" and he had no choice but to "keep close to ground, stay out of

sight to learn and listen". Thanks to this continuous interaction with all kinds of people on the job, WK was able to redefine the products of SE and the markets to target.

When he left for the US, WK wanted to sell electricity in California, produced in hydro-electrical power plants. However, once he was established in this sector, after a difficult start, WK orchestrated the purchase of a co-generation plant: simultaneous production of electricity and steam, the steam being sold separately to industrial clients. This acquisition was to have a profound effect on the future of William Kriegal's venture as co-generation is today a major part of his activities.

On the geographical front too, the company has diversified its markets and California is no longer the centre of activity. The Head-Office is based in New York.

Efficient Lobbying

Getting new contracts and obtaining construction permits means being able to influence local political decision-makers or even federal legislators. WK has always paid particular attention to this aspect of his work and has invested considerable sums of money in fees. He has even managed to obtain a federal exemption to obtain a contract with the American Defence Ministry.

Creating a 100% American Company

The decision to create, locally, a company that would be 100% American, was crucial to the success of the venture. The complexity of the decision-making process when wanting to build a power plant in any given place, could only be dealt with by a company that was totally immersed in American culture and who could offer its partners (local statesmen, heads of utilities etc.) guarantees concerning its long-term commitments. Of the 250 people employed by the company he runs, WK is the only French person.

Managing the economic variables

In a sector where the company has to make long-term commitments on each project, and in a country where the written contract is followed to the letter, just getting deals is not enough to make you successful. In fact, the clients, (the utilities) require the suppliers to make long-term commitments on the price of electricity. The contract lasts for 30 or 40 years and is firm and irrevocable. On the one hand it is a recipe for success. On the other hand, it carries an obligation to supply a product for 30 or 40 years on the basis of a price determined in advance. The long-term profitability of a venture is subject to a multitude of economic and regulatory factors which are out of the hands of the company and against which they must try to protect themselves. It would appear that WK has acquired the reputation for succeeding in this area by securing, systematically in advance, through long-term contracts, many of these key economical factors: raw materials (coal, oil, gas), transportation of these raw materials if they have to use specialised pipeline networks (gas, for example), purchasing contracts for factories, key in hand, within specified deadlines, etc.

The systematic use of contracts to control all of these parameters does cost money, but WK is prepared to pay, firstly because the costs are known well in advance and can be included in the global budget of a project, and secondly because another crucial advantage of the contract is to protect SE in the case of default. In this way, it is not WK, but the defaulting partner who finds himself having to face the utility or the bank.

Once the principal parameters of a venture have been secured in this way, WK finds himself with a set of about 20 different contracts. He can now progress to the next phase in the process which consists of negotiating the loans necessary for the building of the plant (tens of millions of dollars). It is only then that WK can be sure that his venture is viable and

coherent for reasons that we are going to see. WK spends several million dollars in lawyers fees and technical surveys in order to secure these contracts.

A complex but smart way to finance a project

In order to start the construction of a plant, WK must get a "short-term" loan for a period of two to three years. However, the "short-term" bank will only give this loan if there is a "long-term" bank to take over the venture after the plant has been built. The banks require guarantees. However, WK prudently refuses to give guarantees based on SE's assets. Instead he offers the bankers guarantees based on the set of contracts secured for the venture itself. Thus, in the event of any difficulties, the lenders become the owners of the contracts pertaining to the venture, and either can sell, or carry on with the construction and exploitation themselves. Such a deal is not easy to put together in view of the diversity and differences of interest of the various stakeholders.

When a financial deal is being put together on a venture, all the parties involved get together around the negotiating table. Both of the lenders are advised by three firms of lawyers (one for environmental issues, one for the technical and engineering aspects and the last for legal aspects of the final contract), and two firms of engineers.

It is at this point that the set of contracts is systematically taken apart by the lawyers, whose job it is to protect the interests of their respective clients. At some point, the respective interests of the various parties will cease to be the same. All of this needs to be gone over by the lawyers. The lawyers take particular care to determine any potential weaknesses in the individual contracts or any inconsistencies between the various contracts of the project. As they are paid by the hour, it is in their interest to slow this process down, whereas WK is under time pressure so it is in his interest to have "perfect" contracts that will not take too much time to go over.

A careful and vigilant organisation of the "construction" of the contracts.

As we have seen, it would appear that William Kriegal's real talent lies not in his ability to supply electrical power or steam, but in his ability to construct a coherent structure of relevant contracts. To give an idea of the complexity involved, putting together the first venture took a whole year with William Kriegal's team working at an average of 16 hours per day. One venture can mean anything from 500 to 1000 pages of contracts and from 500 - 1000 pages of appendix.

Ensuring that the set of contracts is consistent as a whole, is not an easy task given that the individual contracts are negotiated separately and one after the other. In order to guarantee that the final result is coherent, WK has organised a hierarchical system which ensures vigilance and care at every stage. At the lowest level, every aspect of the project is delegated to somebody with the necessary technical skills; at middle management level, a manager is responsible for making sure that the entire set of contracts is coherent; at the top, a project leader guarantees that every stage of the process is running smoothly and that it is coherent as a whole.

A subtle approach to managing the people

The economic, financial and legal complexity of each project, plus the fact that it is at least three years between the initial contacts and the opening of a power plant, are the main constraints of each venture, and consequently, the main sources of William Kriegal's competitive edge.

SE has gained a distinct competitive edge because WK knew how to attract and keep professionals who were extremely skilled and competent in their own fields (engineers,

lawyers, managers) but who also had entrepreneurial instincts. Recruiting and keeping people with such an unusual combination of qualities is not an easy task, because WK finds himself competing with other professional sectors that hold a strong attraction for such candidates, like Wall Street for example.

At SE, the management of its human resources comprises several areas. Firstly, the salaries offered to the employees are equal to the demands made upon them by the firm. Annual salaries for top-level management varies between \$ 200,000 and \$ 500,000. In return, WK stipulates that his employees must live within a 1 km radius of SE's New-York offices and that they be prepared to come to work at a moment's notice if necessary. According to WK, no matter what time of day or night, you will always find someone in the office. WK himself, made sure he was available day and night for the whole of the first few years.

But paying high salaries is not enough to compensate for the permanent stress of a job where you are always pushing and working to tight deadlines. This is why WK makes sure that his team is not hierarchical and gives great importance to all the firm's activities that can help to promote a friendly and easy-going atmosphere : parties, birthday celebrations, a betting club which WK belongs to, collective investments in small projects etc. WK values loyalty, honesty, trust and enthusiasm.

However, whilst he does everything possible to give responsibilities to his employees, to ensure that their working environment is favourable and that their material and non-material rewards are considerable, WK does not shirk from making the losers face up to their responsibilities. For example, when he bought out one of his competitors that was in trouble, WK only kept on 30 of the 70 current employees because the ventures that were already under way could not support such a large number of employees and their overheads.

Relations of trust with the Compagnie Générale des Eaux

In order to succeed in his venture in the US, WK had to have considerable financial backing and time. These two conditions could not have been fulfilled if WK had been an employee in a large company and if he had had an accountant watching over his shoulder for monthly expenditure account reports.

The fact that he was an independent entrepreneur taking a part of the risk involved onto himself already gave him a considerable amount of autonomy. But his own personal capital would not been enough and the partnership with the Compagnie Générale des Eaux supplied the necessary cash to realise his projects.

The relationship between WK and the Compagnie Générale des Eaux evolved outside of the boundaries of the normal accounting procedures of the company. Thus, for the first three years that he was in the US, WK did not have to answer to or show immediate results to the Compagnie Générale des Eaux. This was only possible because William Kriegal's supporters at the Compagnie Générale des Eaux trusted him and had decided to give him a chance to prove himself and succeed in his venture. They were successful in building a relationship of trust and not of control.

This trust was gradually built up and maintained through the fact that both partners took great care to keep each other informed. WK made sure that he explained his projects well in advance and always kept his promises even if he was not expected to show results.

Two possible interpretations of this story

The discussions that follow the telling of William Kriegal's story show that it can be understood from two somewhat contradictory points of view. The first one, that underlies the introduction of this version, being a sequence of events that constitute a rather nice "success

story" . From another point of view, this story can be seen as overcoming a series of failures and handicaps. The decision to attempt a development on the American market presented a huge risk for someone who didn't even speak English, had no experience of the specificities of the American context, and only the vaguest idea of the technology he set out to sell.

When he left for California, WK. assumed that his connection with an ex-Governor would prove sufficient to smooth his way to a few first contracts. This never happened. Following that, WK. and his lawyer spent eight months prospecting an area where they never concluded a single deal.

WK. had left for the US to sell electricity produced by hydro-electric power stations. If he had limited himself to this type of activity he would never have developed in the way he did. As it happened, most of the present revenue of his company are generated by co-generation (electricity + steam).

When WK. decided to buy out a competitor that was already into co-generation, he made an over-valued offer to get a step ahead of his competitors. However, after auditing the target company's accounts, WK. realised that its directors had misrepresented to some extent the real state of the company. When the shareholders heard about the real state of events, share prices fell promptly. This fall was pursued further with the stock market crash of October 1988. Within a few days, WK. found himself in the position of acquiring the company for a much lower price than he would have been ready to pay at first.

William Kriegal's story presents a particularly good illustration of the complexity of the "success process" in the business world. By focusing on voluntary decision-making and *a priori* rationality, WK. can be seen as a rational entrepreneur who plans everything, doesn't leave anything to chance and aggressively pursues business opportunities. However, if we wanted to explain his success by pure luck, we could point out that we find throughout William Kriegal's story a series of fortuitous encounters (a Parisian associate, Compagnie Générale des Eaux, a Californian lawyer...) which have played a determining part at crucial moments. Furthermore, if we want to put forward an incremental learning approach, we can interpret William Kriegal's story as a series of failures overcome; each challenge bringing some new element to the maturing process of his projects. Yet another way of looking at it can place William Kriegal's story in the structuralist perspective of economists and some sociologists which would argue that WK. could not fail to succeed in the French and American energy market places, given the nature of guaranteed demand due to favourable regulation for independent producers. This hypothesis could be argued to be reinforced by the fact that the very same entrepreneurs (WK. and his French partner) were not successful in making the fortunes they desired so much in France, although they were using those self-same entrepreneurial talents in the real estate sector.

Instead of considering these two hypothesis as contradictory, why not think of them as different and complementary facets of the same reality or environment: bad-luck, trust, vigilance and entrepreneurial instincts blending and strengthening each other at a given point in time to create a winning combination - or *gestalt*. The outside observer will label, *post hoc*, to simplify things, this as a *success story*.