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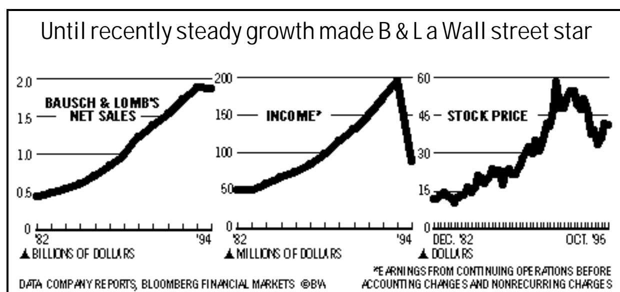
Cover Story

BLIND AMBITION:

How the pursuit of results got out of hand at Bausch & Lomb

By Mark Maremont in Boston with Gail DeGeorge in Miami Copyright 1995 The McGraw-Hill Companies All rights reserved.



Ba dan. In Cantonese, the words mean ``white sheet.'' But for employees at Bausch & Lomb Inc.'s Hong Kong operation, they had another meaning: According to high-ranking sources familiar with the unit, ba dan signified a white invoice with phony sales recorded on it. And there were plenty.

During the late 1980s and early 1990s, Hong Kong was the star of B&L's international division, often racking up annual growth of 25% as it rocketed to about $100 million in revenues by 1993.

Trouble was, in recent years, some of the reported sales were fake. Under heavy pressure to maintain its phenomenal record, sources allege, the Hong Kong unit would pretend to book big sales of Ray-Ban sunglasses to distributors in Southeast Asia. But the goods would not be shipped. Instead, the secret ba dan invoices, which B&L headquarters never saw, would instruct staffers to send the goods to an outside warehouse in Hong Kong. Later, some B&L's sales managers would try to persuade distributors to buy the excess. And some of the glasses, sources suspect, may also have been funneled into the gray market; buyers could profit by shipping them to Europe or the Mideast, where wholesale prices were higher.

But by mid-1994, Hong Kong was having trouble keeping up its juggling act. Tipped off by falling revenues and soaring receivables--since no one was paying for many of the glasses booked as sales--B&L sent a team of auditors to Hong Kong. They discovered significant irregularities, including half a million pairs of sunglasses stashed in a warehouse.

B&L's longtime chairman and chief executive, Daniel E. Gill, declines to comment on the Hong Kong problems; the company says only that it uncovered ``violations of company policies.'' But in the audit's wake, Y.H. Chan, president of B&L's Asia-Pacific Div., took early retirement, and several other managers also left as part of the cleanup.

Meanwhile, in late 1994, the Securities & Exchange Commission started combing through the books at another B&L unit, its U.S. contact-lens division. The SEC investigation was triggered by a BUSINESS WEEK article (Dec. 19, 1994), which revealed that the lens division might have improperly inflated sales and profits in 1993 by shipping huge quantities of unwanted lenses at yearend to its distributors, while assuring many they wouldn't have to pay until they sold the lenses.

The double-barreled problems lay behind B&L'S swift fall from financial grace: After 12 straight years of double-digit growth in sales and earnings from continuing operations (excluding one-time events), B&L blandly announced that excess distributor inventories would slash 1994 profits. B&L's continuing earnings fell 54%, to $88.5 million, on sales down slightly, to $1.9 billion.

As the bad news piled up, Gill, 59, has worked to reassure staffers and investors alike. He has installed new managers in the contact-lens unit and in Southeast Asia. He has replaced B&L's chief financial officer and has announced measures to strengthen internal controls. The problems, Gill insists, were isolated aberrations. In 1993, he says, ``two of our major operating units had difficulties, and what they did was wrong. The minute we got any wind of it, we sent auditors in. We recognized that we needed new leadership.'' Now, he adds, ``our performance is growing back, and we're very proud.''

EXPEDIENCY. Yet a six-month BUSINESS WEEK investigation suggests that the 1993 events were hardly isolated. They were direct, though unintended, byproducts of a corporate culture gone badly awry. The investigation involved extensive interviews with more than 50 current and former executives, including representatives from numerous B&L divisions spread across the world.

Their tales provide a remarkably consistent picture: Driven by Gill's fierce insistence on achieving double-digit annual profit growth, B&L's managers by the early 1990s increasingly resorted to what was expedient--often at the expense of what constituted sound business practice or ethical behavior. They gave customers extraordinarily long payment terms, knowingly fed gray markets, and threatened to cut off distributors unless they took on huge quantities of unwanted products. Some also shipped goods before customers ordered them and booked the shipments as sales, a possible violation of recognized accounting practices. For a period, the company also turned a blind eye to lucrative Latin American sales that may have indirectly aided money laundering (page 92).

To be sure, B&L's performance-oriented ethos delivered outstanding results for many years. But by the early 1990s, when the company's markets slowed at the same time that several acquisitions soured, B&L's culture was a train wreck waiting to happen. The derailment finally took place in 1993 and 1994, when B&L maintained its steep growth targets even as markets stalled.

According to internal B&L financial documents obtained by BUSINESS WEEK, the contact-lens and Hong Kong units weren't the only ones artificially loading up distributors in 1993. Executives in the U.S. sunglass division, Italy, Latin America, and in the Interplak oral-care unit also stuffed distributors with excess goods. Interplak executives, for example, fattened fall sales by giving buyers until the following spring to pay. As a result, the unit's accounts receivable nearly tripled from June to December.

Although the soaring receivables should have been a clear sign to Gill and other top executives that the growth could not be sustained, B&L's internal documents show that the 1994 corporate plan called for most of B&L's largest units to turn in further double-digit gains. When the inevitable collapse arrived, it was bloody indeed. In 1994, the documents show, 6 of the company's 15 largest divisions recorded sales far below plan--and far below actual 1993 sales (page 81).

Gill and other top executives vehemently deny that the cascade of difficulties in one year reflects wider problems with the company's culture. ``It was no accident that Bausch & Lomb had an absolutely outstanding record for the preceding 11 years,'' says Gill. ``We don't feel at all, given that track record, that it's a fundamental cultural issue.''

Instead, in explaining what went wrong in 1993, Gill zeroes in on two top executives who were new to their posts, hinting that their inexperience may have contributed. Both have since left B&L. One, Peter Stephenson, was an outsider who lasted only a year as CFO. The other, Ronald L. Zarrella, was a nine-year company veteran who had headed B&L's fast-growing international division before becoming president and chief operating officer in early 1993. Zarrella left B&L late last year to become head of North American marketing for General Motors Corp. Zarrella declined comment; Stephenson could not be located.

RISING STAR. B&L's intense focus on the bottom line and quarterly results is hardly unique: Many of Corporate America's most successful companies share similar goals. Good managers attempt to balance that orientation with effective controls and compensation plans that also reward practices that pay off in the longer term. B&L's saga shows what happens when those countervailing forces aren't strong enough. ``People spend their time trying to figure out what kind of game to play to make the numbers, not how to satisfy the customer or save money,'' says John P. Kotter, a Harvard business school professor. ``The tendency is for people to step over lots of lines.''

When Dan Gill came to Bausch & Lomb in 1978 to head its fast-growing soft contact-lens division, the stodgy manufacturer of optical equipment, eyeglass lenses, and contact lenses had just $442 million in revenues. Gill, a rising star from Abbott Laboratories Inc., made his mark: Contact-lens profits soared, and Gill won the president's job in 1980. The following year, he was named CEO and chairman.

Young and ambitious, with a salesman's charm and a financial analyst's head for numbers, Gill wasted little time. He sold several inefficient optical businesses while bolstering growth with acquisitions and a push abroad. ``Dan did a marvelous job of refocusing the company,'' recalls Stephen P. Kelbley, CFO from 1984 to 1991.

But from the beginning, some executives questioned how B&L's strong growth was achieved. In 1981, Mark B. Logan was recruited from Becton, Dickinson & Co. to head a host of operations, including the soft-lens division that Gill had been running. Logan soon wondered why lens sales were so slow for the first two months of every quarter. He discovered that under Gill, the division had run big promotions at the end of every quarter to pump up sales. Eye doctors had learned to wait for those deals. Logan says Gill made no bones about it: ``I needed to be chosen CEO,'' he recalls Gill saying. ``I did what I had to do.'' Gill doesn't recall the incident.

The culture Gill created at B&L is a mirror image of him: tenacious, demanding--and very numbers-oriented. Gill began his career as an auditor and still closely examines each division's financial reports every month. One executive says he often received handwritten notes from Gill on issues such as inventory buildups. ``He has a tremendous ability to stay on top of financial details,'' says this former executive.

Achieving double-digit annual growth was Gill's foremost goal. Each division was usually expected to post substantial annual gains. ``Each year, the top executives would agree on what number they wanted to make,'' recalls Harold O. Johnson, the longtime head of the contact-lens unit, who retired early this year. ``The numbers would be divided out by operating units and then assigned. [The president] would come to me and say, `Here's your number.''' Once the goals were set, Gill and other top executives rarely accepted excuses for shortfalls; even Gill's backers agree that making the numbers was key. ``Once you signed up for your target number, you were expected to reach it,'' says former President Thomas C. McDermott, who left B&L in early 1993.

Gill denies that numbers drove B&L's culture to an unreasonable degree or that sales and earnings goals became all-consuming. ``That's simply not true,'' he says. He says goals were set in negotiations with managers, and sometimes adjusted downward if they weren't being met. He adds that many executives have been promoted even after missing targets. But former executives say the priorities came through clearly at meetings of B&L's top two dozen executives, when Gill or his president drilled those who fell even slightly behind. At one teleconference, recalls an insider, the then-head of European operations was raked over the coals by Zarrella because currency fluctuations were hurting profits that were on target in local-currency terms. ``Ron kept going back at him, saying `That's what you signed up for. Do you want me to go to the analysts and say we can't make the numbers?''' says this source.

B&L's compensation structure was also reshaped in a way that buttressed the all-important message. Gill denies this, arguing that bonuses took account of many factors, such as asset management. But former executives say that division heads might get only a paltry bonus if they fell even 10% shy of yearly earnings targets, while beating them brought hefty payouts. And although a small weight was given to asset-control measures such as receivables and inventories, ``you could miss your asset objectives by a mile and still get a big payday,'' says one former executive.

PANIC ATTACKS. Nowhere were the true corporate priorities clearer than in the weighting of Gill's own bonus plan: 30% depended on sales growth, 30% on earnings growth, and 30% on return on equity, another earnings-related measure. Improvement in customer satisfaction rated just 10%. At that, Gill's pay structure differs little from most U.S. CEOs'.

At the same time, Gill rarely discussed specific actions that a division might take to rectify a shortfall. ``Make the numbers, but don't do anything stupid,'' was a famous Gill line. Many executives say they read the message differently. ``I'd walk away saying, `I'd be stupid not to make the numbers,''' says one ex-marketing executive.

The signals sent from the top led some to cut corners, several former managers say. Some divisional presidents, they say, began using tactics that were costly for the company but which maximized their own bonuses. One favorite was extending unusually long credit terms to customers in exchange for big orders. And believing their careers were on the line every quarter, B&L managers also lived in fear of ``Red Ball'' day. It was so named because of the red dot that marked the last day of B&L's 13-week fiscal quarters on employee calendars, which always fell on a Friday or Saturday. ``Mini'' Red Ball days also fell at the end of every month. As Red Ball day approached, ``you'd see panic-stricken account managers offering money off, or extra 30 to 60 days' payment terms,'' says a former Ray-Ban marketing exec. Such moves boosted volume but hurt margins: B&L's customers, says the Ray-Ban exec, ``were trained to wait until Saturday morning,'' knowing they'd get the best deals.

The lumping of orders into a few frantic days each month also made B&L's distribution operations woefully inefficient. Its sunglass distribution center in San Antonio, Tex., stayed open around the clock the last few days of every month in recent years. That meant hiring up to 35 temporary workers, while staffers racked up huge overtime. ``We'd ship 70% of the month's goods in the last three days,'' says a former operations manager. ``The hourly workers must have thought we were nuts.''

By ov erstocking distributors with cut-price products, B&L was partly responsible for another big headache: a flourishing gray market. One reason B&L's U.S. distributors took more than they needed was that they could off-load excess goods for a quick profit, especially in high-priced Europe. By 1990, one high-level insider estimates that of Ray-Ban's $200 million U.S. sales, $25 million was diverted overseas.

Although top executives frowned on the practice, the division's sales managers actively encouraged it. ``A lot of salespeople were getting bonuses based on how much their distributors diverted,'' says this executive. Nor was the U.S. alone: B&L's Latin America managers say they, too, encouraged diversion. The Miami-based unit supplied three New York-area distributors, for example, that shipped most of their goods to Europe. Says Armando Perez-Gili, a former sales executive in the division: ``The pressure to make the numbers was such, everybody was shipping to anyone.'' B&L says that any support of gray marketing by managers ``has been and will be dealt with as a clear violation of company policy.''

THE STINGS. One solution would have been to switch to global product management, but Gill says such a change couldn't be made abruptly. Instead, B&L turned to its internal security department, staffed by ex-Secret Service and police officers. So even as some managers were secretly encouraging diversion, B&L security staffers were setting up elaborate ``sting'' operations in order to shut the diverting distributors down. The result was a tense internecine battle between regions in which many U.S. distributors lost their licenses.

For years, B&L was able to keep this frenetic juggling act hidden from public view. The high-margin contact-lens-solution unit was growing fast. And Ray-Ban's Wayfarer sunglass style caught fire after being popularized in movies such as The Blues Brothers. By 1991, sales and earnings--at $1.5 billion and nearly $150 million, respectively--had more than tripled in a decade. B&L's shares had risen fivefold, to 58.

With success, Gill took on the trappings of a big-company executive. B&L bought a three-plane fleet and later erected a nicely appointed private terminal at the Rochester (N.Y.) airport. By 1989, Gill obtained a security consultant's report recommending that top B&L execs use the company fleet for all travel, including personal trips. B&L declines to comment. Gill began using company planes to reach his home in Florida and a private fishing club in Canada; the value of such trips is included in his income. And Gill commissioned a sparkling new $70 million headquarters building set to open this month.

B&L's new stature also meant big salary jumps for Gill, who took home $362,000 in 1981, his first year as CEO. While shareholders did well, Gill did far better: In 1991, he pocketed $6.5 million, an eighteenfold gain. That was followed by $5.7 million in 1992. Although a fall in B&L's stock cut Gill's compensation to $3.2 million in 1993, Gill still came out ahead of many peers. In an annual study comparing CEO pay at 424 large companies, executive pay consultant Graef Crystal found that even after adjusting for company size and shareholder returns, Gill earned more than double the market average. Because of B&L's earnings and stock-price drop in 1994, Gill received no bonus on top of his $1.1 million salary that year.

B&L's problems were mounting by the early 1990s, though. Growth was slowing in the U.S. and Europe. Gill's strategy of moving beyond optics to a broader range of health products wasn't panning out: Several big acquisitions were either losing money or barely profitable. Ray-Bans were starting to lose cachet. And B&L was steadily losing market share in contact lenses to Johnson & Johnson, which had caught B&L sleeping when it pioneered disposable lenses in 1987.

NEW PACKAGING. From the last quarter of 1992 until early 1994, the dealmaking became frantic. To move Ray-Bans, the division tried one end-of-quarter promotion after another. At one point, says one big Ray-Ban distributor, ``we had nine months' inventory. I bought extra insurance and sweated a lot at night.'' In Latin America, too, Perez-Gili says one late 1993 deal in which he loaded six months' worth of Ray-Bans onto a Chilean distributor was all too typical. Gill denies that such distributor-loading took place.

Nowhere did the situation get more out of hand than in the U.S. contact-lens division. Lacking a disposable lens to counter J&J, the unit tried a shortcut. Starting in 1989, it took the same lenses sold since the 1970s and repackaged them as the frequent-replacement Seequence 2 and Medalist brands. But while a pair of the older Optima lenses went for about $70, the new brands went for as low as $7.50.

When Optima consumers discovered that they were paying roughly 10 times more for the same product, the move backfired. Irate consumers have since filed a class action. ``It was a real ripoff,'' says Tim P. Quinn, one Optima wearer who's suing B&L. ``I was led to believe that they were the only lenses I could wear.'' B&L dismisses the suit, contending that pricing reflects volume discounts for buying more lenses per year.

``QUESTIONABLE.'' Meanwhile, the division was churning out new and ever-more-aggressive marketing promotions. One offered eye doctors 90-day payment terms and a 30% rebate if they took a large package of lenses. The division also had a habit of constantly rolling over unpaid bills so that customers wouldn't return unwanted goods for credit. ``It was a total mess,'' says an ex-rep. ``You needed a degree in physics to figure out the bills.''

The pressure was immense. Sources say managers in one Northeast district ordered reps to simply ship packages worth $1,600 to $2,400 containing a new type of multifocal lens to every account that hadn't ordered any. ``I was told it would be much better for my career to just ship the product into accounts,'' says one rep. All told, says another, several hundred doctors were shipped lenses they didn't order, and the shipments were booked as sales. Accounting experts say booking unordered products as revenues apparently violates accounting standards. ``It sounds wrong,'' says Alvin H. Carley, a longtime auditor with Coopers & Lybrand who is now an accounting professor at the Wharton School. Such transactions ``appear to be questionable as valid sales.''

The worst was yet to come. In mid-December, 1993, according to more than a dozen sources, Johnson called about 30 of B&L's U.S. distributors to a meeting. He told them they were expected to take huge new stocks of older Optima lenses--up to two years' worth--and he threatened to sever their distributorship ties if they refused. However, many distributors were assured verbally that they wouldn't have to pay for the lenses until they sold them. All but two agreed, allowing Johnson to book an extra $23 million in sales in the final days of 1993. But not long into 1994, almost all of the unwanted multifocal lenses came back to B&L. And the distributors refused en masse to pay for the huge unwanted Optima inventories. Now, the division's actions are at the core of an SEC investigation into possible accounting irregularities.

Gill and other top B&L executives blame poorly executed marketing plans--and point the finger for the aggressive tactics squarely at Johnson. Although he approved the general strategy, Gill says he had no idea Johnson would ship all the goods in December. Moreover, after the 1993 fiasco, Gill says he discovered that the contact-lens managers ``made the decision in April or May that they were going for a maximum bonus.''

Johnson calls that account ``ludicrous.'' He says both Gill and Zarrella knew of and approved the $23 million in yearend shipments. Indeed, says Johnson, had he really been seeking to maximize his bonus, just half of that giant yearend shipment would have done it. ``Either I'm completely out of my mind'' to have shipped the whole thing, says Johnson, or ``somebody asked for more revenue to make...the budget for the corporation.''

B&L's internal financial documents clearly show the strain of efforts to pump up sales. Receivables rose about 25% in 1993 to hit $506 million. That equaled 90 days of sales, which accounting experts say is higher than the 45 to 60 days they'd expect. But in B&L's annual report, receivables were shown at just $385 million. Why? B&L ``factored'' $105 million worth of receivables, selling them to a third party to raise cash. B&L argues this is a normal practice that doesn't require disclosure. But Sy Jones, a factoring expert at Coopers & Lybrand, strongly disagrees. ``I would consider it required disclosure to footnote the nature of a factoring arrangement and the interest rate being paid.''

Yet despite the rising receivables, B&L's internal financial documents show no letup in the pressure for results. Revenues for the division were targeted to rise yet again in 1994, from $151 million to $176 million. But with distribution channels chock-full, actual sales for 1994 slid to just $85.8 million, and the unit posted a $61.7 million loss.

Indeed, as the 1993 overloading took its toll, many divisions faced the same sharp drop. While U.S. eyewear sales had been budgeted to rise 5% in 1994 to $200 million, they tumbled to $153.5 million. Latin America and Canada sank 26% below target, while the oral-care unit lagged by 30%. By June, 1994, Gill warned investors that profits would tumble. B&L's shares fell to around 30, though they've since returned to around 39. But investors weren't told the details behind the biggest can of worms: Hong Kong.

In the fall of 1994, auditors jetted out to Hong Kong from B&L headquarters. The team spent eight months combing through records, grilling staffers, and counting inventory. The man they questioned the hardest was Chan, the longtime head of the Hong Kong operation, which handled sales in most of Southeast Asia. Chan's superb track record had made him a ``hero'' around Rochester, recalls former President McDermott. In early 1993, Chan was promoted to head all of Asia-Pacific. Facing intense pressure to keep it up, the unit allegedly intensified the ba dan trick--the fake sale of sunglasses that were dumped in warehouses.

Some of those sunglasses would then be sold to legitimate distributors the next quarter. But sources allege that Chan also may have been boosting sales by diverting sunglasses into the gray market. Hong Kong was a natural origin point for gray-market activity, because Chan was selling glasses for 10% to 30% below B&L's prices in the U.S. and Europe. In part, the low prices were due to local competition and to compensate for high duties in some countries. But sources also say Chan would use his marketing budget to fund secret rebates to customers, in effect lowering their buying price.

Ray-Bans seemed to find their way into the gray market at unusually low prices--perhaps with Chan's direct complicity. In either case, those prices allowed buyers to undercut wholesale prices in Europe and elsewhere. One gray-market dealer told BUSINESS WEEK that he approached Chan personally in early 1992 about buying discounted sunglasses for shipment to Italy and Latin America. Chan directed him to two Hong Kong companies, he says. Invoices provided to BUSINESS WEEK show that one, Chamberyan Thom, offered to sell the Aviator for $25.13 apiece in early 1992 to this buyer. During that period, a large Hong Kong optical chain says it was buying the same model directly from B&L for about $32 to $34. The gray marketeer says many of the glasses ended up in Italy.

S.L. Chiu, the manager at Chamberyan Thom whose signature is on the invoices, denies that Chan referred people to his company for discounted glasses and denies selling such glasses. But when pressed, he added: ``We are not doing that now.''

In 1994, the Hong Kong unit started to unravel. Local sources say the end came when accounts receivable hit the roof, in part because ba dan sales that had been booked to legitimate distributors weren't being paid for. Gill declines comment on this allegation. After B&L auditors started the in-depth probe, they found about a half-million sunglasses worth roughly $12.5 million piled up in a rented warehouse. How they got there remains in dispute. Gill says that in the face of a weakening economy, Chan simply sold too much inventory to distributors starting in late 1993, then decided--without company approval--to take back large amounts in September, 1994. Other sources say some of the glasses were indeed returned by customers, but many were a result of faked ba dan sales.

Chan retired in late 1994, as did his controller, James H.K. Tsang. B&L says both had planned to retire anyway. Neither responded to BUSINESS WEEK's requests for interviews. Several other managers also left around the same time. When the problems came to light in 1994, McCluski says B&L, its auditors, Price Waterhouse, and the audit committee of the board reviewed the situation in Hong Kong. Their conclusion: ``The problems did not materially affect Bausch & Lomb's published financial statements.''

Outside accounting experts say B&L probably could not have known if the Hong Kong unit was indeed using tricks such as fake invoices. But if they could not have known specifics, sources close to B&L contend that lax headquarters oversight shares in the blame. Happy with Chan's numbers, they say, Rochester paid little attention to how he produced them. The targets for 1993 ``were too big for

Southeast Asia,'' says one B&L source. ``I tried to be conservative, to bring it up to headquarters.'' But headquarters, he says, simply told him they hadn't tried hard enough.

One way to gauge a company's culture is to examine how it assimilates an acquisition. What core values does it instill into a new unit? What kind of conduct is encouraged or frowned upon?

Take the case of Outlook Eyewear Co., a big player in under-$30 sunglasses that B&L acquired in 1992. The money-losing company became a training ground for B&L executives. McCluski, now B&L's CFO, was Outlook president from 1992 to early 1994. He was followed by James T. Horn, who early this year was sent to clean up Hong Kong. But in turning Outlook around, the two employed a variety of questionable methods. When Red Ball day loomed and sales were behind target, McCluski or Horn would simply ship some orders in advance, and hope to avoid early shipment penalties. Other times, reps were told to offer incentives such as price cuts or extended credit to move up a shipment by a few days. Outlook also would ship goods early but tell truckers to take their time.

McCluski says neither he nor Horn engaged in these practices. He says some goods were shipped early in the first few months, but only because of warehouse snafus. ``We'd never intentionally ship before a customer's start date,'' he says. And he denies salespeople ever offered discounts to move up sales. But BUSINESS WEEK's account was independently confirmed by eight different sources. If they are correct, Outlook, too, began skirting the line of acceptable accounting practices. ``It's questionable'' if deliberate early shipments should count as sales, says Robert S. Kay, a professor of accounting at New York University's Stern School of Business. ``If it's done deliberately and on a widespread scale, it's wrong.''

After the SEC investigation was launched early this year, B&L underwent a remarkable transformation. Gill and other top executives ordered the company to follow the most conservative practices possible. Insiders and customers say there's no more quarter-end wheeling and dealing. Sunglass distributors are asked to have no more than three months' inventory in stock. Bonus policies have been changed to reflect broader, longer-term goals. B&L has also now shifted to global management of its product lines. Sales for the first half were up 8.5% to $1 billion while earnings from continuing operations apart from one-time changes were down 10.3% to $61.6 million.

B&L's board, too, has lit a fire under management. The audit committee met several times to review B&L's 1994 financial statements and insisted that controls be strengthened. ``The board made it very clear that this type of behavior wasn't acceptable,'' says Kenneth L. Wolfe, chairman of Hershey Foods Corp. and head of B&L's audit committee. But he, too, sees 1993 as an isolated case. ``Unfortunately, when you have operations scattered throughout the world, people do things they shouldn't,'' he says. ``But I don't think there's a larger problem.''

As for Gill, he seems to reserve little blame for himself. ``It's generally accepted that day-to-day operations of a company are overseen by the chief operating officer,'' he says. ``I don't mean to pass the buck, but...as chairman I'd have only a general understanding of what happened.'' Gill also professes astonishment that any B&L exec could have gotten the message that ethics should take a backseat to numerical goals. ``I have no idea'' why people would believe that, he says. ``We think we are the most honorable beings on the face of the earth.''

A sharp dissonance between the message that senior executives believe they're sending out and the message heard by those down the line is also typical of companies with ethical problems, say ethics specialists. The CEO ``may believe he's telling them not to get into trouble,'' says USC's Bennis. ``But if all the verbal and nonverbal signs sent out focus on making the numbers, he's giving them license to do unethical things.''

Real questions remain as to how deep the changes at B&L go. Even Johnson and Chan--the two division heads held most directly responsible--were not punished. And the two men in charge of bringing B&L's questionable methods to Outlook have been promoted and put in charge of cleaning up. ``It blows my mind,'' says a current sales manager at B&L. ``If it's so important now that we cross the i's and dot the t's, what happened to the people who were doing all this before?''

As for Dan Gill, he still sits in the chairman's office in Rochester, awaiting a move to his sparkling new headquarters. One former executive remembers a videotape presentation featuring Gill that was sent out to remote locations after the SEC investigation and B&L's disastrous 1994 results were announced. In the video, this executive recalls, Gill blamed the problems on poor decisions by individual division presidents and said the divisions needed closer monitoring. ``It was like slapping the hands of children,'' says this executive, ``when they were really acting on Daddy's orders.''

Isolated Aberrations -- Or a Way of Business?

Current and former execs say that under CEO Dan Gill, maintaining Bausch & Lomb's double-digit sales and earnings growth was all-important, creating pressures that led to unethical behavior throughout the company:

HONG KONG B&L's Hong Kong unit allegedly inflated revenues by faking sales of Ray-Ban sunglasses to real customers. Some of the glasses were allegedly then sold at cut-rate prices to gray-market dealers. B&L auditors discovered policy violations last year, and Gill appointed new local managers.

MIAMI By accepting cash payments and third-party checks, a Miami warehouse may have indirectly helped launder drug money until mid-1990. Senior B&L managers tolerated the lucrative trade, say former executives. B&L declined comment.

CONTACT LENSES Under pressure to beat sales targets in 1993, contact lens managers shipped products that doctors never ordered and forced distributors to take up to two years of unwanted inventories. These practices appear to violate acceptable accounting standards and have led to an SEC investigation. B&L blames the problems on overaggressive division executives.

GRAY-MARKETEERING Forced to meet inflated sales goals, many U.S., Asian, and Latin American managers knowingly sold contact lenses and Ray-Bans to gray-market distributors, creating a huge gray-market problem for B&L. The company says such sales violated policy and denies its practices led to the problem.

TABLE: Missing the Mark

B&L insiders say that aggressive sales practices left distributors overstocked at the end of 1993. But CEO Gill approved even higher sales and earnings targets for 1994. When distributors balked, sales in many divisions collapsed.

DIVISION MILLIONS OF DOLLARS	1993	1994 Planned	1994 Actual
TOTAL BAUSCH & LOMB			
SALES	1872.2	2051.9	1850.6
OPERATING EARNINGS	300.9	344.7	168.8
US EYEWEAR			
SALES	190.1	200.0	153.5
OPERATING EARNINGS	42.3	48.6	19.7
US CONTACT LENS			
SALES	151.0	176.0	85.8
OPERATING EARNINGS	16.8	20.5	-61.7
ASIA-PACIFIC			
SALES	148.9	169.7	107.8
OPERATING EARNINGS	34.6	46.8	4.0
ORAL CARE			
SALES	68.8	73.0	50.8
OPERATING EARNINGS	2.6	4.2	-10.3
MIRACLE EAR**			
SALE	--	57.9	37.3
OPERATING EARNINGS	--	2.3	-12.9
CANADA AND LATIN AMERICA			
SALES	126.1	154.0	113.4
OPERATING EARNINGS	17.8	27.3	6.4
EUROPE, MIDDLE EAST, AFRICA			

SALES	246.5	249.0	240.6
OPERATING EARNINGS	60.7	60.3	53.0

*Loss **Acquired during 1993
DATA: COMPANY REPORTS

MONEY-LAUNDERING IN MIAMI?

Back in 1985, Bausch & Lomb executives noticed that many of their distributors in Miami and New York were selling to Latin American customers. So B&L set up Lamex, a new Latin American export unit near the Miami airport. It became one of the company's fastest-growing divisions: By 1990, sales hit nearly $25 million.

But many of the Miami deals were highly unusual. Latin American and Caribbean customers would arrive with up to $50,000 in cash to pay for Ray-Ban sunglasses, according to more than a half-dozen former executives. The unorthodox sales added up: In 1990, according to internal B&L documents reviewed by BUSINESS WEEK, Lamex received $5.6 million--23% of its total sales--in cash, cash equivalents, and third-party checks. Former executives say the cash transactions were well known at B&L. ``The auditors would come in and see cash lying on the table and ask, `What's that?''' says Armando Perez-Gili, a former Ray-Ban sales manager. ``I'd say, `One of our customers just paid us.''' A higher-level former manager in Rochester, N.Y., recalls questions being raised at headquarters in 1988, but nobody stopped the flow. ``There was an urgency to meet the numbers,'' he says.

SWIFT JUSTICE? Of course, there's nothing illegal about accepting cash; stiff exchange controls and high tariffs mean many Latin Americans pay cash in Miami. But federal officials say tiny warehouse operators account for most of this trade. Multinationals deal in it only rarely. ``There's a reason that people are paying a lot of cash,'' says one Internal Revenue Service investigator. ``It's an indication customers could be purchasing [with] narcotics currency.''

B&L declined to discuss Lamex, saying in a written statement that ``in an organization the size of Bausch & Lomb, there will be occasions when violations of company policy will be discovered, and we will deal with them swiftly and appropriately.'' But former managers say B&L's Miami shop took an even more dubious form of payment: checks drawn on third-party bank accounts made payable to someone else, and then endorsed over to B&L. Federal officials say such checks were commonly used to launder drug money in the late 1980s and early 1990s. Colombian money-exchange houses were used as go-betweens to launder funds for drug lords, who would provide dollar checks to the exchange houses. Although unfamiliar with the specifics of the B&L transactions and not commenting on them, Wilmer Parker, chief of the drug division in the Atlanta U.S. Attorney's office, says generally: ``If a company was accepting third-party checks not payable to itself, either they were doing so with a blind eye to whether they were aiding and abetting money-laundering, or they were doing it with knowledge of what they were doing.''

If B&L headquarters didn't seem to care much about Lamex' customers, executives in Rochester worried about another issue. After getting wind that the Lamex division might have been diverting goods back into the U.S. market did headquarters order a thorough audit. Insiders say they uncovered significant irregularities, and Lamex' general manager, Anthony Brea, and his controller resigned. Brea admits he diverted lenses through Canada, but says reports of other irregularities are ``totally incorrect.''

HIT THE TARGET. A new management team installed by Rochester spent two months combing through records. One key issue that the new managers never resolved: Did Brea follow rules requiring businesses accepting more than $10,000 in cash in a transaction to file with the IRS? Brea swears that ``in that area, B&L was very strict. We followed all the guidelines.'' But other ex-managers say the IRS forms weren't filled out until late in Brea's tenure. The new managers told buyers that ``if they wanted to pay cash, they needed to follow proper procedures,'' says one. ``We didn't see them again.''

After the cleanup, the new management team presented a report on the Miami operations to top corporate management in late 1991. They claimed that, of $24.6 million sales in 1990, just $13 million was legitimate. The rest went to questionable customers or products that were diverted back into the U.S. or Europe. Nevertheless, B&L headquarters insisted they boost 1991 sales above the prior year's. Says one high-ranking former manager: ``We were told, `The shareholders don't care where the revenues were coming from before. You have to make it up.''