



The UnAccountable CEO

The State of Candor in Business

Ethics Week 2006

BaruchCOLLEGE
The City University of New York

with Laura Rittenhouse
President, andBEYOND Communications

April 4, 2006

© Copyright 2006 andBEYOND Communications Inc.

Why read shareholder letters?

- Consistency in content allows for comparative analysis and quantification.
- Shareholder letters can reveal:
 - ✓ **how well CEOs understand or don't understand their businesses**
 - ✓ **A CEO's commitment to candor and clarity**

How to Quantify Language

Johnson & Johnson – Cash Flow

2002

Yet another measure of financial performance which we have focused on is ✓ **cash flow from operations.** ✓ **"Free cash flow"** ✓ (defined as cash remaining after making the capital expenditures required to support the growth of our business) is, in fact, one of the very best measures of how a company is performing. Its virtue is its clarity. **You either generate cash or you don't. It is not subject to many varying interpretations or accounting changes.** We are pleased to report that Johnson & Johnson's **"free cash flow"** reached an **impressive** ✓ **\$7.1 billion in 2001 – a record –** ✓ **up from \$2.6 billion just five years ago and** ✓ **\$700 million** a decade ago.

18 points for Cash Flow

10 points for Valuation Education

2005

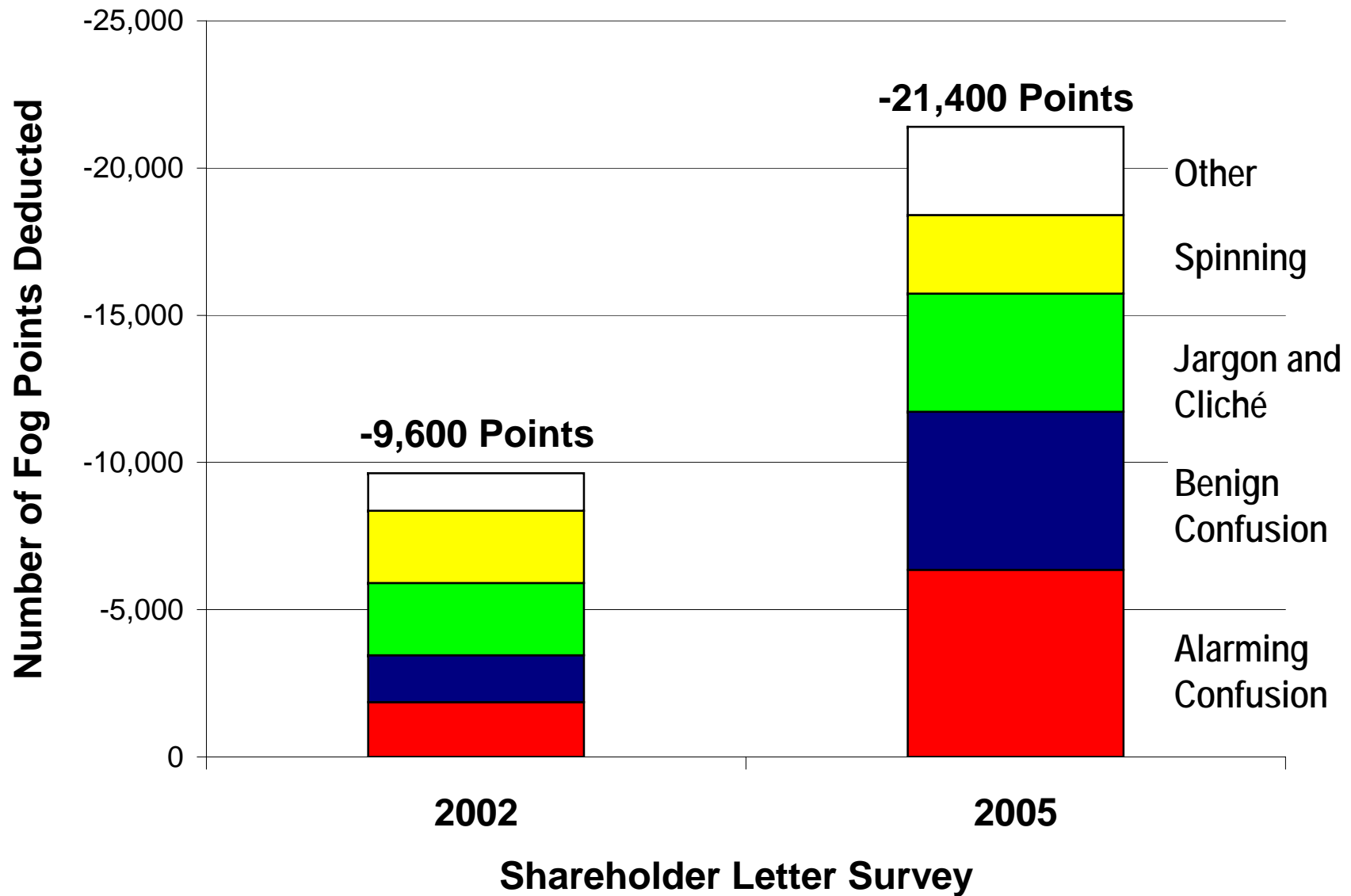
Our ✓ **cash flow from operations** continued to be very strong, ✓ **at \$11.1 billion,** and **facilitated our ability to enter into the largest planned acquisition in our history** – a ✓ **definitive agreement to acquire Guidant Corporation for \$25.4 billion.** We hope to conclude this transaction in the third quarter of 2005, creating an **unparalleled cardiovascular device business** that addresses a broad range of conditions from blocked coronary arteries to arrhythmias to congestive heart failure.

9 points for Cash Flow

(-5) points for Jargon

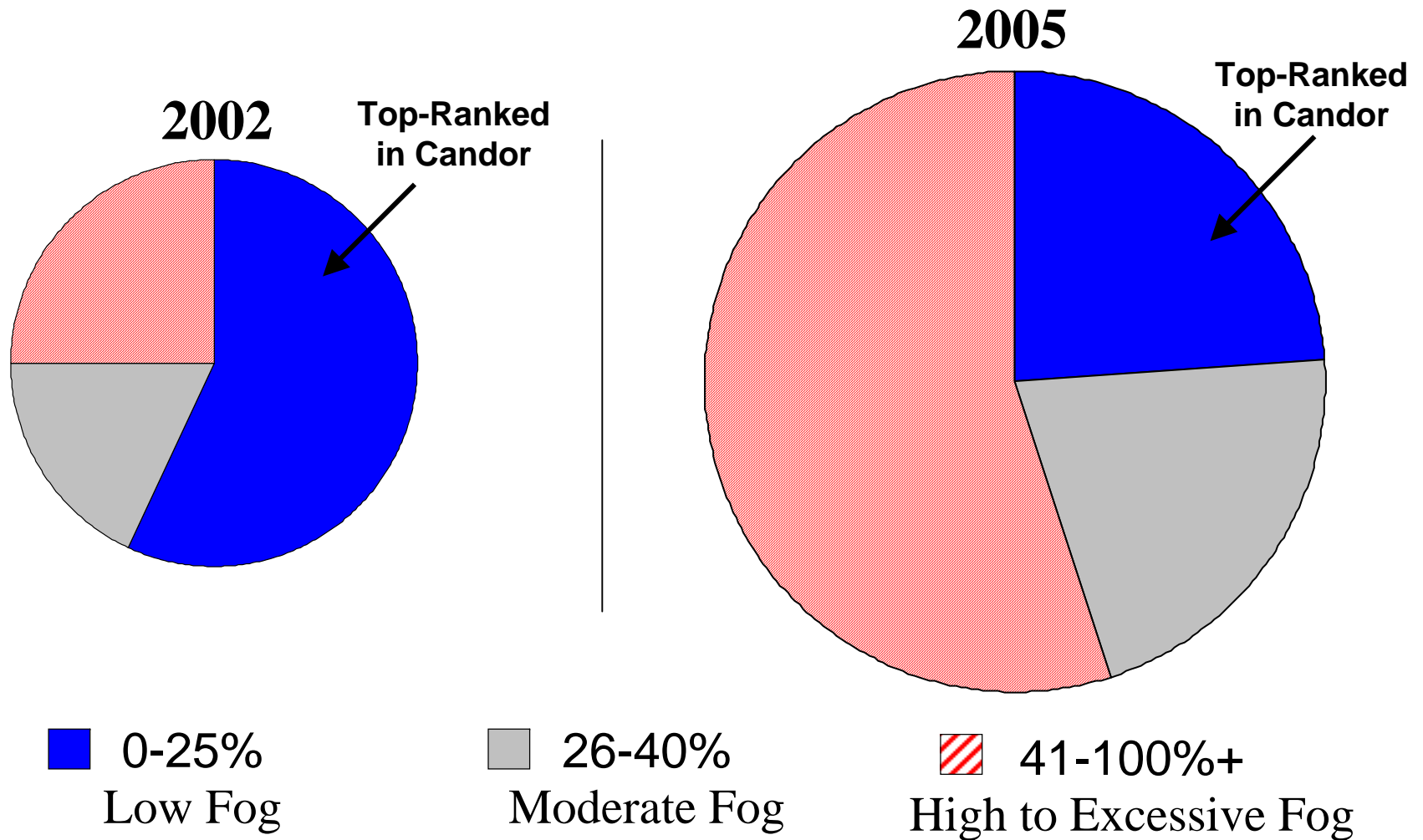
(-3) points for Hyperbole

Since 2002, CEO Transparency has NOT improved, it has grown worse.



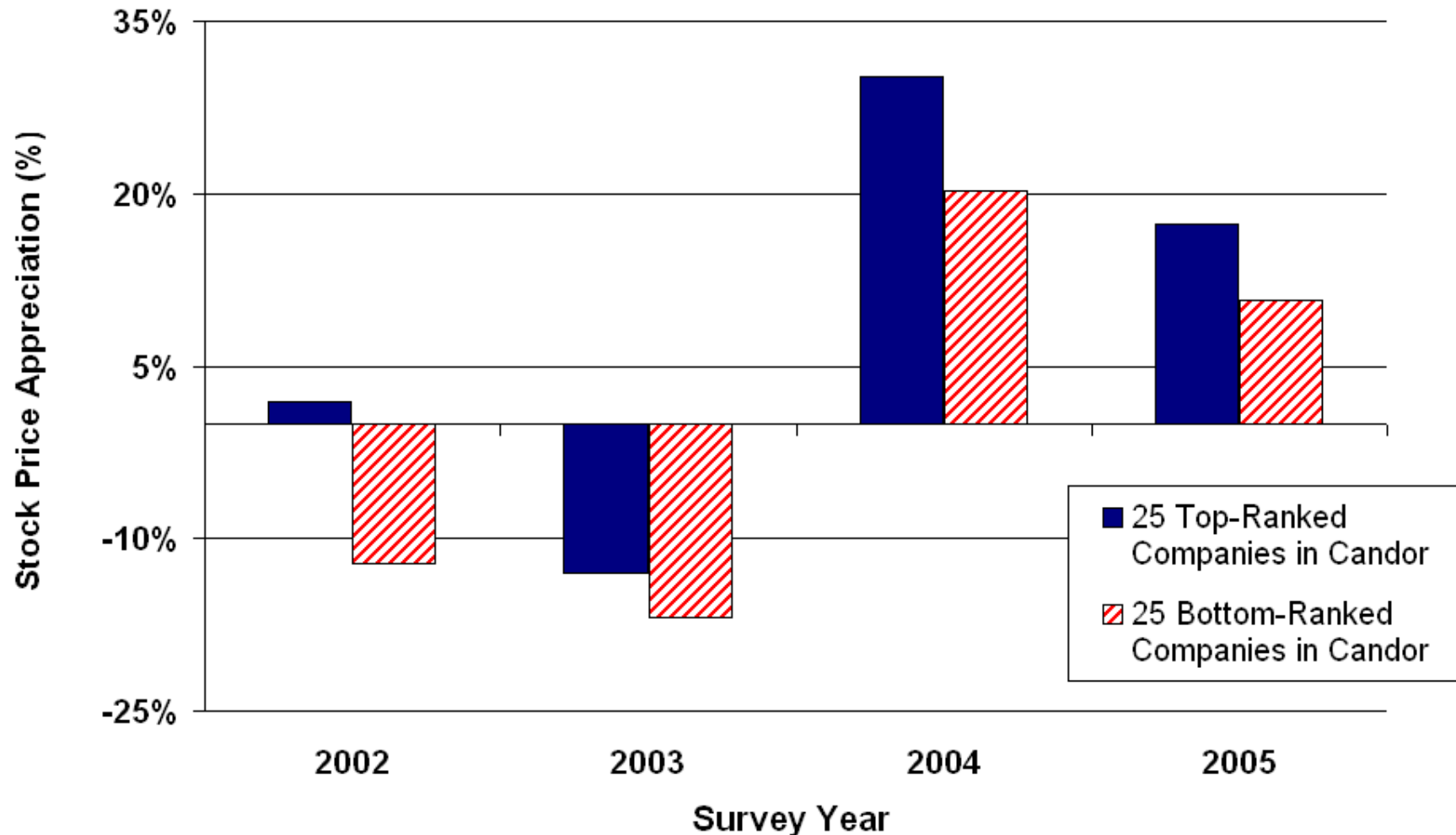
In fact, more CEOs communicate less.

Both the amount of fog and the number of shareholder letters with excessive fog have more than doubled.



Why read shareholder letters? Some CEOs Strive for Candor

The stocks of top-ranked companies in candor outperformed the stocks of bottom-ranked companies



The Stupefying Impact of Jargon /Clichés

Overused words strung together to avoid clarity and induce sleep.

- *Through channel focus we are harnessing our collective strength while utilizing the category capabilities of our specialized business units.*
- *Our technology platforms give our products the results-driven functionality that our customers and members want.*
- *With a solid foundation of thought leadership, we intend to refine and execute on our strategic direction.*
- *In fact, we're already getting the job done, offering innovative, targeted products and services employers and employees value ... promoting superior clinical outcomes and quantifying the superiority of those outcomes with evidence-based medical information ... and delivering best-in-class medical cost management.*

The Illusion of Reporting: Spin

Using words like “double-digit,” and “solid” that are not supported by numbers or facts.

In 2004, we met all these goals. Financially, we outperformed the objectives we set at the start of the year, achieving solid double-digit growth in adjusted operating income before depreciation and amortization. In fact, we demonstrated strength across all our businesses, with every segment reporting double-digit profit growth for the year.

Confuse by Omitting Relevant Details

Ambiguous and incomplete statements that raise more questions than answers.

- *Dow Jones Newswires acquired Alternative Investor, accelerating its entry into the **high-potential newsletters, conference and database businesses.***
- *Good Skin,TM a skin care line that is easy to choose, easy to use and doctor-formulated **to deliver targeted results.***
- *Our performance around the world certainly benefited from increased travel and tourism, recovery in the prestige distribution channel and the **effects of a weaker U.S. dollar.***

Introduce Alarming Context

Statements revealing potential weaknesses in strategy, leadership and execution.

The strategic benefits are obvious and compelling, provided we execute. Let me address the execution question by relating a story.

When Dave Packard took his first professional job at General Electric in 1935, he was given a challenge — quality control of mercury-vapor rectifier tubes. They were made in batches of 20, and every tube in the last batch had failed before Dave was given the job. He began by learning everything he could about why the process might have failed in the past. Working with the factory people to conduct tests and identify every possible cause of failure, Dave ensured that every single tube in his batch of 20 passed its final test perfectly.

I think of this story when I hear the critics predict that the integration of two large companies will fail. Just like Dave Packard, we have done our due diligence.

The Context-Challenged CEO

Perfecting the Art of Doublespeak

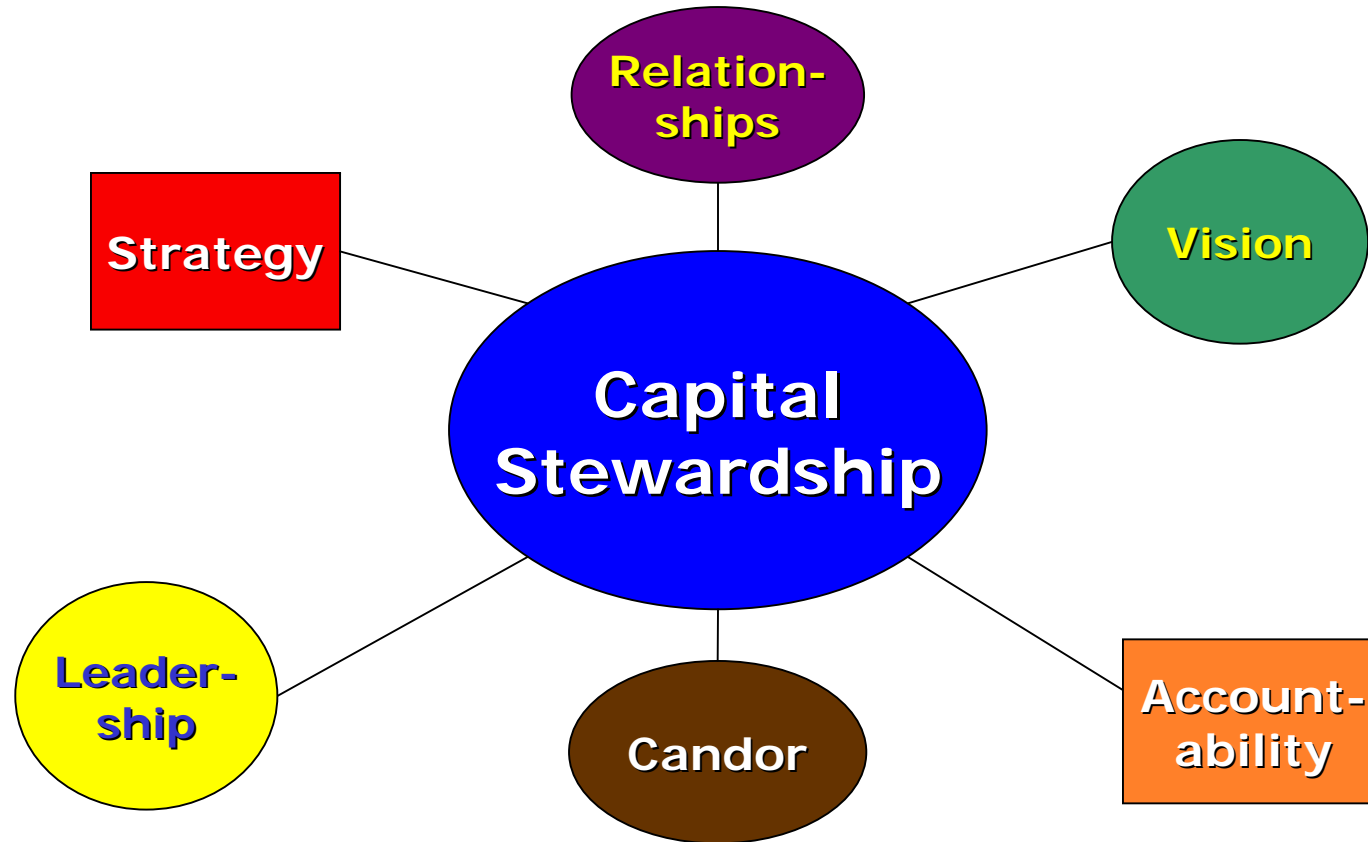
- *We are confident that **local mass media** offers value for shareholders as well.*
- *Today, consumers want technology to simplify the complexities in life. **Tomorrow, people will want MORE mobility with LESS effort.***
- *As we continue our growth and efficiency efforts, our goals will be to further improve **revenue-adequacy**.*
- *The Clear Skies legislation, **which promotes the use of clean, efficient fuel sources like coal**, is especially important to the country's continued economic well-being.*

Why did Warren Buffett recommend that CEOs write their own shareholder letters?

Three Tests of an Accountable CEO

- 1. Communicate candidly – always.**
- 2. Show a deep understanding of the business; how it makes money and why it will last.**
- 3. Practice the financial golden rule: recognize the primacy of capital stewardship.**

The Accountable CEO treats investors as partners, not patsies.



**“Copernican Revolution”- Jack Bogle,
Founder of The Vanguard Group**

The Elephant in the Room

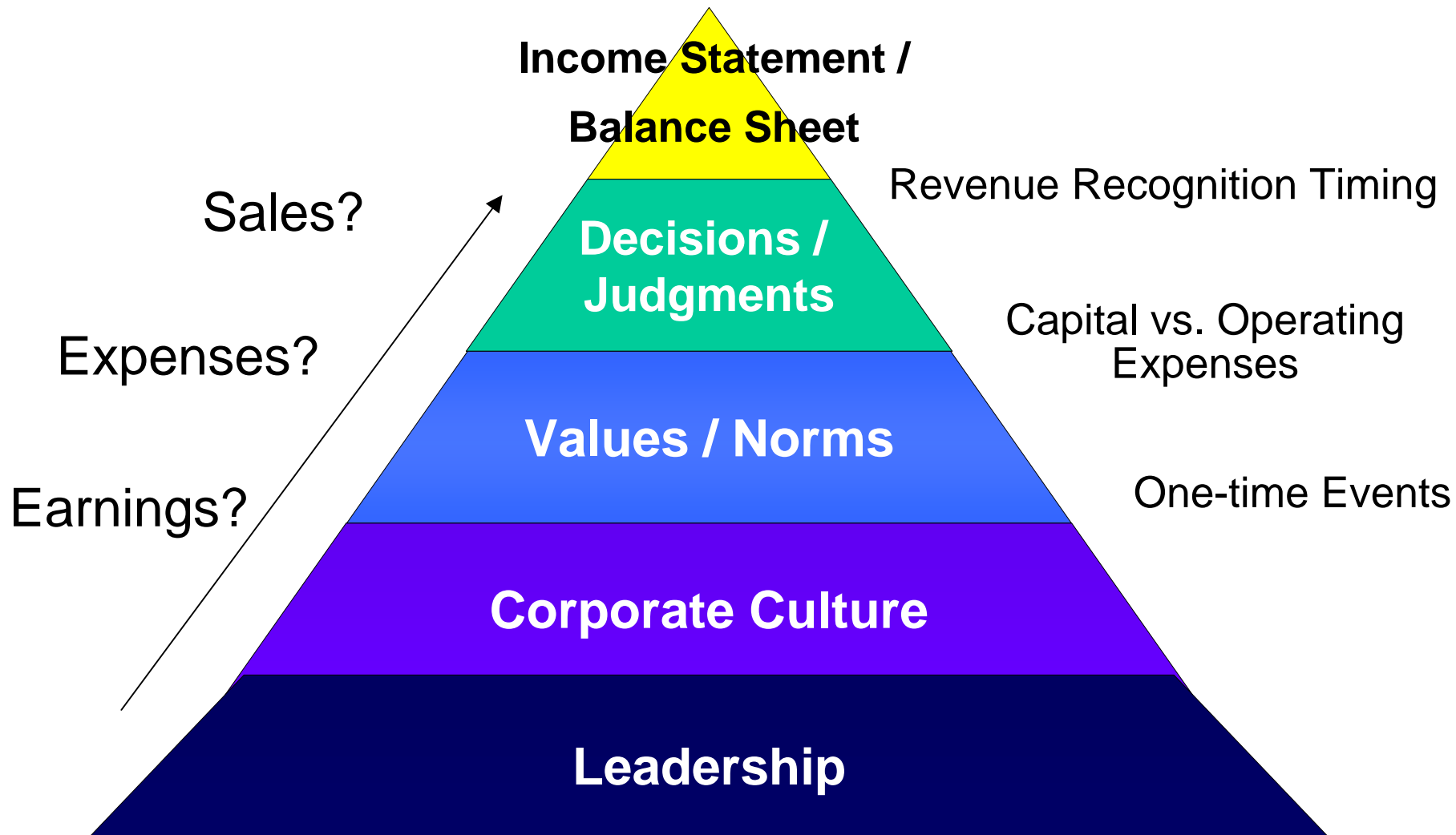
Why would these CEOs choose candor and potentially act against their own self-interest?

10 Top-Ranked Companies in 2005

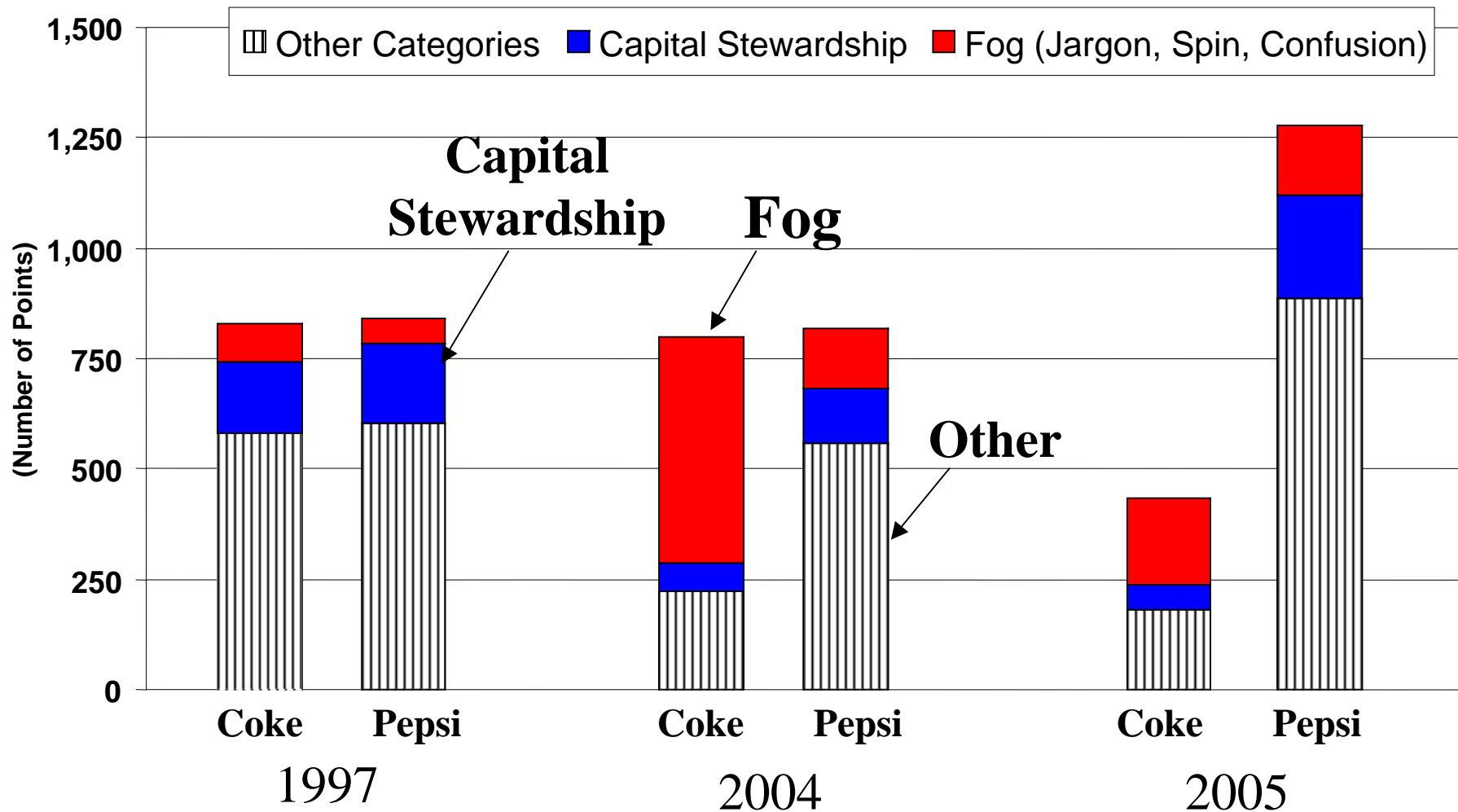
- | | |
|---------------------------------------|--|
| 1. Wells Fargo, Richard M. Kovacevich | 6. Jack in the Box, Robert J. Nugent |
| 2. Alcoa, Alain J. P. Belda | 7. Continental Airlines, Larry Kellner |
| 3. JetBlue Airways, David Neeleman | 8. Charles Schwab, Charles R. Schwab |
| 4. PepsiCo, Steve S Reinemund | 9. Harley Davidson, Jeffrey L. Bleustein |
| 5. Walgreens, David W. Bernauer | 10. Xerox, Anne M. Mulcahy |

Candid CEOs want reliable numbers.

How Accounting Numbers are Manufactured



The Persistence of Leadership, Candor, Corporate Culture and and Performance



The Impact of Candid Leadership

PepsiCo vs. Coca-Cola

January 1, 1997 – March 31, 2006*

	PEP	KO
1997	29.38	51.88
2006	57.79	41.87



* Reflects stock splits.

Data by ComStock

The Bottom Line

- Candor is linked to performance.
- Fear will not inspire candor, so candor will continue to decline.
- Expect performance to decline.
- Who Cares?

Who Cares?

Respect for the word – to employ it with scrupulous care and incorruptible heartfelt love of trust – is essential if there is to be any growth in a society or in the human race. To misuse the word is to show contempt for Man. It undermines the bridges and poisons the wells. It causes Man to regress down the long path of his evolution.

- Dag Hammarskjöld, former U.N. Secretary General

If you want to destroy a society, corrupt the language.

- Vladimir Lenin

Who Cares?

*Recent transgressions in financial markets have underscored the fact that one can hardly overstate the importance of **reputation** in a market economy... **Rules cannot substitute for character.** In virtually all transactions, we rely on the **word** of those with whom we do business.* - Alan Greenspan, former Federal Reserve Chairman

www.andbeyondcom.com