EXECUTIVE SUMMARY

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Settling Old Debts, While Taking on New Risks

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Yale School of Management
The Chief Executive Leadership Institute

Table of Contents

Panelists:
Alan H. Buerger, CEO, Coventry First
William H. Donaldson, 27th Chairman, U.S. Securities and Exchange Commission
Sean J. Egan, Managing Director, Egan-Jones Ratings Co.
Robert J. Kueppers, Deputy CEO, Deloitte
Gary P. Naftalis, Partner & Firm Co-Chair, Kramer Levin Naftalis & Frankel
Keith E. Williams, President & CEO, Underwriters Laboratories

Respondents:
Rick Antle, Professor, Yale School of Management
Norman J. Bartczak, Professor, Columbia Business School
J. Frank Brown, Managing Director, General Atlantic Partners
David Deiters Jr., President, North Highland
Harvey J. Goldschmid, Commissioner (2002–2005), U.S. Securities and Exchange Commission
Edward A. Snyder, Dean, Yale School of Management

Panelists:
Tony Alvarez II, Co-CEO, Alvarez & Marsal
Tig Gilliam, CEO, Adecco North America
Kay Koplovitz, Chairman, Liz Claiborne
John J. Legere, CEO, Global Crossing
Stuart A. Miller, President & CEO, Lennar Corporation
Lynn Tilton, CEO, Patriarch Partners

Respondents:
Elisabeth DeMarse, CEO, Newser
Marty Evans, Former CEO, American Red Cross
Frederick J. Mancheski, Former Chairman & CEO, Echlin
Clarke Murphy, Managing Director, Russell Reynolds Associates

Presenter: **Ivan G. Seidenberg**, Chairman and CEO, Verizon Communications

Panelists:
Kenneth I. Chenault, Chairman & CEO, American Express Company
Sanford R. Climan, President, Entertainment Media Ventures
Douglas Franklin, President & CEO, Multiple Sclerosis Association of America
Gary E. Knell, President & CEO, Sesame Workshop
Philip H. Kowalczyk, President, The Americas, The Body Shop
Jerry Leamon, Global Managing Partner, Services, Deloitte
Gerardo Lopez, President & CEO, AMC Entertainment
Patricia E. Mitchell, President & CEO, The Paley Center for Media
Thomas J. Quinlan, President & CEO, RR Donnelly & Sons Company
James D. Robinson, General Partner, RRE Ventures

Respondents:
Garry Brewer, Professor, Yale School of Management
Eric Brielmann, Partner, Joele Frank, Wilkinson Brimmer Katcher
J.P. Donlon, Editor-in-Chief, *CHIEF EXECUTIVE*
Stephen A. Greyser, Professor Emeritus, Harvard Business School
David W. Miller, Director, Faith & Work Initiative, Princeton University
Albert Morales, Managing Partner, IBM Global Business Services

Key Themes

- **Jeffrey A. Sonnenfeld**, Yale CELI/Yale School of Management

Overview

Slow economic growth and mounting government debt are the primary concerns of business leaders at this moment, and causes for high levels of pessimism among many CEOs. Business leaders see a broken political process and increasing levels of regulation that add costs and hurt competitiveness.

However, as CEOs assess their own businesses, they see opportunities for innovation and growth. Opportunities include developing new products and business models; using technology in new ways; expanding to new geographies; leveraging social media to develop new relationships with customers; and leveraging existing assets to reinvent their companies in a rapidly evolving business context.

Context

Led by Yale Professor Jeffrey Sonnenfeld, the founder and president of the Chief Executive Leadership Institute, the 66th Yale CEO Leadership Summit brought together business and financial leaders, investors, academics, nonprofit leaders, and government officials to examine the state of the economy, the implications of the massive U.S. debt, attitudes toward risk taking, and the opportunities that exist. Some of the key themes from this Summit are provided below and executive summaries of each discussion follow.

Key Themes

- **Participants remain concerned about economic growth.**

  While the worst of the financial and economic crisis has passed, consumer spending—which accounts for 70% of the U.S. economy—has not bounced back, which remains deeply concerning. And, while banks are willing to lend, demand in the real estate market remains soft. In such an environment, many business leaders are being cautious and risk averse.

  These are the immediate concerns. The greater concern is the slowing in the United States' long-term rate of economic growth, which has been gradually declining for the past five decades. Growth this decade may be less than 1%.

- **Other countries are committed to innovation. The United States and U.S. firms need to do so as well.**

  In 2011, China is on pace to become the largest manufacturing country and to file more patents than the United States. China, South Korea, Singapore, and some European countries have national policies to concentrate resources and make significant investments in certain sectors, like alternative energy. This focus on innovation and the sense of urgency being shown around the world threatens to leave the United States behind.

  The solution is to create an environment where innovation can flourish. This includes decreasing unnecessary and excessive regulation, removing obstacles that hinder small businesses from innovating and creating jobs, improving the broken political system, and fostering more communication and collaboration between the public and private sectors.

- **The debt of the U.S. federal government is weighing heavily on the minds of business leaders.**

  The country's mountain of debt could quickly become a crisis. Participants feel strongly that this must be addressed and be a national priority. Addressing the debt requires developing a cohesive national strategy that reforms entitlements and the tax code and cuts discretionary government spending, including military spending.

  High levels of government debt place the U.S. in a risky, vulnerable situation, with significant exposure if interest rates increase. The situation is creating uncertainty for business, as it causes businesses to refrain from making investments or hiring. The business community needs to become more engaged and vocal in alerting policymakers to the risks and implications associated with the debt situation.

- **Despite the challenging environment, opportunities exist and companies are experiencing success by deploying a wide variety of strategies.**

  While the macroeconomic environment is a cause for concern, when describing their own prospects and strategies, most participants are extremely optimistic. Participants see a wide range of opportunities and are taking action to pursue them.

  — **Finding opportunities in distress**. The current environment is presenting attractive opportunities for companies to scoop up distressed assets and turnarounds at favorable values.

  — **Solving hard problems**. IBM's development of Watson is the latest of the company's "Grand Challenges." This challenge involved forming a small team to solve the technological problems associated with natural language processing. The solution has commercial application in areas like healthcare.

  — **Growing globally**. While growth has slowed in the West, other countries continue to present attractive opportunities, leading companies to rethink their investments and structures to capture these opportunities.

— **Leveraging social media**. New companies like Facebook and Twitter are changing how consumers interact with brands, which will have implications for all companies. Leaders from multiple industries talked about the opportunities presented by social media to listen to customers and to form deeper, more trusted relationships.

- **As companies reinvent themselves, their brand and their leadership are critical.**

Keeping a company forever young amid a rapidly changing business environment is a process of continual reinvention. Companies such as American Express and IBM, which is celebrating its 100th anniversary, have reinvented themselves multiple times.

Reinvention is made possible by making the brand king, investing in and nurturing the brand, and having a corporate reputation of high integrity. Building the brand and the corporate reputation are among a CEO's most significant responsibilities, as they are the keys to a lasting legacy.

Investing to create a legacy for the future also requires creating an environment where innovation and risk taking can occur, as innovation produces the new products and services of companies that sustain leadership positions. Companies also build their legacies by investing in hiring and grooming talent.

- **The Yale School of Management is preparing leaders with the competencies they need to lead.**

New Yale SOM dean Ted Snyder said that business schools have focused on teaching people about markets and how to run organizations. These are important competencies, but equally important in today's complex global economy is the need for business leaders to be able to understand the complexities of the world.

IBM's Watson and Other Solutions to Problems You May Not Yet Even Know About

- Introductory Comments: **David F. McQueeney**, Vice President, Software, IBM
- Panelists: **Douglas G. Bergeron**, Chairman & CEO, VeriFone Systems
  Walter W. Buckley, Chairman & CEO, Internet Capital Group
  M. Christine Jacobs, Chairman, President & CEO, Theragenics Corporation
  R.K. Pachauri, UN Intergovernmental Panel on Climate Change (2007 Nobel Peace Prize)
  Michael Schmertzler, President & CEO, Kolltan Pharmaceuticals
- Respondents: **Benn R. Konsynski**, Professor, Goizueta Business School/Emory University
  David Liu, Chairman & CEO, The Knot
  Joel R. Reidenberg, Center on Law and Information Policy, Fordham School of Law

Overview

Once the world's innovation leader, America no longer innovates as it once did. China is now filing more patents and other countries have focused policies to innovate within certain industries. America is falling behind. The United States needs a greater focus on basic research, needs to consider focusing on certain industries (like alternative energy), and needs greater partnership between government and business.

But IBM's experience in developing Watson and winning The Jeopardy! Challenge shows that innovation is still very much alive. With a small, focused team IBM took on an extremely difficult challenge and devised an effective, innovative solution. With focus, commitment, determination, adequate investment, small teams, and passionate leaders, innovation is possible. America must make it a priority and must invest in innovation.

Context

David McQueeney described IBM's development of Watson and participation in The Jeopardy! Challenge. Panelists and respondents reacted to Watson and offered comments about other significant problems that America faces.

IBM's Watson

Throughout IBM's 100-year history it has continuously reinvented itself. One strategy has been to engage in "Grand Challenges" that focus teams within the organization and demonstrate the company's capabilities. The first Grand Challenge was a series of chess games between IBM's Deep Blue computer and chess champion Garry Kasparov in 1996 and 1997.

Inspired by the success of Deep Blue, about four years ago IBM embarked on The Jeopardy! Challenge. The aim was to develop technology that could beat the best players on the television quiz show Jeopardy! Most IBMers thought this challenge was not possible but David Ferrucci was convinced it could be achieved. With a total investment of around $200 million, Ferrucci led a 25-person team over 3–4 years in developing Watson, named for IBM's founder, Thomas Watson.

The challenge was to create computers that could engage in natural language processing. A computer must be able to process natural language that is intentionally clever, decipher the question, and determine the answer, all in a matter of seconds. Watson had to be able to:

— Handle a **broad, open domain**, as questions could be asked on any possible subject.

— Process very **complex language**.

— Answer questions accurately, with **high precession**.

— Be **confident**. Since contestants must ring in to answer a question, and are penalized if they don't answer correctly, confidence in answering correctly is necessary to ring in.

— Answer with **speed**.

Key elements of IBM's approach included:

— **The team that was formed**. A team of researchers was assembled with expertise in difference disciplines. These researchers, who had traditionally "swum in their own lanes," were asked to swim together.

— **The process that was used**. There is not a database with all of the answers; the process requires parsing the language in the question and engaging in analysis of the language to try to determine the answer to the question. IBM studied past Jeopardy! games to understand the types of questions asked, developed a process and algorithms to parse the question, and developed a series of extremely complex processes to answer the question. The process involved tremendous learning and improvement; in 2007, IBM's computers couldn't compete with a Jeopardy! champion; by 2011, Watson could win about 70% of the time.

By 2011 IBM believed its technology had developed to the level where Watson had an excellent chance to beat legendary Jeopardy! champion Ken Jennings. However, there was no guarantee that Watson would win and the Challenge involved risk to the IBM brand. The result: Watson did win, though the margin of victory was closer than most people realize.

> *"We wanted to prove the ability to process human language . . . the real challenge now is to apply this to the practical domain."*
> — David McQueeney

- **IBM is now working to apply the technology in Watson to a practical domain, with an initial focus on healthcare.**

  The first practical application of Watson that IBM is pursuing is focused on assisting physicians in making diagnoses. The technology ranks possible diagnoses and show physicians the sources used in the ranking. Physicians are open to assistance, but they want to understand the evidence used. Also, if Watson has low confidence about a diagnosis, it can pose a question. For example, it could say, "If I know more about [a particular topic], I could give you a better answer."

  Panelists from the healthcare industry see much promise in the use of technology like Watson to help clinicians use evidence to make better decisions at the point of care. Other comments from panelists focused on:

  — **The benefits of small teams**. VeriFone's Douglas Bergeron observed that the experience of the Watson team confirms his own personal experience that small teams are more nimble, less bureaucratic, and better at solving hard problems.

  > *"Big teams find it hard to solve tough problems. To solve the world's problems requires small teams."*
  > — Douglas Bergeron

  David Liu agreed. The challenge at his fast-growing company, The Knot, is fighting off the calcification of becoming a larger company—now with 600 people and multiple offices around the world. The bigger an organization gets, the more difficult it is to remain fast and nimble. The small team approach employed by IBM on Watson, and seen at Google, seems the most effective way to attack complex problems.

  — **The process used to develop Watson**. Professor Konsynski said, "The process is more important than the product." IBM blended a great deal of skill together and created a process focused on continuous analytics. The process and this product will lead to better decision making.

  — **Concerns about privacy**. While Joel Reidenberg sees the promise of the Watson technology in an area like healthcare diagnoses, but he has privacy concerns about how this technology could be used. IT systems could make automated decisions that begin to look like Big Brother. Imagine how the Chinese government might use such technology to monitor its citizens.

  > *"I'm worried about the implications of computers thinking about things."*
  > — Joel Reidenberg

  Mr. McQueeney understands the concern and believes that the social value of new technologies must be balanced with privacy concerns. Professor Konsynski said that a technology—like the wheel—is not inherently beneficial or malevolent; technology is a tool that humans can use for various purposes.

Observations on Other Major Challenges

- **The United States is falling behind on innovation.**

  While the United States has led the world in innovation, the rest of the world is now challenging the U.S. for innovation leadership. For the first time, in 2011, China is on target to outpace the United States in the number of patents filed. Countries like South Korea and Singapore have identified specific industries and have invested heavily to stake out a strong position in these industries. For example, South Korea has announced that it will invest $35 billion to develop renewable energy technologies. Countries are investing in basic science to drive scientific and technological innovations.

  Several of the panelists are deeply concerned about this. Dr. Pachauri sees the U.S. falling behind on innovation, particularly in the area of climate change and alternative energy. This is occurring at exactly the same time that other countries are focused on innovation.

  > *"The U.S. is failing behind on innovation."*
  > — R.K. Pachauri

  Michael Schmertzler said that the U.S. lacks a respect for and isn't investing in basic science and research. Christine Jacobs cited political barriers that often hinder the ability to commercialize successful innovations.

- **Changing the trajectory of innovation requires greater collaboration between the public and private sectors.**

  The panelists agreed that creating an environment where innovation flourishes requires greater collaboration and partnership between business and government. The government must send clear signals and must get the private sector involved in defining what these signals should be.

Fixing What Is Broken: Risks Over Digging Out of Debt

- Panelists: **Elaine L. Chao**, Secretary of Labor (2001–2009)
  Jon S. Corzine, Chairman & CEO, MF Global
  Michael F. Holland, Chairman, Holland & Co.
  Christopher Shays, Member of Congress (1987–2009), State of Connecticut
  David M. Walker, CEO, Comeback America Initiative
  John C. Whitehead, Retired Co-Chairman, Goldman Sachs
- Respondent: **D. Quinn Mills**, Professor, Harvard Business School

Overview

The U.S. government faces an urgent debt crisis. To date, the Fed and China have been major purchasers of U.S. debt, but it is not certain if they will continue to buy this debt and at what price. This crisis must be addressed to prevent potentially dire consequences, including bankruptcy. (No less than former Goldman Sachs co-chairman John Whitehead sees this as a possibility.)

The U.S. needs a plan to work through this crisis, something that has historically been lacking and that will be difficult to agree upon in the current political climate. Former U.S. Comptroller General David Walker believes that plan must include raising the debt ceiling, immediately lowering spending for 2012, and revising the country's long-term budget, which will necessitate reforming entitlements and finding savings in many other areas. The business community must become much more active in communicating to government the importance of acting now to prevent a crisis.

Context

In this session, panelists discussed the risks associated with the U.S. government's massive debt.

Key Takeaways

- **The U.S. debt is a looming disaster.**

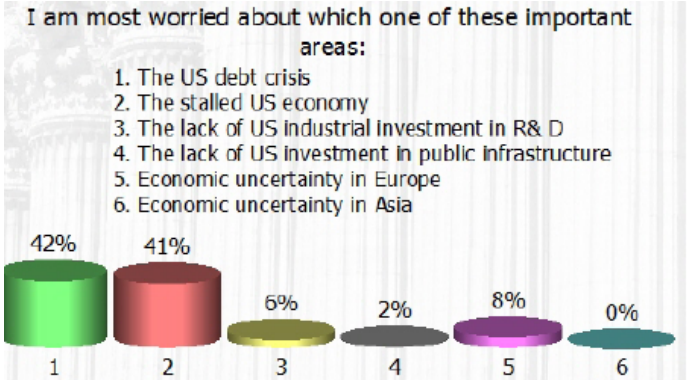
  John Whitehead sounded the alarms about the U.S. government debt. He termed the current situation "an urgent problem" and "a huge crisis." He sees a pending disaster and believes bankruptcy could be around the corner. He doesn't believe that U.S. bonds are AAA and believes the Fed has run out of ammunition. Even if the Ryan Plan were to be approved, which seems unlikely, there will still be annual deficits of $1 trillion per year and the national debt will grow by $6 trillion over the next 10 years.

  "Bankruptcy could be around the corner."
  — John Whitehead

  Mr. Whitehead sees the most significant problem as, "Who will buy our debt, and, at what price?" The buyers of the debt have been the Chinese and the U.S. Federal Reserve. Mr. Whitehead expressed significant concern that the Fed "has been used" to bail out the federal government by buying $600 billion in government bonds. Former U.S. Comptroller General David Walker is equally disturbed, accusing the government of "self-dealing in our own debt." If the Fed were to stop purchasing government debt and the appetite of the Chinese diminished, a disaster could ensure.

  The poll below (taken before Mr. Whitehead's comments) showed that participants view the debt crisis and the stalled U.S. economy as the two areas they are most worried about.

  Michael Holland believes that Chinese purchase of U.S. debt will decrease, but Stephen Roach and Jon Corzine both disagreed. They both still see China continuing to buy U.S. debt for now so that the U.S. has funds to purchase Chinese exports. But long term, as China moves away from its export model, the appetite of the Chinese for U.S. debt may decrease. (In a later panel a participant said that many foreign investors continue to purchase U.S. debt because despite the uncertainty that exists, U.S. debt is still seen as safer by many investors than other options.)

  Dean of the Yale School of Management, Ted Snyder, commented that in addition to the debt crisis and the massive federal deficits is the related issue of the huge unfunded liabilities, which also must be addressed.

- **The United States needs a specific plan to address the debt, both in the short term and the long term.**

  All panelists agreed that the U.S. must address the debt as failure to do so has dire consequences. Sean Egan said the U.S. could be put on a negative watch and could potentially be downgraded, which would increase the country's cost of borrowing. Mr. Walker outlined the following steps that he feels must be taken:

  David Walker

  — **Raise the debt ceiling**. Mr. Walker sees it as essential that the debt ceiling be

raised. He is certain that it will be raised. The questions are when it will be raised and what agreements will be reached in order for it to be raised.

— **Agree on lower spending for 2012**. It is essential to take concrete action to dramatically lower spending and reduce the deficit for 2012. There are definitely opportunities to lower spending since discretionary spending has increased 30% since 2007.

— **Agree on statutory budget control rules**. Mr. Walker believes that addressing the debt crisis requires significant long-term steps like reforming entitlements, modifying the tax system, changing the healthcare system, reducing discretionary spending, and not exempting defense spending from cuts. He also believes it is necessary to put specific targets in place with automatic enforcement mechanisms.

- **The business community needs to become more vocal about the need to reduce the government debt.**

The debt crisis has a significant impact on the climate for business. It creates uncertainty, makes it a less attractive environment to make investments, could drive interest rates up, and could lead to inflation.

> *"If the U.S. has a debt crisis, it will affect the entire world."*
> — David Walker

However, Mr. Walker said that despite the impact that this debt crisis has on business, "The business community has been missing in action."

Michelle Caruso-Cabrera observed that in general the business community is more interested in trying to manipulate the tax code to their advantage than focused on reducing the government's debt.

- **As significant of a problem as the debt is, in the short term there are other risks that may be greater.**

No one believes that the government deficit and the mountain of debt are acceptable; everyone sees them as a problem. However, despite worries about the U.S. debt, some panelists expressed even more immediate concern about other areas:

— **Consumer spending**. With consumer spending representing 70% of the U.S. economy, Stephen Roach is extremely concerned about the anemic levels of growth in consumer spending. Over the past 13 quarters, consumer spending has grown at an annual average rate of just 0.5%. Yet even after this prolonged period of virtually no spending growth, the debt-to-income ratio is still around 120%, meaning that consumers still have massive amounts of debt. Mr. Roach is concerned with a prolonged period of economic stagnation that could resemble Japan.

> *"I'm worried about this 0.5% trend and what lies ahead."*
> — Stephen Roach

Ms. Caruso-Cabrera agreed, saying, "The world seems more concerned with another economic slowdown [than a default by the U.S. on its debt]."

— **Other countries' debt.** As bad as the debt situation is for the United States, Sean Egan believes that the situation in Europe is even more concerning. Mr. Egan believes that the U.S. must get its house in order in the next few years, but during that time, the U.S. can "muddle through." Other countries that lack the size of the U.S. can't muddle through and therefore are even more troubling in the short term.

Other Important Points

- **More of the same.** In audience polling, 71% of participants voted that Congressman Weiner's personal misconduct is "about the same" as the misconduct of numerous other politicians.

Debt Crisis Ripple Effect on Global Market Growth and Security

- Panelists: **Ashton B. Carter**, Undersecretary, U.S. Department of Defense
  Michelle Caruso-Cabrera, Anchor & Reporter, CNBC
  Thomas H. Glocer, CEO, Thomson Reuters
  Barry M. Gosin, CEO, Newmark Knight Frank
  Jeffrey B. Kindler, Former Chairman & CEO, Pfizer
  Lawrence Leibowitz, COO, NYSE Euronext
  Lowell C. McAdam, President & COO, Verizon Communications
  David F. Melcher, President, ITT Defense and Information Solutions
  Shankar Narayanan, Managing Director, The Carlyle Group
  Nicholas T. Pinchuk, Chairman, President & CEO, Snap-on Incorporated
  Stephen S. Roach, Chairman, Morgan Stanley Asia
  Frederick O. Terrell, Vice Chairman, Credit Suisse
  R. James Woolsey, Director, CIA (1993–1995); Chairman, Woolsey Partners
- Respondents: **Saul J. Berman**, Partner & Vice President, IBM Global Business Services
  Robert A. Pastor, Professor, American University
  Jennifer A. Sethre, CEO, Asia Sales and Marketing
  Steven A. Shaw, President & CEO, Volt Information Services
  Shyam Sunder, Professor, Yale School of Management

Overview

The massive U.S. debt is likely to have significant ramifications for global markets, the economy, and security. A debt crisis would disrupt markets, raise interest rates, and hamper economic growth—which is already fragile. Government debt also has a significant impact on business. Uncertainty is greater, which affects investment, causes businesses to act more cautiously, and hinders job growth. Reducing the debt requires reforming entitlements, reassessing defense spending, and rethinking the role and activities of government.

Context

The panelists identified multiple ripple effects of the debt crisis, both domestically and internationally, affecting both how government will operate and the business community.

Key Takeaways

- **A debt crisis will affect markets and interest rates.**

  While David Walker is certain that the U.S. debt ceiling will be raised, he is uncertain about the impact on global financial markets. Increasing the debt ceiling—particularly without cuts in spending or entitlement and tax reform—could increase interest rates in order to attract buyers for U.S. debt. This would be problematic for the United States, which has huge interest rate risk. A 100 basis point increase in interest rates costs the United States $150 billion, and the country gets nothing for it.

  Ted Snyder also raised the concern of inflation. When countries run out of monetary options and can no longer use fiscal stimulus, they think that inflation can wash away their debt problems—which won't work.

- **Debt issues further hamper U.S. economic growth, which is already languishing.**

  Professor Quinn Mills fears that the United States may become a "no growth economy." This affects the labor market and keeps unemployment high. In the 1960s and 1970s when the United States experienced an economic downturn, it exited a recession with strong results; it was common to experience growth of 10%. But now growth is a tepid 1.8%. Barry Gosin shared this concern, finding it amazing that growth is less than 2% despite the massive amounts of stimulus spending.

  Yet even before the debt crisis, U.S. economic growth has been slowing. Without changes in politics and policies, Professor Mills sees growth as unlikely. According to Professor Mills:

Decade	GDP Growth
1960s	6%
1970s	4.5%
1980s	3%
1990s	3%
2000s	2%
2010s	Possibly less than 1%

  Yale economist Guy Ranis shares the view that economic growth should be the country's leading priority. He disagrees with those who say the government and the Fed have no more tools at their disposal to stimulate growth. Despite the deficit, he disagrees with cutting government in the short term, preferring more government stimulus and possibly even a QE3 from the Fed.

- **Debt issues are affecting business leaders' attitudes about investment and growth.**

  Verizon COO Lowell McAdam views debt as creating uncertainty, and stated that business doesn't like uncertainty. Uncertainty causes companies to become more cautious when making investments and to wipe

some investments off the books, which hurts job growth. Even though Verizon is still investing billions of dollars in wireless and the cloud, the current environment causes the com-pany to be more cautious.

> *"Debt creates uncertainty and business doesn't like uncertainty. Uncertainty hinders investment, makes businesses more cautious, and wipes investments off the books."*
> — Lowell McAdam

Real estate investor Barry Gosin said that real estate relies on growth in the economy. Currently, there is "no wind in the sails" for those in real estate. Everything in the industry is about downsizing and reducing expenses. It is as if the country is swimming with a weight around its neck.

Jon Corzine said that managers in this uncertain environment have to be cautious and have to "protect their downside." He sees companies taking conservative capital positions and continuing to focus on having adequate liquidity.

- **U.S. debt will force a rethinking of the role of government and of America's role in the world.**

Professor Mills shared a quote from former Defense Secretary Robert Gates, who said, "America can be a superpower or a welfare society, but not both." U.S. debt and continued growth in entitlements is turning the U.S. into a welfare state. If this doesn't change, it will force the U.S. to scale back as a global super-power at the same time that China's ambitions continue to grow.

> *"America can be a superpower or a welfare society, but not both."*
> — Quinn Mills, quoting Robert Gates

David Walker pointed out that at the end of World War II, the United States accounted for 50% of global GDP, had no foreign debt, and had favorable demographics, with 16 people paying into Social Security for every 1 person drawing out from Social Security. Today, the U.S. represents just 22% of global GDP, the dollar is much weaker, there is a huge amount of foreign debt, and there are 3.2 people paying into Social Security for each person in Social Security. In addition, there are massive unfunded liability obligations that are growing faster than the economy.

In addition to being forced to rethink the country's role abroad, panelists described the need to rethink the role of the government domestically and the role of the Federal Reserve.

— **Domestic priorities**. Mr. Walker stated that much of what the government does is not enumerated in the Constitution. He called for a rethinking of government's role. There are some things that government shouldn't be doing at all; some things government should consolidate and do more efficiently; and some things government should do more of. An area that does make sense for the government is coordination of disaster relief, despite the comments of some politicians who have questioned this role.

Marty Evans, former CEO of the American Red Cross, agrees that the government must be involved in disaster response, but believes that a more cohesive strategy is required, something that the country has long ignored.

— **Fed's role**. Participants disagreed with the role of the Fed. Mr. Walker believes the Fed should concentrate on inflation and the value of the dollar, and that other Fed activities go far beyond its intended scope. Professor Ranis disagreed. He believes the Fed also should worry about employment and bubbles.

- **Debt will force the United States to reexamine and cut defense spending.**

Currently spending on defense is roughly $700 billion, which represents about 15% of the total federal budget, and total spending on national security (including defense) accounts for about 20% of the budget. This represents about 50% of all discretionary spending.

Per Undersecretary Ashton Carter, there is huge waste in defense and the defense budget must be on the table. While spending will decrease as the U.S. leaves Iraq, other cuts are necessary. Mr. Carter hopes defense can realize productivity improvements like those that have occurred in the private sector. His hope is not to compromise the country's capabilities, make tradeoffs about the country's national security strategy, or decrease the base defense budget. Areas for examination include:

— **Staffing**. This represents $300 billion of the $700 billion spent on defense and includes compensation and benefits. It was noted that competitive compensation is necessary to attract an all-volunteer force. However, panelists suggested that compensation and retirement benefits may be overly generous and haven't been examined in years. A person may serve for 20 years and then be paid for 60 years. In this time of budget crisis, all costs related to staffing must be reexamined.

— **Goods and services**. This represents the other $400 billion in defense spending. Professor Sonnenfeld noted that under Mr. Carter's leadership the Department of Defense has cut spending by hundreds of billions. Still, panelists see significant opportunities for improving and streamlining the bureaucratic procurement process.

Former congressman Chris Shays said that the defense budget is linked to the country's social budget. He said, "It is hard to control social costs when we don't control defense costs."

Other Important Points

- **Russia's future.** Russia is in a precarious situation. The country has valuable natural resources but has low life expectancy and a shrinking population. The current population is 140 million, but Russia could decline to fewer than 100 million people. China has never recognized Russia's claims to Siberia and the rich natural resources that are there. There is much potential for tension in this area over the long term.

Fixing the Problems Despite the Rules: How to Maneuver Around Regulatory Uncertainty

- Panelists: **Alan H. Buerger**, CEO, Coventry First
  William H. Donaldson, 27th Chairman, U.S. Securities and Exchange Commission
  Sean J. Egan, Managing Director, Egan-Jones Ratings Co.
  Robert J. Kueppers, Deputy CEO, Deloitte
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  Edward A. Snyder, Dean, Yale School of Management

Overview

Business leaders are concerned that regulation creates costs, hurts profitability, and hurts competitiveness. And, the slow process through which regulation is created results in uncertainty that makes it difficult for CEOs to make commitments and investments. In general, business leaders want less regulation and faster development of regulation. Yet regulation has value. It can create trust and give consumers and investors confidence in markets, which is needed.

The key is balancing the need for regulation with its costs so that regulation is intelligent, relevant, and developed quickly, and so that it doesn't hinder innovation.

Context

Panelists shared largely negative views on regulation and described strategies for proceeding in a world with even greater regulation.

Key Takeaways

- **Intelligent regulation is necessary and has value.**

  Former SEC chairman William Donaldson and Frank Brown both cited the need for regulation. Mr. Donaldson said that people say they are philosophically opposed to regulation, but do they really want to drive with no traffic lights? He argued that some sorts of regulation are necessary.

William Donaldson

  Frank Brown agreed. Having lived across the world, much of the confidence in the United States and in U.S. markets emanates from regulation. While people in the United States complain about regulation, people in other parts of the world actually respect the U.S. for its regulation. In fact, part of the reason people internationally continue to purchase U.S. debt is because they see investing in the U.S. as safer than other options; regulation plays a role in creating this perception of safety.

> *"I'm no fan of regulation, but there is a need for intelligent regulation."*
> — Frank Brown

  Mr. Brown believes that intelligent regulations involve a cost-benefit analysis, and David Dieters sees the secret to effective regulation lying in how regulations are implemented.

- **But panelists are concerned that regulation goes too far, which hurts business and national competitiveness.**

  Yale SOM Dean Ted Snyder said that over the last 100 years, governments have taken a larger share of output and are playing a greater role in market-oriented economies.

  Business leaders are frustrated with and concerned about the amount of regulation their businesses must navigate. Gary Naftalis said there is a general perception among politicians that any problem deserves a regulatory solution—which is not always the case. Lowell McAdam expressed the sentiments of many participants by simply stating that Verizon is "very concerned about regulation." Participants argued that regulation imposes costs and hurts competitiveness.

  A video clip was shown of JPMorgan chairman Jamie Dimon listing the numerous financial sector regulations that have been imposed following the financial crisis. He also stated that 300 more rules are still coming and he asked Fed chairman Ben Bernanke if the Fed knows the cumulative impact of these regulations. (Stephen Roach said Mr. Bernanke admitted that the Fed does not know the cumulative impact on the competitiveness of the U.S. economy.) Panelists see in Mr. Dimon's surprisingly blunt and public questioning of Mr. Bernanke a pushing back on the amount of regulation that has been imposed.

> *"Is the solution to regulate and to clamp down so hard that the economy doesn't have the ability to right itself?"*
> — Stuart Miller

  Stuart Miller of homebuilder Lennar argued that there is demand for new and existing homes, but restrictive rules about down payments, documentation, and FICO scores make it hard for

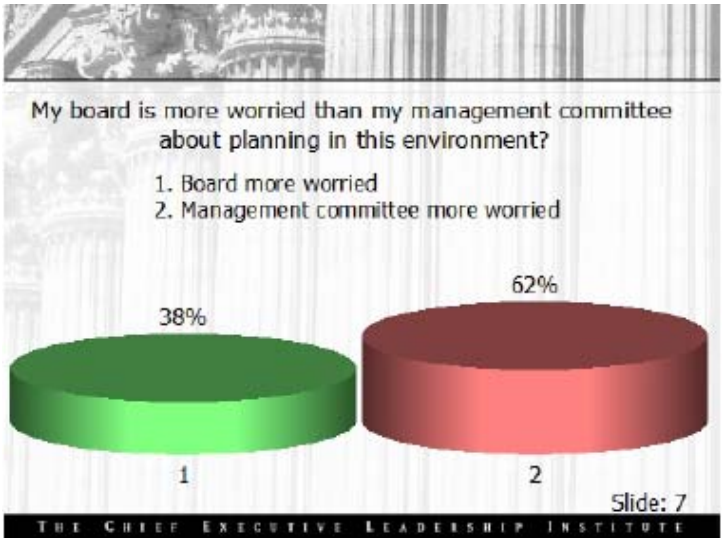
those who want to buy homes to secure financing. He is concerned that the government is clamping down so hard that it is constraining the economy and is preventing the economy from righting itself. (Other participants weren't as convinced that there is strong consumer demand for homes and were not necessarily opposed to more stringent requirements for borrowers.)

- **Particularly troubling is the slow pace of regulation.**

Developing hundreds of new regulations is a slow process that takes years. During that process, managers don't know what the regulations will be, and don't know their cost or impact. Deloitte deputy CEO Robert Kueppers sees this slow pace of regulation development as creating tremendous uncertainty, which makes it difficult for management to make investments or commitments.

> *"[Because of regulation] it is a hard environment in which to make commitments or investments."*
> — Robert Kueppers

Mr. Kueppers believes that the challenges associated with regulation make the managers who must operate in this environment more concerned than boards, as shown below.



- **Innovation proceeds faster than regulation.**

A segment from *60 Minutes* was shown that highlighted the use of supercomputers by high frequency quantitative securities traders. Some of these traders are leasing computer space from NYSE Euronext in order to access data a fraction of a second faster. NYSE Euronext COO, Larry Leibowitz, said that these traders bring added liquidity and volume to the market, which is beneficial. However, others believe that quantitative systems have gone too far and that they lack transparency, have no social value, provide users with unfair advantages, and should be regulated (or banned).

Mr. Leibowitz realizes that consumers are often distrustful of new technologies that they don't understand and that innovation and technological development outpace regulation—because regulation tends to be so slow.

Larry Leibowitz *Lynn Tilton* *Stuart Miller*

Former SEC commissioner Harvey Goldschmid argued that the U.S. stock market works because people trust it. (Currently more than 50% of Americans are invested in the market.) Therefore, any technological innovations that threaten consumers' trust in the market should be treated very cautiously.

> *"Technological innovation happens faster than regulation, but technology doesn't help with confidence [in the markets]."*
> — William Donaldson

Thus, with new technologies, a balance must be struck. On the one hand, regulators need to be cautious so as not to over-regulate, but proceeding with a new technology too quickly may cause a loss of confidence.

The Delight of Distress: Building Companies, Communities, and Countries Amid Adversity

- Panelists: **Tony Alvarez II**, Co-CEO, Alvarez & Marsal
  Tig Gilliam, CEO, Adecco North America
  Kay Koplovitz, Chairman, Liz Claiborne
  John J. Legere, CEO, Global Crossing
  Stuart A. Miller, President & CEO, Lennar Corporation
  Lynn Tilton, CEO, Patriarch Partners
- Respondents: **Elisabeth DeMarse**, CEO, Newser
  Marty Evans, Former CEO, American Red Cross
  Frederick J. Mancheski, Former Chairman & CEO, Echlin
  Clarke Murphy, Managing Director, Russell Reynolds Associates

Overview

Despite challenging circumstances, opportunities abound. There are opportunities in distress and in temporary staffing; opportunities in turnarounds and in expanding abroad; and opportunities to innovate, in established industries and by taking advantage of new social media platforms.

For America to capitalize on future opportunities requires creating a more educated, skilled workforce that can compete globally, and removing barriers for small businesses.

Context

In this session, panelists offered lessons and shared thoughts on achieving success despite a difficult environment.

Key Takeaways

- **Significant opportunities exist in all situations, including distress.**

  Stuart Miller sees attractive opportunities in distressed real estate. For the second time in its history, his company has formed a new enterprise to scoop up and work out distressed assets. Several private equity firms also are having success investing in distressed real estate assets.

  Adecco, the country's largest temporary staffing service, also sees opportunity in the country's current employment situation. Increasingly firms need to add professional talent and capabilities in areas such as finance, IT, and engineering. But because companies remain uncertain about the future they are reluctant to hire full-time staff. So, companies are adopting a flexible staffing model, which has helped drive Adecco's growth.

  > *"We are doing well because there is uncertainty to hire . . . companies have a need for talent and are choosing to engage in a flexible model to satisfy their demand."*
  > — Tig Gilliam

  There also are abundant opportunities in turnarounds. Alvarez & Marsal has overseen turnarounds in a broad range of industries, including financial services, automotive, manufacturing, and healthcare. The company is now utilizing the same skills and discipline to help public sector entities, including cities like Detroit and school districts like New Orleans orchestrate financial and operational turnarounds.

  Lynn Tilton finds opportunities in abandoned companies that others have neglected. She has assembled a portfolio of companies in industries such as manufacturing and aerospace. Many of these companies were once-great brands that failed to innovate. She is bringing jobs to manufacturing communities in small-town America by creating lean, efficient operations, and by pushing her firms to innovation.

  > *"I believe that the U.S. has to make things . . . I'm trying to save old companies that have lost their way and are not innovating."*
  > — Lynn Tilton

- **The same core values that enable companies to succeed in stable situations apply in a turnaround.**

  Clarke Murphy said that often countries and companies require a deep crisis before change occurs. A crisis compels a sense of urgency and forces companies to adapt and innovate in order to survive.

  But this doesn't need to be the case. Alvarez & Marsal's Joe Berardino said, "The same values that get you out of a ditch are what you need to keep companies healthy." These values include honestly confronting reality, having a holistic perspective that combines the finance function and operations, and having a sense of urgency.

- **In times of distress, partnerships can be a strategy for growth.**

  Kay Koplovitz described how low consumer spending over the past few years has made it a challenging time for a fashion company like Liz Claiborne. The company has had to reduce the number of brands it offers and has less marketing money to put behind its brands.

But a strategy that can work in this environment is partnership, particularly with international partners. By finding the right partners a company can leverage the partner's capabilities to expand into new areas and grow profits without requiring much if any capital.

- **Untapped opportunities exist in global trade.**

  Frederick Mancheski described how he led the growth of Echlin from a $13 million U.S. auto parts company to a $4.8 billion enterprise by expanding to Canada, Mexico, South America, Europe, Australia, and Asia.

  Professor Robert Pastor argued that NAFTA has been successful, and even greater opportunities exist through trade with Canada and Mexico. In general, the United States and companies in the U.S. don't recognize or take advantage of the opportunities that exist in trading with these partners. Americans look at Mexico and see drugs and violence, yet significant opportunities exist.

  Guy Ranis argued that completing free trade agreements with South Korea and Colombia should be an area where there is political agreement. These free trade agreements can benefit U.S. companies, help the economy, and create jobs.

- **Even in challenging environments, disruptive innovation is still possible.**

  IBM's Saul Berman recounted how the music industry has gone through a period of distress, yet today the industry is larger than ever. However, with new technologies and new business models, the people making money are different from in the past. This shows that during periods of distress, industries change and the pie may be divided differently, with the innovators winning a larger share.

  Elisabeth DeMarse of Newser sees tremendous innovation taking place in using social media platforms to disrupt existing business models. Innovation in social media has just begun.

- **Changes in government policies are needed to assist small businesses and boost workforce development.**

  Extensive research shows that the majority of jobs are created by small businesses. Yet multiple barriers hinder small businesses in growing and creating jobs. For example, the U.S. patent office is extremely slow to review and approve new patents, even though patents lead to jobs. Also, compliance with regulations such as Sarbanes-Oxley is extremely challenging and costly for small companies. In J.P. Donlon's view, the government should take steps to streamline the patent office and decrease the regulatory burden on small firms.

  Also, the government must help narrow the skills gap that exists to create a competitive workforce for the future. Former Secretary of Labor Elaine Chao said that even with high rates of unemployment in the United States, there are four million high-skilled jobs going unfilled because of a skills gap. In the future, the United States can't compete effectively for low-skilled, low-wage jobs; in the global economy, we will lose to other countries. To compete, the United States must invest to create an educated, highly skilled workforce.

> *"Jobs are changing. We need to equip workers with the advanced skills that they will need to compete."*
> — Elaine Chao

  In Ms. Chao's view, the government must keep taxes and regulation low, have fiscal discipline, and invest wisely in effective workforce training and development programs.

  Lynn Tilton argued that as the U.S. works to create the workforce of the future, it is important not to abandon the blue-collar workforce of the past; there must be a transition. Blue-collar workers can't become highly skilled overnight. The country must fight to preserve industries, like textiles, that other countries are winning because their government is subsidizing them. Ms. Tilton said the United States lost the textile industry not because of lower productivity or higher labor costs, but because the Chinese government subsidized the cost of cotton.

Other Important Points

- **Back in the USA.** Elisabeth DeMarse mentioned a report from Bain that indicates a possible resurgence of manufacturing in the United States. Because of rising labor costs in China and because of high distribution costs, it may be more profitable for companies to move their manufacturing back to America.

Legend in Leadership Award

- Recipient: **Kenneth I. Chenault**, Chairman & CEO, American Express
- Presenter: **Ivan G. Seidenberg**, Chairman & CEO, Verizon Communications

Presentation

In presenting Ken Chenault the Legend in Leadership Award, Ivan Seidenberg described how Mr. Chenault transformed American Express by taking a great company and making it even stronger. He showed courage, attacked sacred cows, restructured when necessary, breathed new life into a great brand, delivered consistently outstanding performance, and demonstrated tremendous leadership. He also has been a highly respected leader in the broader business community.

Former American Express CEO Jim Robinson described Mr. Chenault as a true leader. He is attuned to the feelings of others in his organization and has a large legion of followers.

In accepting this award, Mr. Chenault shared the following thoughts about leadership:

- **The role of a leader is to define reality and give hope.**

  While anyone can perform an analysis, many people refuse to understand and accept reality. Leaders clearly define and focus their organization on reality. But they go further. In all situations, they have optimistic attitudes that are grounded in values, develop pragmatic solutions, and take risks, and in doing so, develop followers.

> *"There is nothing more important than leadership and the constant commitment to leadership. Leadership is complicated, but here is a simplification of it that comes from paraphrasing Napoleon: The role of a leader is to define reality and give hope."*
> — Kenneth Chenault

- **The reputations of leaders are made during times of crisis.**

  We live in volatile, uncertain times. In such circumstances, people want to see constancy in their leaders. People want to know that their leaders are leading them in the right direction. People want leaders who are decisive, compassionate, and willing to take action. Leaders who demonstrate these characteristics will have followers and will even be afforded a few mistakes.

- **Leaders must be visible.**

  Leaders must constantly communicate and must do so in an open, direct way. They must retain their composure in all situations and can't freeze up.

Ted Snyder *Ken Chenault* *Ivan Seidenberg*

Keeping Revolutions Forever Young: Investing in Legacies for the Future

- Panelists:
  Kenneth I. Chenault, Chairman & CEO, American Express Company
  Sanford R. Climan, President, Entertainment Media Ventures
  Douglas Franklin, President & CEO, Multiple Sclerosis Association of America
  Gary E. Knell, President & CEO, Sesame Workshop
  Philip H. Kowalczyk, President, The Americas, The Body Shop
  Jerry Leamon, Global Managing Partner, Services, Deloitte
  Gerardo Lopez, President & CEO, AMC Entertainment
  Patricia E. Mitchell, President & CEO, The Paley Center for Media
  Thomas J. Quinlan, President & CEO, RR Donnelly & Sons Company
  James D. Robinson, General Partner, RRE Ventures
- Respondents:
  Garry Brewer, Professor, Yale School of Management
  Eric Brielmann, Partner, Joele Frank, Wilkinson Brimmer Katcher
  J.P. Donlon, Editor-in-Chief, *CHIEF EXECUTIVE*
  Stephen A. Greyser, Professor Emeritus, Harvard Business School
  David W. Miller, Director, Faith & Work Initiative, Princeton University
  Albert Morales, Managing Partner, IBM Global Business Services

Overview

Keeping an organization forever young is a continuous process of reinvention. This process starts with a company's brand and reputation, leverages existing assets, and involves building and strengthening the trust that exists between a company and its customers. Reinvention also entails creating an environment where innovation can flourish and investing in talent. Panelists also believe that building a future legacy will include having greater transparency and adapting to the new realities of social media.

Context

Panelists shared ideas for reinventing companies and industries, and creating legacies for the future.

Key Takeaways

- **Keeping a company young is a process of continuous reinvention grounded in a clear vision.**

  Ken Chenault sees reinvention as the key to keeping a company forever young. American Express has reinvented itself multiple times and is continuing to do so. When a company sets out to reinvent itself, the leader must articulate a clear vision that provides hope about the future, and leaders must demonstrate values and integrity. Being honest is a minimum requirement; the true definition of integrity is consistency of words and actions. Also critical in the process of reinvention is not throwing away the company's legacy assets, but leveraging these assets.

- **Investing in a company's future legacy starts with its brand and reputation.**

  Sesame Workshop CEO Gary Knell said that an organization's legacy starts with the notion that "Brand is king." The legacy starts with preserving and enriching the brand, and doing nothing to injure or diminish the brand.

  Professor Greyser agreed and linked a company's brand to its reputation and its integrity. A company's brand is derived from its achievements over time. This includes its financial performance, its ability to adapt to changing circumstances; its new products; and its other accomplishments. A firm's reputation is also based on the values that are demonstrated; there is a difference between hollow values, which are merely words, and real values, which combine words and actions. CEOs are the guardians of an organization's reputation. A reputation and a brand can be bequeathed if they are invested in and nurtured.

> *"The key element of legacy is reputation. The CEO is the guardian of reputation . . . it can be bequeathed if it has been nurtured."*
> — Stephen Greyser

  An organization's reputation, and that of its leaders, will be impacted by its level of transparency and openness. Eric Brielmann sees a company's disclosure patterns, its messaging, and its consistency as having a significant potential impact on its reputation.

- **A long-lasting legacy is based on trust.**

  Several panelists and participants focused on the importance of trust. Brands and relationships with customers are based on trust. Sandy Climan described how social media enables companies to listen to and interact with customers, resulting in more trusted relationships. Philip Kowalczyk related how The Body Shop is investing in its future legacy by innovating its products and its customer experience, which strengthen the trusted relationship with customers. At the same time, The Body Shop is taking steps to improve the trusted relationships with employees by improving safety and offering a new employee wellness program.

  Steve Shaw commented that the problem in the political system is that trust is sorely lacking, which prevents anything from getting done. Reshaping the political system requires building a foundation of trust. David Miller

Steven Shaw

sees trust as perhaps the central idea coming from this Summit. He saw trust as a key component in IBM's development of Watson and in Ken Chenault describing the success at American Express.

> *"If we want to compete and innovate, perhaps at the root of it is trust."*
> — David Miller

- **Today, keeping a company young requires good management, targeting specific segments, and actively engaging in government relations.**

  Jim Robinson observed that as the context for business changes, the best products and services don't always win, but the best-managed companies do. Compared to past eras, he now sees CEOs having to spend much more time on government relations. Going forward, he sees social media as a powerful change agent that will have a dramatic impact on business.

  To reinvent his company, Mr. Knell says that Sesame Workshop is now focusing on very specific target audiences, as opposed to just the mass market. He sees this focus on narrower segments as a model for reinvention and creating a future legacy.

- **Companies can stay young by creating an environment for innovation and investing in talent.**

  IBM's Albert Morales believes the keys to building an organization's future legacy are:

  — **Building an environment for innovation**. The country's future legacy, and that of individual businesses, will be shaped by the ability to build an environment where innovation can flourish. This includes innovation in products, services, and business models.

  — **Investing in talent**. Both companies and the United States need to make investments to create the skilled workforce to compete. Deloitte's Jerry Leamon said that this year Deloitte will be hiring 30,000 people and then making significant investments to train these individuals and immerse them in Deloitte's culture.

  — **Engaging in public service**. As IBM celebrates its 100th anniversary, it views this occasion as an opportunity to look forward. Part of looking forward involves making a significant investment of time and resources in community service. This will enhance communities and strengthen IBM's brand and reputation.

- **The future of the media and entertainment industry will be very different from the past.**

  Sandy Climan described the present moment as the most exciting time in the history of the media business. Previously, the media industry was a clubby, tightly controlled business where companies focused on controlling distribution channels. That model is undergoing profound change. The industry is becoming global; bandwidth has increased; and social media provides a mobile, always-on platform for instant communication from anywhere to anywhere, with no barriers to entry. Media companies will have to listen to and connect with customers in new and different ways. The future of media won't look anything like the past and there are likely to be a host of new players that emerge.

Other Important Points

- **The good race.** David Miller counsels students to pursue their dreams, not dollars. He encourages people to think about life as a journey and to reflect on the elements that St. Paul incorporated into "The Good Race." These are: prepare well; run well; deal with adversity well; and finish well.