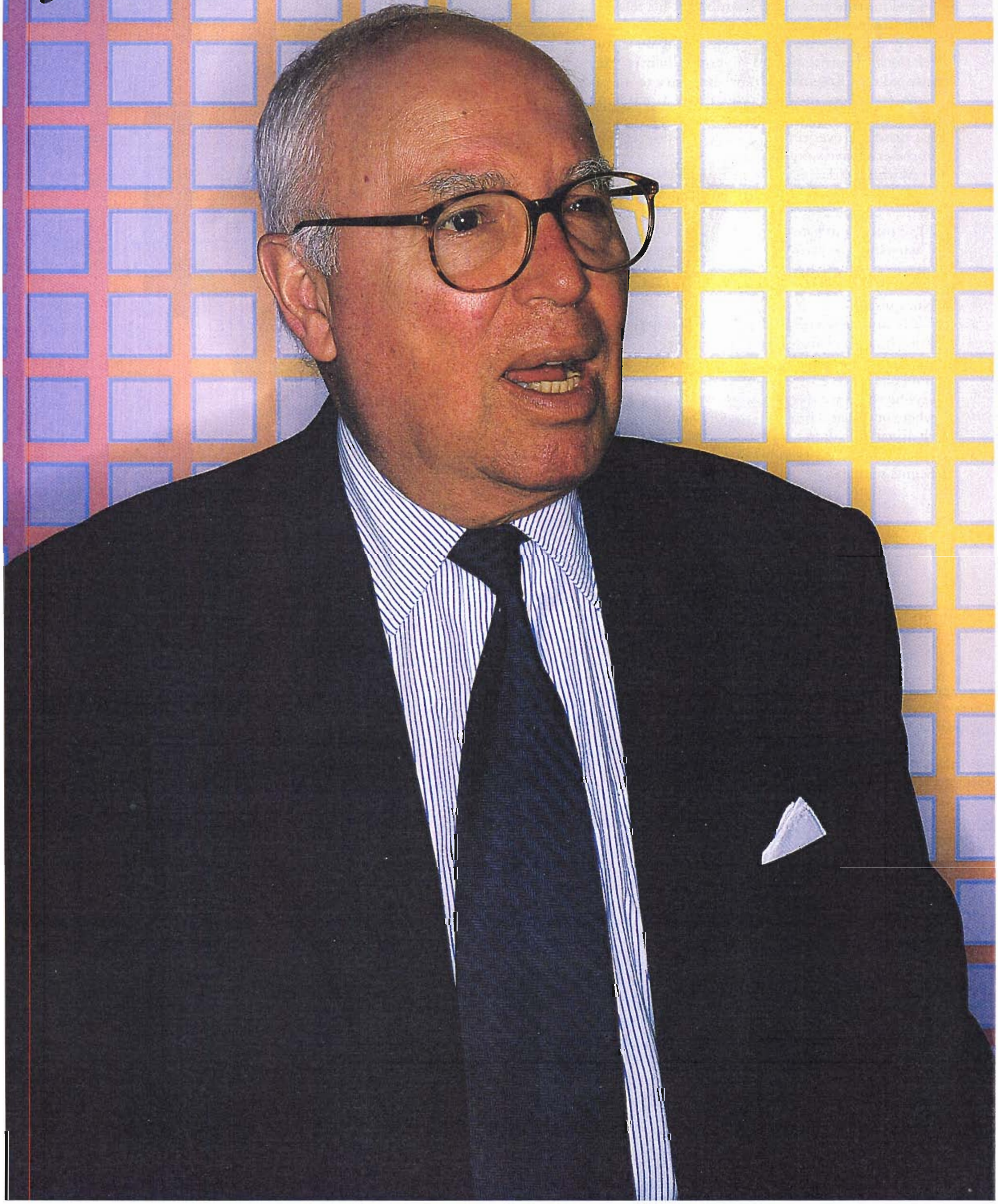
INTERVIEW

John Gutfreund: The Streetwis



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In his new life, the former head of Salomon Brothers encounters civility in the boardroom, zings the occasional hapless CFO, and urges due diligence before anyone agrees to join a board. And yes, today's markets scare him.

Once the most powerful man on Wall Street, John H. Gutfreund almost vanished from view in 1991 after a scandal involving some of his top lieutenants forced his resignation as chairman of Salomon Brothers, the investment bank. These days, Gutfreund, 70, runs his own investment firm in New York City and is a director of a number of small to midsize corporations. His board service has been a learning experience, for him—and for the chairmen who signed him up. As the following interview with *Corporate Board Member* makes clear, the man who routinely urged ambitious young Wall Streeters to be ready to "bite the ass off a bear" still speaks his mind.

After 40 years in the rarefied air of Wall Street, what was your biggest surprise when you met the board members of mid-cap companies located west of the Hudson?

Their courtesy and camaraderie. You get a feeling of non-corrosiveness in personal relationships. People aren't attempting to savage one another, sticking a knife in somebody and pulling it out. Courtliness does not mean that people are incompetent, it just means they have a different style.

That's certainly the case at Baldwin Piano & Organ, a grand old brand name, where I was first retained as an adviser. They were facing fierce competition from Yamaha, and I suggested to the CEO that if I served on the board, they would receive my services for a quarter of the price. She accepted. It was a good deal for her, and I have fun because they're nice people. I think they appreciated that I'd been supportive in a time of terrible travail. The civility factor means something to me. On Wall Street, it's all knees and elbows.

And what do you think surprised the midwestern companies about how Wall Street functions?

The extent of the greed, probably. Wall Street is ruled by the amount of money it can make for itself—its bankers, traders, and underwriters. It's interested in consummating the largest deal, with the least risk, in the shortest amount of time. That, of course, does not define the midsize company or what it needs.

For example, my first directorship was with AquaPenn Spring Water Co., a small company based in Pennsylvania that sold spring water. Its board was composed of local people from State College. We took the company public and it prospered for two or three years. But it wasn't interesting to anyone on the Big Board because the dynamics of water are not explosive, unlike technology or telecommunications.

After three or four years we entered into negotiations to sell the company because we didn't feel we had the capital and strength to be a strong player against our two major competitors. I was helpful in terms of dealing with the bankers and trying to optimize the financial results.

Is there a Topic A that is common to all the boards on which you serve?

Absolutely, and it doesn't make any difference what kind of business it is. The big issue is: Why isn't anybody paying attention to us, what can we do about it, and what can we do to improve the price of our stock?

What do you tell your fellow directors when they ask these questions?

That stocks are sold, not bought. You have to tell a story about your business that will interest people and then sell it to Wall Street. If good analysts cover you and if you can manipulate them, you will have the ability to raise the share price.

What are your criteria in accepting board memberships?

The companies have two things in common: the desire to go into a broader market and the potential for growth.

For example, AccuWeather is a Pennsylvania company that uses satellites to deliver weather forecasts to about 600 newspapers and radio and television stations across the country. It's a fascinating business, and they have developed a strong brand name and have a number of options for the future.

They are thinking about going public and approached me to give them a broad view of what might be possible. What I bring to AccuWeather, and other companies for that matter, is business experience in terms of a public offering, and I can help them identify alternative methods of maximizing return on investment.

Gutfreund's public directorships

AMBI
(develops and markets dietary supplements)
Ascent Assurance
Baldwin Pianos and Organs
Ebercel
(makes batteries)
Foamax International
(manufactures polyethylene foam)
LCA-Vision
(operates laser vision-correction clinics)
Universal Bond Fund

None of this is the sexy stuff of a Silicon Valley company, because that's not where I bring much to bear. And frankly, the rules by which those companies are currently operating do not make a heck of a lot of sense to me. They do stock deals before their stock is valued and issue stock with not even a prospect of making any money for the next few years.

"ANY PROSPECTIVE DIRECTOR SHOULD ACQUAINT HIMSELF MORE THAN CASUALLY WITH THE COMPANY AND CHECK THE REFERENCES OF THE CEO AND EXISTING BOARD MEMBERS. I'M NOT CERTAIN THAT MOST OF US DO ENOUGH CHECKING."

Do you socialize with other directors when you go to board meetings in different parts of the country?

No, I don't. At Salomon, I learned the hard way that you couldn't be friendly beyond the business relationship unless you are an extremely strong person who knows exactly where you are going and what you want to do. I enjoy the intellectual stimulation of working with board members from different backgrounds, but not the social aspect of board memberships. My business is not touring golf courses around the country.

How much due diligence do you do prior to accepting a board position?

Any prospective director should acquaint him- or herself more than casually with the history of the company and check the references of the CEO and the existing board members. I have been offered positions on boards and said "no thank you" because the reputation of the people was not consistent with my own self-image. It is important not to be a slave or captive of the CEO or major shareholder. I'm not certain that most of us do enough checking when we join a board.

Eye to eye with Stephen Joffe, CEO of LCA Vision, which operates laser eye surgery clinics.

Did you ever wish you'd checked out a company more thoroughly?

I didn't do enough due diligence with Foamex International, the largest foam company in the United States, whose board I joined in 1998.

It was only after I became a board member that I discovered the company had various problems, particularly as they affected management. I was brought onto the board by former vice chairman, now chairman, Marshall Cogan. As an outside director, I was asked to retain an investment banker and a lawyer to prepare an independent analysis of pricing the stock to take the company private. We came up with a bid, but the deal fell through. Six months later, there was another deal. The majority of the board voted yes. I voted against it, and the deal fell through again.

What lesson did you learn from this experience?

What a saga! I learned more than a few of them. The biggest, as I said, is to check out a company before joining its board.

Did you resign from the Foamex board?

Actually, I did not stand for re-election. I was brought onto the board to guide the company through privatization, but the company has tried three times and failed three times. And I feel that I am no longer the right contributor.

What advice do you have for a board looking to expand?

It's important to get people from different business backgrounds. I don't think it's necessary to have another car man on my board because I'm running a car company. I want somebody that's experienced in other areas, such as manufacturing or finance. You need board members with proven expertise in areas that might be of interest to the business you are in.

I don't care about getting a rainbow coalition. The important thing is to have a team who can get the job done, and if the people on your team happen to look different, that's great.

"I AM UNCOMFORTABLE BECAUSE I DON'T SEE HOW 14-YEAR-OLDS (MY SON'S AGE) TRADING STOCKS EVERY DAY AFTER SCHOOL ON THEIR LAPTOPS CAN END UP WITH ANYTHING BUT DISASTER."

How should directors be compensated?

Fairly. Serving on these boards is not about the money. You are paid anywhere from $10,000 to $25,000 and you may receive a few options, but you don't get rich. If you want to get retired people, or people who are not the best, you can get away with offering a less attractive financial incentive. If a company wants to attract the best people, it probably needs to have a larger investment path. At the same time, it's not appropriate for a small company to pay high directors fees. Compensation can be a combination of cash, stock options, and warrants. If the company has the potential for growth but is not there yet, stock is a better bet, because they don't have the cash.

What is an outside director's biggest responsibility?

The major task is to assess whether or not the management has the capacity to choose the right people to work with them and take responsibility for the various components of the business. As a company grows, the CEO must develop a strong team and be willing to shed a few responsibilities. In mid-cap companies, the CEO is often also the chief cook and bottle washer and probably considers him- or herself responsible for everything.

The fewer outside directors there are, the tougher the job for the rest of us. The internal directors tend to defer to the CEO, particularly if that individual is also a major shareholder.

Have you ever pushed a CEO to make a decision he or she didn't want to make?

That's part of our job. We have to be able to say, "Look, your public relations is third-rate or your finance guy isn't smart. I'm not going to sit through another meeting where this guy has only half the numbers." Sitting at a board meeting is not supposed to be a voyage of discovery for the directors. I want the information before the meeting and I want it clear. If there's a problem, I'll be glad to talk to the CEO before the meeting.

I have pushed a number of CEOs to attempt to do what they believe to be best for their company. If that's not possible and they can't provide a good return to the shareholders, they may well be at a competitive disadvantage and should consider selling the company.

Is e-commerce high on board agendas?

There's no question that you have to consider the Internet as part of the space you wish to occupy or as some component of your business. You cannot ignore it. The question is, can you engage in this business without hurting your present business, and do you have the staff or can you afford to get the staff? People outsource an awful lot these days, but can you outsource e-commerce? I don't know.

Let's go back to Wall Street for a moment. How is the technology sector affecting the markets? What do you see on the horizon?

The whole world, not just Wall Street, is in the process of transition, and it shall continue. The domination of the stock exchange is disappearing. The financial community is now dedicating its capital to high-return opportunities. Every day, the momentum in the market accelerates because the intermediary roles are diminishing. Now public firms are run by very talented employees in combination with shareholders. There is no longer any sense of lifetime employment—careers are finalized in three years. You can see how excess plays out in some of the stock pricing.

In addition, you have this enormous unmeasured public investing phenomenon. I believe that the day-trading public investment is just like a casino that is radically overdone. It's irresponsible. Margins should be maintained at a higher level. There are a lot of people who are going to lose their houses, their cars, and whatever they can hock because they are not informed speculators. The complexity and variety in the present environment is hard to understand and manage.

Forget the simple worries of privacy, security, and liability—I worry about the fact that the world is operating like a short-term casino and everybody is infected with instant gratification. I am uncomfortable because I don't see how 14-year-olds (my son's age) trading stocks every day after school on their laptops can end up with anything but disaster.

We are in an era of free-market dominance, and I believe that without a "Ten Commandments" in most sectors of our lives, we are not going to be able to stay out of trouble. Perhaps that's a very old-fashioned view.