EXECUTIVE SUMMARY

Yale SCHOOL OF MANAGEMENT

CEO SUMMIT

Transforming with Transparency:

Investing in Innovation amid Public Scrutiny

New York Stock Exchange | June 3 - 4, 2014

PRESENTING SPONSORS

CNBC FIRST IN BUSINESS WORLDWIDE.

Deloitte.

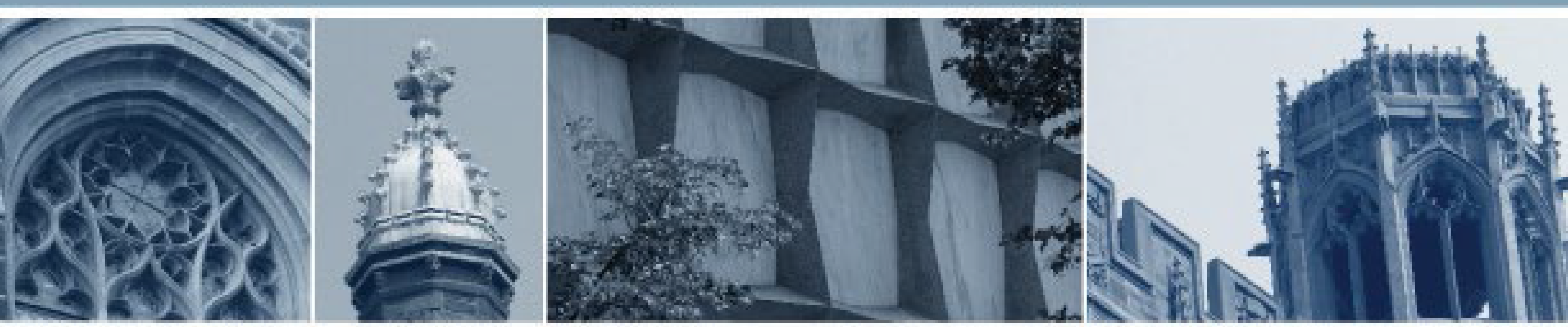
IBM

KORN FERRY

NYSE

PEPSICO

ups



Yale SCHOOL OF MANAGEMENT

Chief Executive Leadership Institute

Table of Contents

Key Themes from June 2014 CEO Summit

The 77th Yale CEO Summit, led by Yale Professor Jeffrey Sonnenfeld, was held on June 3 and 4, 2014 at the New York Stock Exchange. This Summit brought together business executives, government officials, leading academics, a delegation of officials from China, and other thought leaders with the theme of "Transforming with Transparency: Investing in Innovation amid Public Scrutiny."

This Summit focused on transformation: transformation and public scrutiny relating to mayors and city leadership; transformation and markets; transformation and invention across borders; and transformation and innovation in the age of activist investors. Two legends in leadership were also honored: retiring NYSE Euronext CEO Duncan Niederauer and Home Depot CEO Frank Blake.

Ringing the opening bell at the New York Stock Exchange.

Transformation and Public Scrutiny: Mayors and City Leadership.

A city can be described as an entity between a business and a nation, with similarities to both, and a mayor can be thought of as the CEO of a city—though a CEO under tremendous public scrutiny.

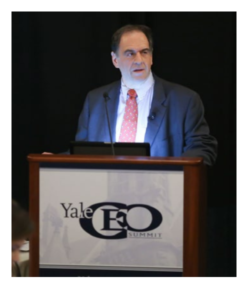
There are distinct advantages to creating *de novo* "startup" cities. Professor Paul Romer of the NYU Urbanization Project examined why the world needs charter cities. Niansha XU, Chairman of China Poly Group, discussed the role of private investment in startup cities in China. And Stuart Miller, CEO of Lennar Corporation, described his company's experience creating startup communities.

Startup cities have many of the same advantages of startup companies: leaders have a blank slate and can be creative in making decisions, unencumbered by baggage or legacy issues. Those creating new cities have wide latitude in making decisions about urban design, the provision of services, and infrastructure. Like any startup, a leader must be able to sell their vision and attract capital. (For charter cities, once rules are established the private sector can come in and invest.) And as with a business startup, even with careful planning, it is difficult to predict the path a startup city will actually take, what its culture and personality will be, and how it will evolve.

While startup cities mirror startup businesses in many ways, the challenges of managing and transforming an existing city rival the challenges of transforming an existing business. As the mayors of 10 American cities (Akron, Albuquerque, Anaheim, Carmel, Irving, Nashville, Oklahoma City, Shreveport, Stamford, and St. Paul) shared, the challenges of transforming a city, while under intense public scrutiny are formidable. Mayors must be able to articulate transformative long-term visions, while delivering short-term results to satisfy diverse stakeholders, who have wide-ranging interests.

Mayors must understand how the changing business climate and changes in specific industries are affecting their city and must work with business leaders to support their transformations. Mayors must innovate and take risks, but must be cautious because if they make a mistake, they won't get reelected. Mayors must be creative in attracting new capital and jobs, yet in doing so, must be cautious not to be viewed as overreaching, as can occur if constituents don't see value in a mayor's efforts to seek opportunities in foreign markets. Mayors must understand the current culture of their city—including important groups, such as the police—and then work to change this culture, as several mayors are actively doing.

Transformation and Markets: Technology, Risk Taking, and Restoring Market Trust

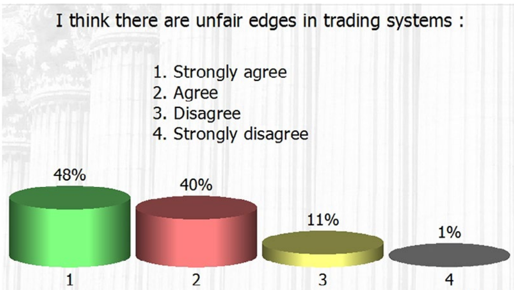


Jeffrey Sonnenfeld

Main Street America still doesn't trust Wall Street. In a real-time poll of CELI participants, 73% said they do not believe that market trust has returned for the individual investor. Growing income inequality and lingering fears of economic insecurity contribute to an overall lack of trust in the financial system.

And this lack of trust isn't limited to the individual investor or the general public. With the increased use of sophisticated technology for high-speed and high-frequency trading—which some argue is a positive innovation for the financial markets—even some knowledgeable, sophisticated experts believe that technology enables "front running." The concern is that technological innovations intended to improve market speed and efficiency are fueling perceptions that the market is "rigged." Among CELI participants, 72% are concerned about HFT (high-frequency trading) in the exchanges. (This topic is getting increased attention due to Michael Lewis' new book *Flash Boys*.) About 65% of participants do not believe the markets are rigged but 88%

believe there are "unfair edges" in trading systems. Such concerns, whether justified or not, undermine investor confidence in the markets and can inhibit investment and risk taking.



The key question is, "What can be done to restore market trust?" Politicians often advocate litigation and prosecution—against corporations and individuals—as a politically popular way to satisfy the angry mob. However, increased prosecution is not seen as the way to restore trust.

Though few business leaders are fans of more regulation, greater regulatory intervention is a possibility in acting to restore trust. Some CELI participants advocated for a principles-based system as opposed to a rules-based system, with some seeing the need for a hybrid—a principles-based system with rules. Senator Chris Dodd, the co-sponsor of Dodd-Frank, acknowledged that regulation imposes costs and adds complexities, but said there are times when regulation, though unpopular, may be necessary.

To restore greater trust in the financial markets, several CELI participants believe that the SEC—which has tools at its disposal—must play a greater role, which could include regulations around HFT. Also, business leaders must communicate to the public the unmatched strengths and benefits of U.S. markets.

Transformation and Invention across Borders: the U.S./China Relationship

The relationship between the U.S. and China is going through a period of transition, as China continues to transform itself both economically and politically.

Most see China's economy growing more slowly than it has in the past as the country attempts to transform itself from an investment- and production-driven economy to one driven by domestic consumption. At the same time, China's leaders are attempting to implement various economic, financial, and political reforms, which some see proceeding at a slower pace than was planned.

The pessimists are worried about the sustainability of China's economy. They argue that stated economic growth rates of 7-8% are being artificially propped up by government stimulus, such as the unnecessary building of millions of condos. There are concerns about China's political stability as the country's new leader is consolidating power in an unprecedented way and is pursuing an anti-corruption campaign that poses a threat to many.

The pessimists are also worried about China's foreign policy. Some participants commented that "the U.S.-China relationship is in rapid decline," as China is increasingly contesting U.S. actions. There are also growing regional security concerns, resulting in what some see as the most fragile situation in the region in several decades. Among those expressing concerns were individuals who had previously been more bullish on the U.S.-China relationship and on China's economy.

But others—including several attendees from China—were more optimistic, and believe the U.S. tends to have an overly pessimistic perspective. While economic growth has slowed somewhat, it remains strong; the slight dip in growth is not surprising or worrisome as the country shifts its model from production to consumption and from goods to services. Participants were reminded of the astounding progress that China has made in just the 25 years since Tiananmen Square. In this short period China has created a flourishing stock market, become a member of the WTO, established laws for the protection of private property, and become a hotbed of entrepreneurial activity—developments that were previously unthinkable.

The optimists believe the U.S.-China relationship remains strong and through mutual understanding and further engagement will only deepen. They continue to see benefits for consumers and businesses around the world as Chinese companies spread their wings internationally, and they see significant opportunities in China for foreign companies, including favorable investment and business opportunities particularly in Guandong Province. Just one example is the growing film industry in China. Each day 15 new movie screens are being erected in China, yet more than 100 cities with one million people or more still have no movie screens. China is also beginning to produce much more content, and while lack of IP protection remains an issue, since China is now a content producer, the country is doing a somewhat better job of protecting intellectual property.

Several CELI participants indicated that countries are closely watching how the U.S. acts regarding China, both economically and politically. Some CELI participants expressed the view that countries have been disappointed with the perceived lack of leadership, consistency, and staying power of the U.S. and the Obama administration in dealing with China. However, historically, the economic relationship has continued to grow even during periods of political tension. How the relationship continues to evolve is uncertain. Some are optimistic about an even stronger relationship, while others are concerned that rising tensions based on China's geopolitical aspirations could derail this critical relationship.

Transformation and Innovation in the Age of Activist Investors

After focusing on the transformation of cities, financial markets, and relationships between countries, the conversation turned to why and how companies must transform themselves.

One driver of corporate transformation is the presence of activist investors, of which there are different types. The term "activist investor" typically conjures up the image of an antagonistic, abrasive investor who plans to replace the CEO, change the management team, and fundamentally change the strategy. But there are other types of activist investors, as exemplified by Ralph Whitworth, who was termed an "ambassador" and who is known for collaborating with CEOs and other board members to increase enterprise value. When Whitworth decides to invest in a company and to join a company's board, unlike most activist investors he is typically received enthusiastically by a company's CEO. This is because Whitworth and his partner have real-world experience in operating companies and have served on numerous boards of successful turnarounds. They bring operating experience and understanding, financial savvy, discipline, focus, and patience, which has helped companies such as Home Depot and HP.

But many companies and CEOs prefer to avoid any external activist investor by proactively behaving as "internal activists." They work to identify critical inflection points when behaving the same way will no longer work and transformation is required. Internal activists focus on long-term value creation and recognize that constant innovation is imperative to avoid commoditization or cannibalization. The need for innovation – or invention of entirely new technologies and products – is essential in every industry, ranging from chemicals to pharmaceuticals to information technology. Companies that don't constantly invent, innovate, and transform themselves will be overtaken. Financial engineering may provide a short-term band aid but doesn't replace sustained innovation.

In assessing important characteristics of companies that have transformed themselves, CELI participants mentioned the ability of CEOs to communicate a clear vision to investors and employees; leaders who can change the culture and boost employee engagement; and companies that can maintain their relationships with loyal customers, while entering adjacent markets to attract new customers with new products. Among the characteristics of CEOs who successfully lead transformations are having passion and discipline, thriving on pressure, having the courage to make bold bets, and demonstrating the confidence to lead the organization in an often difficult new direction.

Mayors as CEOs:
City Saviors, Survivors, Seers & Statesmen Under Scrutiny

OPENING REMARKS

Paul Romer, Professor, NYU Urbanization Project
Niansha XU, Chairman, China Poly Group
Stuart A. Miller, President and CEO, Lennar Corporation

RESPONDENTS

Richard J. Berry, Mayor, Albuquerque, NM
James C. Brainard, Mayor, Carmel, IN
Christopher B. Coleman, Mayor, St. Paul, MN
Mick Cornett, Mayor, Oklahoma City, OK
Karl Dean, Mayor, Nashville, TN
Cedric B. Glover, Mayor, Shreveport, LA
David R. Martin, Mayor, Stamford, CT
Donald L. Plusquellic, Mayor, Akron, OH
Tom Tait, Mayor, Anaheim, CA
Beth Van Duyne, Mayor, Irving, TX

Overview

As experts on the building and evolution of cities made clear, cities are where the action is. Across the world, individuals are migrating to cities because cities are centers of employment, innovation, and vibrancy. In any city, it is the role of leaders to establish rules and create infrastructure so citizens and businesses can thrive. Once rules are established, it is the role of city leaders—particularly mayors, who are analogous to CEOs—to act as competent managers in adapting, ensuring safety, transforming the culture, partnering with business, attracting capital, listening to all stakeholders, and solving problems. Mayors have incredibly challenging jobs, as they must build and transform cities under tremendous amounts of public scrutiny. Mayors from 10 of America's most successful, innovative cities show that transformations can be achieved with strong mayoral leadership.

Context

Professor Paul Romer described why cities are so important to countries and societies, Niansha XU, chairman of China Poly Group, discussed the importance of investment in China's cities, and Stuart Miller, CEO of Lennar, described Lennar's experience creating a start-up city. Mayors from 10 of America's most successful, transformative cities summarized their cities' success, priorities, and challenges.

Key Takeaways

Cities are where the action is.

Professor Romer declared, "Cities are where the action is." He said this is a statement about what is happening both on the ground, as well as in people's mindshare. Cities have people's attention and most of the most important activities taking place in the world are occurring in cities. Just as "factories" became a unit of analysis in the industrial era, "cities" have become a unit of analysis in the modern era.

There are two major issues related to cities: 1) building them so that more people can live in cities; and 2) managing them. These issues are playing out differently in emerging and developed markets.

- **Emerging markets: in building cities, use of public space is critical.** A massive migration to cities is taking place in emerging markets, which could last for the next 100 years, with billions of individuals moving to cities. As new cities are built, such as amazing cities like Shenzhen in Guandong Province, it is critical to save enough public space for cities to thrive economically and to provide a satisfying quality of life. In 1811, a commission in New York City recommended allocating about 30% of the city's space to roads and sidewalks. In contrast, most cities allocate only about 5% of all space for these purposes. The decisions being made as cities are built in emerging markets will dramatically impact the quality of life for decades to come.
- **Developed countries: in managing established cities, safety is primary.** For mayors in developed markets, safety is the foundational consideration. Economic development, education, and all other civic initiatives are based on a foundation of safety. Take Detroit, for example. It is necessary to reduce the crime to turn the city around.

> "Cities are where the action is. . . . The most important issues will play out in cities."
> —Paul Romer

Cities occupy a unique position between nations and businesses.

In governing nations, legislators enact policies. Some speakers compared local city councils to legislatures, which are often policy driven and extremely political. In a city, it is necessary for the political leaders to establish the rules and provide basic infrastructure. Once the rules are set, the success of cities is about management and attracting private sector investment. It was after the rules were set for New York City in the early 1800s that private investors had greater certainty and could make long-term investment decisions. After the rules are established, it is the private sector that propels a city forward.

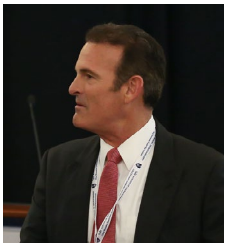
As in running a business, competent management is essential to run a city, as running a city is truly a day-to-day managerial challenge unlike any other. It is important for cities to start with a clearly developed plan. But as business leaders know, all plans are subject to change as circumstances change. City leaders must be flexible and able to adapt to unexpected, changing circumstances.

> "You can plan a city, but you don't know where it will go."
>
> —Paul Romer

Professor Romer and Lennar CEO Stuart Miller both observed that cities, like businesses, evolve through different life stages. There is a startup stage, a growth stage, and at times there are turnarounds, workouts, and bankruptcies. Miller commented that every city is different, each with its own personality, and there is no one-size-fits-all formula for a city's evolution.

Miller shared an example of an unexpected surprise related to a new city his company was involved in building in the Southwest, with about 15,000 homes. On this city's opening weekend about 28,000 people came to see and potentially buy homes. Lennar had anticipated significant diversity among the potential buyers, yet among those who showed up, around 90% were Asian Americans. Miller used this example to illustrate that running a city—whether a new or an established one—requires dealing with the unexpected and adapting, as managers must do daily.

> "Leading a city is a management process. You have to be adoptable, open minded, and flexible as the city evolves."
>
> —Stuart Miller



Stuart Miller

Mayors are like CEOs of cities—both startups and turnarounds.

Most participants agreed with the analogy of a mayor as the CEO. Like corporate CEOs, each mayor's situation will be different, based on the unique challenges faced. Mayors in new cities must focus on creating rules, long-term planning, and attracting capital and business. Mayors in challenging turnarounds must focus on articulating a clear vision, changing the culture, ensuring safety, and leveraging the city's strengths to attract business and investment.

Niansha XU

Niansha XU, chairman of China Poly Group, agreed that mayors in China have responsibilities similar to CEOs. He said that cities in China, particularly China's many new cities, are always in need of money. It is the role of mayors to attract capital, including foreign capital, and to actively work to help solve local problems, especially those of importance to businesses.

A distinct challenge faced by mayors is the number of stakeholders that make demands of mayors and the degree of public scrutiny faced. Stakeholders have wide-ranging interests, and are often extremely vocal and critical of mayors. While mayors may be innovative and may desire to take bold actions, such actions are filled with risk. Due to the public spotlight, one significant mistake can prove career ending.

Much can be learned from the experiences of some of America's most successful mayors.

This Summit welcomed successful mayors from some of America's most vibrant, transformative cities. This included the mayors from Anaheim, California; Albuquerque, New Mexico; Carmel, Indiana; St. Paul, Minnesota; Oklahoma City, Oklahoma; Nashville, Tennessee; Shreveport, Louisiana; Stamford, Connecticut; Akron, Ohio; and Irving, Texas.

Many of these mayors lead cities with high levels of safety, strong economies, and positive environments for business. Several also have been reelected for multiple terms, receiving an incredibly high amount of the vote. Important lessons shared by these mayors include:

- **Make safety the first priority.** Several mayors agreed with Professor Romer and have focused on making their cities safe.
- **Change the culture.** In cities where transformation is required, this transformation must begin with a leader who changes the culture. Tom Tait, the mayor of Anaheim, and David Martin, mayor of Stamford, both highlighted the importance of culture change.
- **Improve transparency and accountability.** In this age of public scrutiny, to satisfy citizens and attract investment, mayors are pushing for far greater transparency and accountability.
- **Engage the private sector.** In cities that are thriving economically, like Nashville and Oklahoma City, a key reason is because of the strong relationships formed between city government and business. This shouldn't be an adversarial relationship; it should be a productive, collaborative, mutually beneficial relationship.

- **Listen to all stakeholders.** These mayors described the importance of having the pulse of their communities by constantly engaging with and listening to all groups of stakeholders. Beth Van Duyne, mayor of Irving, described listening to citizens as if they were customers.
- **Think and plan long term.** While each of these mayors understands the need to be flexible and to adapt to changing circumstances, mayors also described thinking long term about the best interests of their cities. In Carmel, they are thinking 100 and even 500 years out. Oklahoma City's mayor attributes strong economic development to major capital investments made by the city, with the support of business.
- **Identify and leverage strengths.** A transformation was required in Akron as the city lost three of its four largest employers. This transformation involved taking a hard look at the city's strengths and then leveraging these strengths by attracting new companies, many from Western Europe and Israel, who could take advantage of these strengths.

Donald Plusquellic

Professor Romer observed that mayors serve in the hardest, most challenging, most difficult jobs that exist. These jobs are no longer 9 to 5; they are 24x7. He noted that as new cities are built and as existing cities transform themselves, these cities will become more competitive. And countries with more competitive cities—especially the U.S. and China—will see national benefits.

Market Transformation:
Transactions, Timing & Trust

Comments

Christopher J. Dodd, Chairman & CEO, Motion Picture Association of America
William H. Donaldson, 27th Chairman, U.S. Securities & Exchange Commission
Gregory J. Fleming, President, Investment Management, Morgan Stanley
James S. Chanos, Managing Partner, Kynkos Associates
Duncan L. Niederauer, CEO (2007-2014), NYSE Euronext
Robert Wolf, CEO, 32 Advisors
Richard C. Breeden, 24th Chairman, U.S. Securities and Exchange Commission

Respondent

Norman J. Bartczak, Professor, Columbia Business School

Overview

U.S. financial markets have gone through a period of transformation. The markets are now more democratized and liquid than ever. Transaction costs are dramatically lower and trades are executed faster. And, U.S. capital markets continue to provide access to capital for the world's most innovative companies.

However, there remains a sizeable gap between what financial leaders on Wall Street see as the many strengths and benefits of the U.S. financial system, and the perceptions of individual investors, many of whom still lack trust in the capitalistic system and in financial markets. With the attention being paid to high-frequency trading, this lack of trust extends beyond individual investors to include savvy CELI participants, a majority of whom think there "unfair edges" in trading systems.

The question is what can be done to restore market trust. More prosecutions are not the answer, nor is the answer more legislation or regulation, which adds cost and complexity. There was a general view that the SEC has tools at its disposal to help ensure fairness and restore trust, but using these tools has not been a priority for the SEC. Also, the strengths and benefits of the U.S. financial system could be better communicated to better educate the skeptical public.

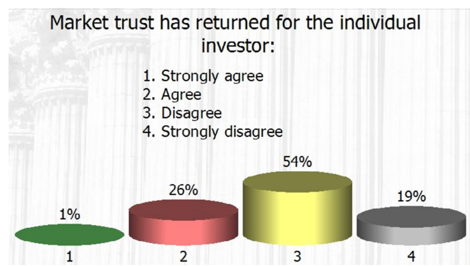
Context

Financial leaders and former policymakers examined the lack of trust in the financial markets, assessed the validity of claims that the markets are rigged, and discussed what can be done to restore trust.

Key Takeaways

Individual investors still lack trust in the markets.

CELI Summit attendees believe that Main Street does not trust Wall Street. In a real-time poll among attendees, only 27% believe that market trust has returned for individual investors, while 73% said they do not believe that trust has returned. These results are consistent with other surveys mentioned that shows lingering lack of trust among individuals.



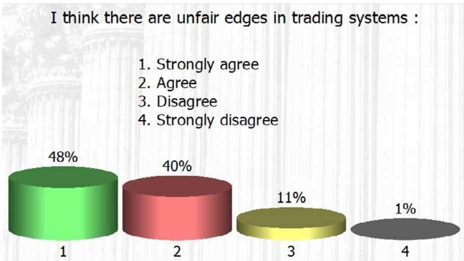
Former Senator Chris Dodd said that the public is deeply distrustful. Around 26 million people lost jobs as a result of the 2008 financial crisis and about 5 million homes were foreclosed upon. The nation lost around $13 trillion in wealth. MassMutual CEO Roger Crandall said that public distrust and skepticism about markets is deep and pre-dates the 2008 crisis. He sees it as tied to economic insecurity, which is related to stagnant household income, a growing disparity of wealth, and even the offshoring of jobs. People are distrustful of government, corporations, and all types of big institutions.


Christopher J. Dodd

Even sophisticated business leaders have concerns of "unfair edges" in high-frequency trading systems.

Beyond the lack of trust among individual investors, even many of the sophisticated business leaders who attended this CELI Summit have concerns. Among participants, 72% are concerned about HFT (high-frequency trading) in exchanges, concerns which have been stoked by Michael Lewis's recent book *Flash Boys*. While some participants expressed skepticism towards this book, terming it as fiction and claiming that Lewis's incentive is to sell books, others believe that Lewis raises legitimate concerns.

A concern raised by Lewis in this book was around "front running." The idea is that through the use of sophisticated high-speed technology, one trader of equities could have an unfair advantage over another. Brad Katsuyama, who plays a prominent role in *Flash Boys*, has argued that the financial markets are rigged. Among CELI participants, 63% do not think that the markets are rigged, but 88% believe there are "unfair advantages" in trading systems.

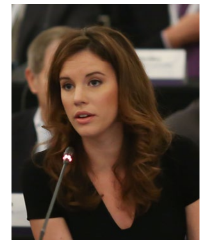


NYSE Euronext CEO Duncan Niederauer argued strongly that the equity markets are not perfect, but they are certainly not rigged. He said that SEC actions to decrease spreads and lower transaction costs resulted in faster markets with far more trades, which drove investments in new technologies to enable this high volume of super-fast trading. Other CELI participants, including Senator Dodd and several notable financial leaders, agreed that the markets are not rigged.

The key question: how to restore market trust?

Even if most political, business, and financial leaders do not believe that the markets are rigged, there was agreement that practices such as front running could undermine investor confidence. The question that was debated was "what can be done." Several responses were offered, though no clear consensus emerged. Among the ideas discussed were:

- **Increased prosecution.** There seems to be a general clamoring among the public for arrests and prosecutions. But several CELI participants said they do not see insufficient prosecutions and see a trend of criminalizing activities that were not previously illegal. Increased prosecution was not seen as the answer.
- **Increased litigation.** CELI participants already see a terribly litigious environment and perceive that the legal system is rigged against corporations. The plaintiffs' bar files litigation, knowing that most executives and directors would rather just settle than go to court. It is the exception when a CEO has the willingness and courage to actually go to court. One business leader said that her corporate legal fees are more than the payroll for her 120,000 employees. Greater litigation is definitely not a solution for restoring market trust.
- **Increased legislation and regulation.** Senator Dodd argued that both the TARP legislation and Dodd-Frank were necessary, but were extremely unpopular. It was necessary to bail out banks to avoid a calamitous meltdown and it was necessary to develop new regulations for the modern financial system. However, he acknowledged that Dodd-Frank is complex, and as with all regulation, imposes costs on business. But in the aftermath of the financial crisis and because of changes in the banking and financial systems, regulation was necessary. Even those who have issues with certain provisions of Dodd-Frank agreed with the need for systemic regulation. However, as important as these legislative and regulatory actions were, they have not restored public trust. It is also not clear that further regulations specifically focused on HFT would be helpful in addressing the problems that exist or restoring trust.
- **Adopting broad guiding principles versus imposing rules.** Robert Wolf believes that if some party were gaining an advantage by front running they would be acting unethically. But he argued that because the financial system is so dynamic, not all problems can be imposed by enacting rules. He feels that this is an instance for a principles-based solution as opposed to a rules-based solution. CNBC anchor Kelly Evans doesn't believe that a purely principles-based system would be adequate. She argued that it is naïve to assume that all parties have the same principles and would behave in the same way. She sees rules as an unfortunate necessity. Senator Dodd believes that realistically there needs to be a combination of both principles and rules.


Kelly Evans

While greater prosecution, regulation, and adoption of a principles-based system were not necessarily seen as remedies to restoring trust or addressing possible front running, two ideas for which there was general support were:

- **Greater action by the SEC.** Several participants, including new Deloitte & Touche CEO Catherine Engelbert, expressed support for the SEC playing a greater role. Mr. Niederauer said that solving the HFT issue is not up to the exchanges; the SEC will have to lead the charge. Those championing greater SEC involvement believe that the SEC already has the tools and authority; what is needed is for the SEC to make this a priority.

  Former SEC chairman Richard Breeden does see a potential role for the SEC, but reminded attendees of the extreme pressure already on the SEC from the wave of new regulations. Also, he questions the idea of "fairness." Different people have different views about what is fair. If one company invests in technology and capabilities to trade faster, is it unfair to take advantage of these capabilities? He understands that technology impacts markets and sees the need for standards, but doesn't see an easy fix.
- **Communication of benefits.** Several participants argued that America's financial markets are performing well and delivering numerous benefits. America's markets have become democratized and provide the best liquidity in the world. The speed of transactions is high and execution costs are extremely low. Since the 2008 crisis, indices are up more than 150%, which should make individual investors happy. Further, there is a strong system for innovative companies to access venture capital and access the capital markets for going public. While some Americans may have concerns about economic security, investors should be confident about the strength of the financial markets. Educating the public represents an opportunity and a step toward restoring trust.


Gregory J. Fleming

"America's financial model is the best in the world."
—Gregory J. Fleming

Entering and Exiting Risky Markets

OPENING

Kevin Rudd, 26th Prime Minister, Commonwealth of Australia

COMMENTS

Ashton B. Carter, Deputy Secretary of Defense (2011–2013), U.S. Department of Defense
Robert Hormats, Under Secretary (2009-2013), U.S. Department of State
Stephen S. Roach, Senior Fellow, Yale Jackson Institute for Global Affairs
Robert E. Diamond Jr., Former President & CEO, Barclays PLC
Catherine Engelbert, Chair & CEO-elect, Deloitte & Touche LLP
Niansha XU, Chairman, China Poly Group
Joel Myers, President, AccuWeather
Seifi Ghasemi, Chairman & CEO, Rockwood Holdings
Gerardo Lopez, President & CEO, AMC Entertainment

RESPONDENTS

Kelly Evans, Co-Anchor, *Closing Bell*, CNBC
Joel R. Reidenberg, Professor of Law, Fordham University
Nels B. Olson, Vice Chairman, Korn Ferry

Overview

China's economic progress over the past 25 years is astounding and significant political and economic reforms are under way, though the pace is slower than many anticipated. As China's economy grows, many observers see China becoming more ambitious in geopolitical terms, which is decreasing regional stability in Eastern Asia.

Some are pessimistic about China's future, believing economic growth is being propped up and will slow, with concerns about China's domestic and foreign policies. Others are more optimistic, seeing a mere bump in the massive transformation from a production economy to a consumption economy. Regardless of perspective, the world is watching how America responds to China and how the U.S./China relationship evolves. Those from China are much more optimistic about China's economy, about continuing economic and political reforms, and about the long-term relationship between China and the United States.

A key unanswered question is whether politics will trump economics or whether economics will trump politics.

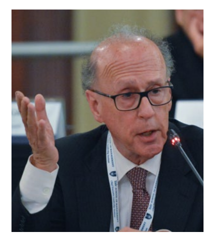
Context

Policymakers and business leaders with extensive experience in China, along with members of China's delegation at this Summit, offered their perspectives on how economic and political reforms are progressing in China, as well as the status of the U.S ./China relationship.

Key Takeaways

China is transforming economically, though more slowly than some have anticipated.

Several participants, including CNBC's Michelle Caruso-Cabrera, noted the astounding economic progress China has made in the 25 years since Tiananmen Square. In a short period, China has established a flourishing stock market, become a member of the WTO and other major international organizations, added provisions to the constitution for the protection of private property, and become a hotbed of entrepreneurial activity.


Stephen Roach

Yale's Stephen Roach, former chairman of Morgan Stanley Asia, explained that China is undertaking a huge transformational experiment of shifting from an investment and production-driven economy to a consumption economy and an economy with a far greater service sector. Roach argued that China has a clear strategy and is making progress in changing its model. This strategy includes increased urbanization and providing a greater social safety net for citizens. While economic growth may have slowed somewhat from previous levels, and while there may be some bumps in the road as this transformation takes place, Roach sees China as on course, with sustainable growth. However, he noted that as China transitions away from being a surplus savings economy – which has funded U.S. deficit spending – to an economy with savings absorption, there will be implications for the United States.

Several others, such as former Australian Prime Minister Kevin Rudd and noted investor and China sceptic Jim Chenos, were far less positive about China's economic progress. Rudd commended China's reform plan, but sees China's financial and economic reforms being implemented at a much slower rate than was anticipated. He believes economic growth is being artificially propped up by fiscal stimulus and commented that implementing agencies are frustrated. He also has concerns about China's domestic policies. These concerns are related to the unprecedented consolidation of power by Xu Jinping and possible repercussions from the anti-corruption campaign under way. Chenos believes stocks of Chinese companies have dramatically underperformed and sees a bubble in residential real estate, as millions more condos have been built than are needed.

There are rising concerns about regional security in Eastern Asia.

Both Mr. Rudd and former Deputy Secretary of Defense Ashton Carter believe that the relationship between China and the U.S. has declined over the past year. Mr. Carter explained that the economic success of Japan, South Korea, China, and India was made possible because of peace and stability in Asia, which stemmed from U.S. military power in the region.

But there is a growing sense in China that "now is our time." Increasingly China wants to exert more power and call the shots, and is more overtly contesting things. The result is a decrease in the stability in the region and growing concerns. Mr. Rudd said that regional security is in the worst state since the Vietnam War. Issues in the region include tensions between China and Japan, the situation with North Korea, a situation between China and the Philippines that has gone from bad to worse, and a situation between China and Vietnam that has gone from good to bad. A former American government official sees these hotspots as highly emotional subjects that will be hard to resolve.

Both Rudd and Carter are more worried about the region than they have been in some time, a view shared by several others in attendance. However, Mr. Rudd believes that China wants 20 years of regional peace and security, as a lack of stability could undermine continued economic development.


Ashton Carter

The world is watching how the U.S. acts toward China.

Mr. Rudd commented that with China increasingly asserting itself on the global stage, the entire world is looking to the U.S. for optimism, which at times seems lacking. Former Under Secretary of State Robert Hormats explained that there is a big difference between power and effective leadership. The U.S. clearly still has tremendous power. But leadership comes from consistency and staying power, and the U.S. is often not consistent. Domestic issues, the stagnant economy, and distrust of the government by many Americans is hurting U.S. credibility externally. Mr. Rudd believes that the U.S. too often talks down about itself and sees the glass as half empty. He believes the U.S. should be more confident and optimistic.


Kevin Rudd

"The world needs American optimism and leadership."
—Kevin Rudd

Those from China are far more optimistic.

The leaders of the delegation from China were far more optimistic about China's economy, China's reforms, and the long-term relationship between China and the United States. These individuals believe that a deeper understanding of China is needed by American business leaders and government officials, but they see that understanding growing. They see significant opportunities in China for U.S. and international businesses, encouraged business leaders to come to and invest in China (particularly Guangdong Province), and believe the business relationship between China and the U.S. will continue to improve.

Mr. Hormats said that historically, even during times of political tensions the economic relationship has grown, and he expects it to continue to do so.


Zhiwei LIU

Other Important Points

In addition to the main threads described above, other topics mentioned by participants included:

- **Government competence.** Mr. Carter is concerned about the lack of managerial competence among those who work in government. The government's response to Hurricane Katrina, the healthcare website, and management of the VA are all examples of spectacular failures. With enormous needs in areas such as infrastructure and education, lack of public confidence in managerial competence will result in lack of support for any government initiatives.
- **Nationalism.** In the view of Robert Hormats, a consequence of domestic issues in the U.S., waning U.S. credibility across the globe, and lack of consistency in foreign policy is rising nationalism in many countries.
- **Censorship.** In discussing censorship in China and elsewhere a key distinction was made: in the U.S. and other free markets, companies or groups may decide on censorship for commercial or possibly religious reasons. In China, censorship is driven by the government, not the market, which is very different.
- **Intellectual property.** When thinking about business in China, IP and cybersecurity continue to be major concerns of U.S. companies. However, there is a general perception that IP theft is improving, albeit slowly, as Chinese companies become increasingly interested in protecting their own IP.

Setting the Activists' Stopwatch: Market Patience for Risk, Timing and Invention *and* Time for Turnarounds and Transformation: The Internal Activists

COMMENTS

Kenneth C. Frazier, Chairman, President & CEO, Merck & Co.
Roger W. Crandall, Chairman, President & CEO, MassMutual
Joseph Papa, Chairman & CEO, Perrigo
Steve Papa, Founder, Endeca
Alfred Z. Spector, Chief Science Officer, Google
Thomas Quinlan, CEO, RR Donnelley & Sons
Jeffrey Yordon, Chairman & CEO, Sagent Pharmaceuticals
Tim Zagat, Founder, Zagat Survey
Nina Zagat, Co-Founder, Zagat Survey
Frank Blake, CEO, The Home Depot
Andrew N. Liveris, Chairman & CEO, The Dow Chemical Company
Myron E. Ullman, CEO, JC Penney Company
Margaret C. Whitman, President & CEO, HP
Farooq Kathwari, Chairman & CEO, Ethan Allen Interiors
Chris Galvin, Former CEO, Motorola
Robert S. Miller, Chairman, American International Group
Lynn Tilton, CEO, Patriarch Partners
Rory P. Read, President & CEO, AMD
Ralph V. Whitworth, Principal, Relational Investors

RESPONDENTS

Ravi Dhar, Professor, Yale School of Management
Melanie Kusin, Vice Chairman, Korn Ferry
David Miller, Professor, Princeton School of Theology
Saul J. Berman, Partner & Vice President, IBM Global Business Services

Overview

Businesses that don't transform themselves will die. Yet many companies and boards are content to continue doing things the same old way. Activist investors take action when they see an inflection point, believe a company could perform far better, and see transformation as essential. Companies can preempt this by acting as an "internal activist." Such companies engage in constant innovation, invention, and transformation to create long-term value.

Companies that have transformed themselves use their capital wisely to deliver the best returns. They transform their cultures to engage employees, put incentives in place to change behaviors, and sustain relationships with current customers while attracting new ones. Those who lead transformations have passion, thrive on pressure, have the courage to make bold bets, convey confidence to employees and investors, and make operating decisions with discipline.

Context

After focusing on the transformation of cities, financial markets, and the transformation in China, CELI participants examined why and how companies transform themselves.

Key Takeaways

At times business transformations are driven by external investors.

A general perception of activist investors is that they are antagonists focused on short-term returns. They purchase a stake in a company, often replace the CEO, and then engage in financial engineering, such as cutting R&D and forgoing capital investments, to boost profits.

This was largely the story at JC Penny where an activist investor thought the company should make radical changes and induced distress. This investor brought in a new CEO who proved to be disastrous. Under this CEO the company targeted a new group of customers and neglected its established customers, tried new product assortment and merchandising strategies, and engaged in some financial engineering. Tremendous market value was destroyed and the company teetered on the brink of survival. Former CEO Mike Ullman has returned to JC Penny and restored financial stability. The company has a good team in place, loyal customers, and is focused on rebuilding the basic building blocks that drive success.

Ralph Whitworth

In contrast to this antagonistic activist investor is Ralph Whitworth of Relational Investors. Whitworth is seen as ambassadorial. His decision to invest in a company and take a seat on a board is usually welcomed with open arms. At Home Depot, Whitworth helped the company rethink its business model by moving away from constantly building new stores to operating existing stores more efficiently. At HP, Whitworth has worked with CEO Meg Whitman to get the company's cost structure in line with revenues and with competition, while pouring investment into new growth opportunities, such as cloud, business analytics, security, servers, and printers.

Whitworth sees multiple successful models for investors. A common theme where Whitworth has been involved is companies that are at an inflection point in their growth trajectory, where the board has not read the situation and reacted. Often Whitworth has seen boards and companies continue to do more of what they have been doing, without confronting reality. As industries mature, companies often pay more for less attractive assets. Home Depot provides an example: the company had doubled its revenue but was earning less than its cost of capital.

Among activist investors what differentiates Whitworth and his partner David Batchelder is that they have deep operational experience and have served in multiple capacities on multiple boards. They understand the importance of leaders who can change a company's culture and engage employees in a turnaround. They know that decision cycles in large companies take time, which many investors are not sensitive to, and that execution is hard. Those who have worked with Whitworth sing his praises for his approach and credibility with other investors.

Some companies preempt external investors by acting as internal activists.

Andrew Liveris

No companies or leaders want to be cajoled and pressured by an external investor. Andrew Liveris, CEO of Dow Chemical, constantly thinks and behaves as an "internal activist." This means constantly creating long-term value through innovation and reinvention to stay in front of commoditization and cannibalization. It means making long-term investments in R&D and facilities, and attracting investors who are attracted to this value-creation story, and aren't focused on the value created this minute or this quarter.

Merck CEO Kenneth Frazier also aspires to attract investors who understand the industry and the company's business, and want to stick with Merck long term. The lifecycle for a new pharmaceutical product is 15 years, the number of new life science ideas that become commercial successes is very low, and over the past decade the entire industry has not returned its cost of capital, as it had for the previous three decades. The key for Merck is breakthrough scientific inventions that can improve health outcomes and create tremendous value for society and investors. This requires engaging in constant invention and selecting the right inventions to fund.

Rory Read, CEO of AMD, said that companies have to face reality and understand the changes that are taking place. In the short term, they must sustain their current operations to provide the cash flow the company needs while transforming the company to "catch the next wave." Companies that become too content and aren't motivated by either external forces or internal pressures will miss this next wave.

Successful transformations have several common themes.

Investors and business leaders who have participated in successful transformations and turnarounds observed that the following elements are typically present:

- **The right leader.** A transformation requires a leader who can articulate a clear vision to employees and investors, and change the culture. Ralph Whitworth observed that under Meg Whitman's leadership employee engagement scores at HP have improved dramatically and the culture has changed, which is the direct result of her leadership.
- **A good team.** Steve Miller, currently the Chairman of AIG and a veteran of numerous turnarounds, goes into a turnaround by himself, without a handpicked team of outsiders. When he arrives at a distressed company, he typically finds a good team of dedicated, loyal, entrepreneurial people.
- **Proper incentives.** In Whitworth's experience, change within companies comes from leadership and economic incentives. He said it may not be possible to herd cats, but it is possible to move their food. Shifting economic incentives is a powerful way to get people to understand and accept change.
- **Constant innovation.** Investor Jim Chanos said that investors look through financial engineering. They want to see where growth will come from. Lynn Tilton, who has purchased and turned around hundreds of companies, sees innovation as the lifeblood of a turnaround and of sustaining success.
- **Leverage existing capabilities in new ways.** Snap-on Inc. CEO Nicholas Pinchuk explained how Snap-on rethought its business. It has transformed itself from being a maker of wrenches for auto mechanics to a provider of tools to solve mission-critical problems. Without restarting or needing to turn itself around, Snap-on has transformed itself by leveraging its existing equity in new markets, with new customers, in new ways.
- **Retain existing customers.** Mark Penn, now at Microsoft, has seen both successful and failed turnarounds. He believes a key element of a successful transformation is when a company enters a new market without leaving behind its old customers. He mentioned how Microsoft has evolved from PCs to the Internet, and from the Internet to mobile and the cloud. At each juncture, Microsoft retained its current customers while evolving and moving to the future.

Leaders of successful transformations demonstrate many similar characteristics.

In addition to the businesses that have been transformed exhibiting common elements, those who have led transformations have shown similar leadership characteristics. These have included:

- **Confronting reality.** Successful turnarounds and transformations are led by people who have a firm grip on the current realities facing the industry and their company. They understand their customers, their employees, their investors, and the challenges they face. All actions are based on this clear understanding of reality.
- **Demonstrating passion.** Lynn Tilton cautioned that any transformation or turnaround is incredibly difficult and is not for the faint of heart. Those who lead such undertakings must have passion and be motivated by love. In her case, her motivation is to preserve jobs and the American dream for her 120,000 employees and their families.
- **Thriving under pressure.** Meg Whitman said that the pressure of a turnaround is unrelenting and the work is never done. To succeed in such an environment a leader must thrive under constant pressure.
- **Exhibiting courage.** Rory Read said that being willing to disrupt the status quo and engage in change takes courage. This courage is about simultaneously balancing and executing the existing business while focusing on the future and attempting to catch the next wave.


Lynn Tilton

- **Operating with discipline.** Ralph Whitworth expressed concern about leaders making bold bets based on courage. He sees the key characteristic in turnarounds as making decisions based on discipline. The discipline he looks for is allocating capital in the best ways. He looks for concrete stories and good ideas around value creation.
- **Leading with confidence.** Several participants described the need for making decisions based on confidence, and demonstrating confidence to employees and shareholders. Without confidence, leaders engage employees in pursuing their vision.

Legend in Leadership Award
Duncan L. Niederauer, Chief Executive Officer, NYSE Euronext

PRESENTER
William H. Donaldson, 27th Chairman, U.S. Securities & Exchange Commission

In presenting the Legend in Leadership Award, Jeff Sonnenfeld and William Donaldson reflected on the state of the New York Stock Exchange when Duncan Niederauer took the helm in 2007. At the time, the NYSE was an old institution, in rapidly changing circumstances, with a dated brand, and without adequate investments in technology.

Under Niederauer's leadership the NYSE transformed its market model, diversified its revenue streams, invested in new technology, modernized the trading floor, repositioned its brand, flattened its organizational structure, and strengthened its culture.

The NYSE has transformed itself from a public utility to a public company. It also has been part of successful mergers and has persevered through unprecedented crises, including the once-in-a-lifetime financial crisis—for which there was no playbook—as well as the flash crash, Hurricane Sandy, and a thwarted hostile takeover. Throughout these crises, Niederauer demonstrated leadership by being accessible to and honest with the media. Despite very difficult, rapidly changing conditions, NYSE Euronext has returned to global leadership in listings and the amount of capital raised, and is now the home for about 70% of technology IPOs, up from around 15% at the beginning of Niederauer's term.

Mr. Niederauer said he is most proud of following his mentor John Whitehead's words by managing down, not up, and leaving the NYSE better than he found it. Niederauer sees himself as the embodiment of the American dream; only in America can the son of an immigrant can become the CEO of an organization such as the NYSE.

William Donaldson presenting Duncan Niederauer the Legend in Leadership Award.

Legend in Leadership Award
Frank Blake, Chief Executive Officer, The Home Depot

PRESENTERS

Andrew N. Liveris, Chairman & CEO, The Dow Chemical Company
Myron E. Ullman, CEO, JC Penney Company

In presenting the Legend in Leadership Award, Professor Sonnenfeld, Andrew Liveris, and Mike Ullman recognized Frank Blake for having revived, rebuilt, extended, and transformed The Home Depot, one of America's most iconic companies.

Mr. Ullman described how Mr. Blake is a lawyer who previously clerked for a Supreme Court justice and served as the general counsel for the Environmental Protection Agency, as deputy counsel to Vice President George Bush, and as deputy secretary at the U.S. Department of Energy. For several years he was the general counsel for General Electric, before running different G.E. businesses.

Blake became the CEO of The Home Depot at a very difficult time for the company. He spent time with other leaders in the retail industry to learn about retail, and went about uniting the team at The Home Depot. He has changed the culture at the company, has reinvigorated the company and restored confidence, and through his actions the company's stock price has experienced tremendous growth.

He leads with a sense of purpose and demonstrates deep caring for customers, employees, owners, and the community. Andrew Liveris described Mr. Blake as "a real guy" who has transformed and reset The Home Depot. Mike Ullman termed Mr. Blake "a standout leader in the retail industry who is inspirational to other leaders."

Mike Ullman and Andrew Liveris presenting Frank Blake the Legend in Leadership Award.