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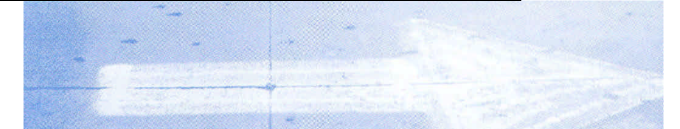
TIME TO MOVE AHEAD

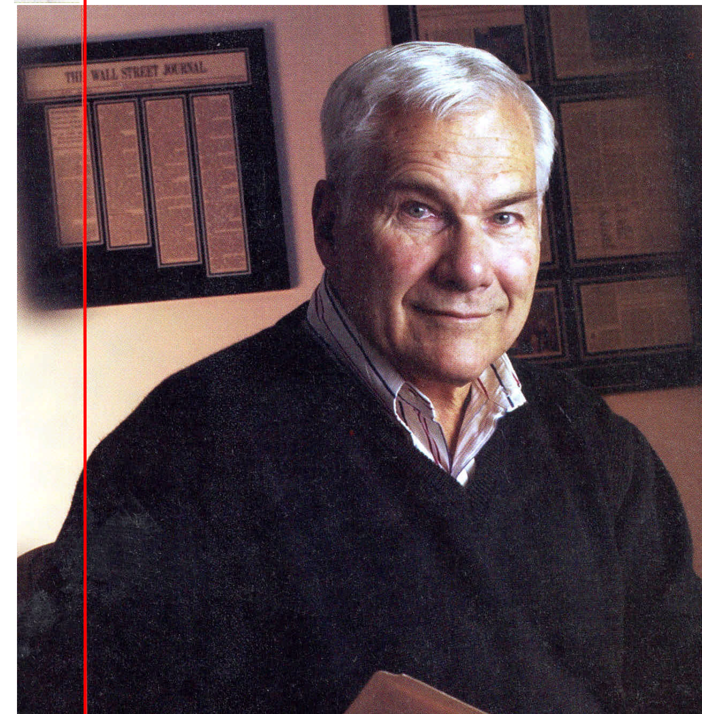
PRESIDENT BUSH, NEW YORK'S MAYOR GIULIANI, AND OTHERS HAVE URGED US ALL TO RETURN TO NORMAL. BUT EVEN AFTER THE PASSAGE OF A WHOLE SEASON, IT STILL SEEMS AS THOUGH NORMAL NO LONGER EXISTS. THERE CERTAINLY ISN'T A BENCHMARK AGAINST WHICH ANY OF US CAN MEASURE OUR PROGRESS TOWARD NORMALCY IN THE STARK NEW WORLD.

WHAT EVERYBODY CAN DO, OF COURSE, IS MOVE AHEAD, AND WE HOPE THE STORIES ON THESE PAGES WILL HELP BOARD MEMBERS PICK UP THE PIECES, THINK DIFFERENTLY, AND LEARN NEW WAYS OF DOING THINGS. ALL OF WHICH, COME TO THINK OF IT, ISN'T SO FAR FROM NORMAL AFTER ALL.

Back to Business, but Differently

As they struggle to help their companies regain normalcy, board members are facing a whole new set of problems, including cash flow. Here's how to think about some of them.





CORPORATIONS THAT BACK OFF ON THEIR R&D SPENDING "MIGHT BE CONSUMING THEIR SEED CORN AND DIGGING THEMSELVES A GRAVE."

STEVE LAZARUS
AMGEN BOARD MEMBERS

Even before the terrorist attacks, company directors found themselves under siege. The capital markets had turned cold, a recession loomed, top executives were complaining about suddenly worthless stock-options packages, and angry shareholders looking for someone to blame were hiring lawyers to help them settle scores. The events of September 11 exacerbated all that. "What's going on, in the economy and internationally, presents a set of conditions which, to say the least, are extraordinarily challenging." Says Steve Lazarus, the managing director of Arch Venture Partners and a director of biotech giant Amgen Inc. and health-care services from First Consulting Group Inc. "An enormous amount of confidence has left the marketplace, and corporations, which are judged by their share price, face a long struggle."

No one need explain that to venture capitalist Betsy Atkins. She joined the board of Lucent Technologies Inc. in April 2000, when the company's stock was trading in the $60's. Those shares were recently changing hands for a little more than $6. In the course of this steep slide, Atkins has had to help oversee the firings of Lucent CEO Richard McGinn and CEO Deborah C. Hopkins; the layoffs of approximately 40,000 workers; write-downs totaling more than $7 billion; the sale or spin-off of once-promising corporate assets, including enterprise-networks unit Avaya Inc. and micro-electronics business Agere Systems Inc.; the suspension of dividends on Lucent's common stock; and the shedding of the company's private golf club in Somerset County, New Jersey. Today the Lucent board continues to wrestle with a class-action lawsuit filed by employees who claim that managers of the company's pension plan breached their fiduciary duty by investing some of the plan's assets in tumbling Lucent shares. The board is also searching for a permanent CEO to replace Henry Schacht, who was brought out of retirement and back into the job after McGinn's dismissal.

Who said being a director was easy? Not Atkins. "It's a very hard job," she conceded. "The only way to respond to crisis, in my experience, is with hard work." The president of Baja Corp., an early-stage venture capital firm based in Coral Gables, Florida, Atkins has more hard work in front of her as director of Polycom Inc., which makes videoconferencing hardware and software. Its stock has also fallen precipitously over the past two years, although the company's videoconferencing business, as an alternative to air travel, could prove to be a beneficiary of the terrorism.

While Lucent and Polycom may have been battered more than most, directors everywhere are grappling with comparable problems. In the area of corporate strategy, for example, boards are shifting their attention from growth to their companies long-term health and ability to weather a protracted recession. As for the threat of class-action lawsuits, "a lot of law gets made when the markets and the economy are down," says attorney **Roger E. Barton** of **Barton Barton & Plotkin LLP** in New York City. "Shareholders and others are looking at situations where what they bargained

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BETSY ATKINS
LUCENT DIRECTOR

for is not as much as what they got. In looking for a place to lay off some of the blame, they'll consider the actions of directors much more carefully than they would in the good times when everybody is making money."

Buffered by a slumping stock market and a slowing economy, many directors see their main challenge as simply steering corporate ships through the storm. Warren Batts 69, a seasoned director who serves on the boards of Sprint Corp., Cooper Industries Inc., and Allstate Corp., says this means keeping closer tabs on cash flow and capital spending and paying more attention to the quality of the balance sheet.

"In the past we'd been sailing along without those issues being a major concern, because the credit market was very vibrant and our own cash flows were vibrant - we had healthy businesses," says Batts, the retired chairman of Premark International Inc. (now part of Illinois Tool Works Inc.) and also the former chairman and CEO of Tupperware Corp. "Now we've got to make sure we don't run into the old credit-crunch cliff that brings companies to their knees."

Ensuring adequate cash flow typically begins with cash conservation, since issuing stock would only net fire-sale prices and issuing debt would bring on new interest expense. Cash-saving measures aren't especially palatable either, but often they're straightforward : eliminate non-essential expenditures, pare inventories, speed the collection of receivables, reduce the workforce if necessary, and perhaps sell assets. The trick, of course, is to avoid cutting so deeply that it damages a company's long-term viability - especially a company whose fortunes are tied to fast-changing technology.

"If corporations that are reliant on technology back off on their research - and - development spending and simply sit on their hands, they may enjoy a somewhat strengthened cash flow at the moment," says Lazarus. "But they might be consuming their seed corn for the future and digging themselves a grave." Adds attorney Gabor Garai, managing partner of the Boston office of Epstein Becher & Green PC., "The issue isn't one of merely hoarding cash, but of figuring out how you can use cash in a way that maximizes shareholder returns." At Amgen, the value of the company's stock fell from a closing high of $78 in July 2000 to below $60 by early October 2001. Nonetheless, Lazarus and other directors have supported Amgen's resolve to continue investing in R & D. The company says its R & D expenditures for 2001 were 25% to 27% of sales, in line with what it spent in each of the two preceding years. In late October Amgen declined to discuss its planned R & D spending for 2002, something it typically announces in November.

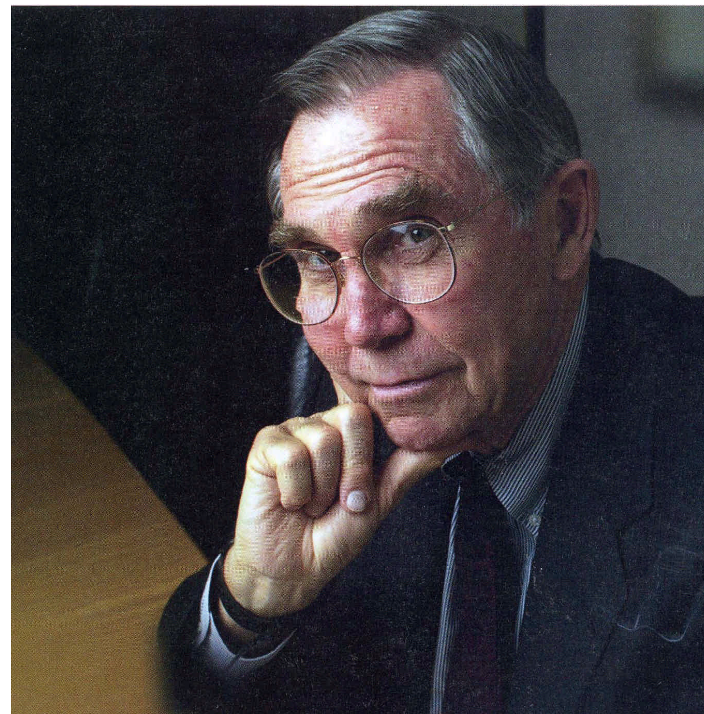
If cash conservation alone won't keep a company afloat, the directors may have to tap the capital markets in ways they'd ordinarily shun. Lucent, in dire straits last summer, chose to issue nearly $1.9 billion of convertible preferred stock that throws off an annual dividend of 8% and can be converted into Lucent common at a 22% premium over its closing price of $6.13 on August 1. An illustration of how expensive that financing was: Long-term investment-grade bonds are currently yielding only about 7%, and offer no conversion privileges. Nonetheless, CEO Henry Schacht said after the offering that the proceeds, combined with cash-conservation measures, had left Lucent with more than enough cash on hand - over $6 billion - to cover its near-term requirements. Lucent hopes to use only $3.2 billion to $3.5 billion of that reserve before returning to positive cash flow and profitability in 2003, he said, but given the uncertainty of the times, the company wanted to make sure it had "belts, suspenders, parachutes, and skyhooks" in place to tide it over.

For some directors, the biggest decision of the coming year will center not on staving off a cash shortage but on figuring out whether to defend their companies' independence. As *Corporate Board Member* reported in the cover story of the Autumn 2001 issue ("Going Private," www.boardmember.com/issues/2001_4/), private equity firms are likely to start circling around outfits whose stock has taken a beating, and acquisitive corporations with cash in their pockets may join the shopping spree. In October, for example, SunGard Data Systems Inc. agreed to pay $825 million to acquire the computer services unit of Comdisco Inc. SunGard has nearly $600 million in cash and short-term investments, and virtually no long term debt. Comdisco is struggling and operating under Chapter 11 bankruptcy protection.

In the meantime, companies with weakened stock remain in play. Cooper Industries rejected a cash and stock offer from rival toolmaker Danaher Corp. last summer, for instance, but rather than try to salvage its independence, it invited other bids in the hope of getting a better price. As Garai points out, directors must be prepared to consider every possible means of maximizing shareholders value. "The fundamental business challenge directors have is to represent the interests of shareholders," he says. "And to do that requires looking at all the strategic alternatives available to the company, at all times, in a very in-depth way."

For a while, stock buybacks were viewed as a smart method of boosting shareholder value, especially when a company's stock price had fallen into the bargain basement. As an alternative to spending company money on dividends, they do offer tax advantages to shareholders. Even so , 2002 may not be the year for buybacks. "In today's world, cash is king for most companies," Garai says, noting that few outfits have so much of the stuff that they can afford to use some of it to buy their own stock.

Besides, a buyback can invite shareholder suits. Corporate watchdog Neil Minow warns that managers may have a personal interest in promoting a stock buyback if they're holding options that would benefit from an increased share price, one of a buyback's objectives. "Directors should put the burden of proof on management to explain why a stock buyback is a better use of the company's capital than, say, R & D or an acquisition," says Minow, who edits the Corporate Library (www.the corporate library.com), a



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website on corporate governance. "They want to make sure this is a decision based on a thorough review of all the alternatives, and not one undertaken out of desperation or a lack of other ideas."

If anything in the year ahead proves more controversial than a stock buyback, it may be repricing stock options held by top executives and other key managers. Because of the market's decline, many of those options are deep underwater : their exercise price is above the market price of the stock.

Institutional shareholders and other critics fault repricing on several counts. For one thing, new rules set by the Financial Accounting Standards Board stipulate that in some cases, companies must take a charge against earnings equal to the difference between the values of the new options and the old ones. This expense weakens a company's bottom line and, by rewarding management for presiding over weakening shares, is likely to invite shareholder protest and litigation. More serious, especially in these times, repricing sends a worrisome signal about a company's prospects. "What you're in essence telling your shareholders," says attorney **RogerBarton**, "is that from now through the next three or four or five years, managers don't expect the stock to increase to the exercise price."

Repricing still has boardroom fans, however. "I truly hate to reprice options," Lazarus says. "But if I were dealing with one of the fledgling companies in our venture portfolio and we needed to reprice in order to incent people to stay with the start-up company, we would do it."

Sometimes, agrees Garai, repricing is the only way to hang on to your talent. Other times it's not. "If all your competitors are doing it, you may be able to get away with it," Garai says. "If they're not, then you probably don't need to do it, because your people aren't going to be leaving for greener pastures; they're going to be worried about keeping the jobs they have."

Whatever they decide, directors should brace themselves for more than the usual scrutiny in the year ahead. Directors who vote to issue stock while the market is depressed - or to approve a management-led buyout of the company - face possible repercussions from shareholders if the market rebounds sharply thereafter. Yet directors who veto such measures, only to see the company flounder, also stand to take heat from disappointed shareholders.

In recent moments, Lucent's board has seen all this and more. Atkins keeps her balance by sticking to a basic strategy, and advises other directors to do the same. "You have to keep in mind that as a director, your job is to increase the value of the company to shareholders," she says. "Never lose sight of that. If you make all your decisions based on what's going to build a strong company long term - even when it's a difficult decision, and even though there may be some challenging questions or even threats of a lawsuit - you're doing the right thing. You have to be passionate about having the courage to do the right thing."

And be sure your opinion makes it into the board's minutes.

FOUR THINGS TO DO WHEN THE GOING GETS TOUGH

• Spend more time on the job. "Avoid the temptation to distance yourself from what's going on inside the company." Says attorney Gabor Garai. People are not generally good at digging in during times of trouble because it's not fun, it's depressing. But it is often what distinguishes a successful board from a less successful one. Consider spending two or three days a month at the company, just walking around and talking to people of all levels. You'll get an accurate granular feel of what's really going on. It's a lot better way to spend your time than showing up in court a year and a half later, when you've been sued."

• Make sure your board's skills are diversified. Venture capitalist Steve Lazarus says a board is derelict in its duty if it doesn't assemble a group of directors who can bring different strengths and experiences to bear on strategic decisions and can, if necessary, steer the company through a crisis. Boards also need to make sure that the directors'outside interests don't compromise their fiduciary duty, says attorney **Roger Barton**: "This is especially true as a company shifts toward insolvency and the fiduciary duties shift from the shareholders to the creditors."

• Improve communications and investor relations. "Shareholder complaints that directors didn't give them enough information and didn't give it to them soon enough are always the basis for shareholder lawsuits," says corporate watchdog Neil Minow. "For that reason, the big burden is on the audit committee to make sure the company discloses material news on a timely basis and with a lot of candor." Most boards, Minow adds, have yet to ensure that their companies are taking full advantage of the internet as a communications medium and investor relations tool.

• Reassess management. "In a declining economy, which usually has a declining stock market associated with it, some of management's shortcomings may show up a little more clearly," says Ken West, senior consultant for corporate governance at TIAA-CREF, which provides benefit plans to nonprofit and education-related employers. "This is when the board might be able to see that it's been a little too tolerant, and consider a change in leadership."