The Small Investor’s Best Friend

Welcome to “Profiles in Investing”, brought to you by The Bottom Line and The Heilbrunn Center for Graham & Dodd Investing. Every week we will profile a leading investor and get an inside look into their investment philosophy. In a slight departure from the norm we interview one of leader of the retail investor.

Up next, Arthur Levitt.

Professional History
• 25th Chairman of the SEC
• Owner, Roll Call, a newspaper that covers Capitol Hill
• Chairman of the New York City Economic Development Corporation
• Chairman of the American Stock Exchange
• Graduated Phi Beta Kappa from Williams College and served two years in the Air Force
• Currently: 
  o Senior advisor to the Carlyle Group
  o Board of Neuberger Berman
  o Board of Bloomberg

ER: You’ve been called the small investor’s best friend. Can you comment on how you came into that role?
AL: I had an agenda when I came to the Commission. I felt our markets work best when they enjoy public confidence. The heart of that confidence is the individual investor. The SEC’s role as the custodian of the capital markets involves its oversight of the interests of the individual investor. I thought that in recent years, in a strongly deregulated political environment, the rights of individual investors were being eclipsed by both institutional and corporate commitments on the part of policy makers. So, I made the decision that every Commission initiative, every rule making proposal, every response, would be viewed in terms of how it played out for the retail investor.

ER: What led you to this viewpoint regarding the primacy of the retail investor?
AL: Part of it was my own background as a retail broker working with individual clients. Part of it was my family experience; from my mother a long time school teacher who was deeply interested in her pension options. And from my father, who was the sole custodian of what was then the largest pension in the United States—the New York State Commission bringing enforcement cases against companies or individuals who game the system will we be able to avoid the drift towards numbers that are hopes rather than research on firms for which they serve as investment bankers, will be responsive to many of the conflicts we have today.

ER: On the other side of the research equation, the media

AL: I can well imagine a small investor getting an inside look into corporate America, its accounting and legal community, stock exchanges—but only by recognizing the primacy of the individual investor can, in my judgment, the interests of the capital markets be best served. I thought that in recent years, in a strongly deregulated political environment, the rights of individual investors were being eclipsed by both institutional and corporate commitments on the part of policy makers. So, I made the decision that every Commission initiative, every rule making proposal, every response, would be viewed in terms of how it played out for the retail investor.

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AL: Not really. FD is such a popular initiative and is now part of the fabric of security laws. It is very difficult for me to see any regulator, at the federal or local level, endeavoring to compromise it.

ER: What issues do you see the SEC tackling in the future?
AL: I’m not sure; you have to ask them that question. Clearly, they are going to place great emphasis on shareholder rights, probably voting rights. Market structure, is going to be another issue, and finally, making use of their additional budget—to beef up enforcement and to expand their investor education programs.

AL: Is there something you regret not accomplishing while you were at the SEC?
AL: No, I don’t think regulation can address a practice such as that. Embarrassment and humiliation is the best way to get at that practice, and creating the kind of board and audit oversight that discourages such practices.

ER: Do you have any concerns that FD may be overturned by future leaders at the SEC?

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AL: Is there something you regret not accomplishing while you were at the SEC?
AL: Yes. I think there are always things that you wish you could have done better. I wish I had carried the initiative to expense stock option to a better conclusion than I did—that was when I decided not to risk having the FASB being overruled by Congress in an initiative that I should have supported. And I regret that our settlement with the accountants at the end of my term did not go further.

ER: Is there something you regret not accomplishing while you were at the SEC?
AL: No, I don’t think so. It would have been very difficult. But, on further reflection, I might have been better off having failed in that effort than succeeding in a more moderate proposal. However, with the ban on consulting and the accounting oversight board brought about by Sarbanes-Oxley, investors are well served.

ER: What is your thoughts on Sarbanes-Oxley? Has it gone far enough?
AL: The two areas of Sarbanes-Oxley that I regard to be the most important are the independent funding of the FASB and the creation of the public company accounting oversight committee. However, I don’t think we will really have an appraisal of the effectiveness of Sarbanes-Oxley until we have another bull market.

ER: What actions can be taken right now to restore investor confidence in the market place?
AL: Sending corporate miscreants to jail and a comprehensive investigation of mutual fund practices.

ER: Moving on to a different topic. You recently participated in the launch of Columbia Business School’s new ethics program. What role should academic institutions play in shaping the moral compass of business leaders?

AL: Academic institutions can create a forum, but can do little to change the moral compass of future business leaders. By highlighting the excesses of the ’90s as well as the consequent deterioration of the ethical values, academic
Making a Difference with Yogurt

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ership, they will not have a majority of control. Because I’ve negotiated a majority of board seats, I will maintain control. We created this relationship to make sure that Stonyfield gets to know them as a company and to ensure that we can pull out if we don’t like how the relationship is developing. I have to tell you that over the past two years, it’s been better than I though it was going to be. In terms of the autonomy they’ve given me and the synergistic benefits of working with them. They are very eager and working hard to learn everything they can about organics.

My view is that things is that we don’t have time to mess around as a society and as a species. We are facing some very big challenges; the current Administration’s belief to focus on alternatives means that we’ll be out of them pretty soon. Their lack of love with oil and lack of focus on the environmental aspect of the fossil fuel isn’t as well as the social and political costs of this means that we have a lot less time than we think to make meaningful changes that will reverse the climate. We are losing the power of Danon to reach all over the world is very exciting.

BK: Lately, organics seem to be very popular with certain demographics. The Greenmarkets in New York, which sell many organic products, have been a huge success, and businesses like Whole Foods have taken off. Do you think demand for organics is a fad?

GH: Well, you know a lot of people say that organic isn’t proven. I like to say that actually the chemicals aren’t proven. We have an immense amount of data coming through the pipelines that show the health effects of our diet. It’s really been since World War II that we have stopped eating organic foods. Every world leader in history, Julius Caesar, Charlemagne, George Washington, and Harry Truman all grew up on organic foods. This generation has been consuming vast amounts of chemicals. Studies have shown that people on conventional diets have urine that contains nine times the pesticide levels of kids who have been on organic diets—far beyond EPA standards for safety.

Is it a fad? I guess it’s a fad in the same way that being alive and healthy is a fad. I think it’s going to be around for a while. I think increasing numbers of people are coming to organics for peace of mind and health. People want to live quality and healthful lives. We all know something is wrong out there, and we know that something has to be done differently. The trends are clear: more and more medical professionals are sending people in the direction of organics.

Organic is no longer just about Whole Foods. You can find organics in every single retailer in America, and you can bet that’s not because retailers have had a religious experience where they realize this is the right thing for the world. They’re doing it because it’s good for their bottom line. People want to realize that we have the power, our voting—our purchasing can reshape anything that’s out there. The biggest learning for me at Stonyfield is the immense power that consumers have to dictate what goes on the shelf. People need to realize the power they have and use it. We live in this world where we get up to sleep. The click of the television is a very dangerous thing, because you get the impression that you are the customer and that you don’t have any power to shape what’s on. In fact, you have the power to determine the sponsor’s success, and you can change the entire game.

Let’s forget about the language of socially responsible business. Let’s talk about keeping your stock price up. Let’s talk about return on assets or investments. I don’t have to talk in social terms; I don’t have to talk about climate change. All I have to do is high prices on a little bit will make you more money. Period. End of story.

Are we looking for a way to talk about something else?

BK: What kind role does brand play in the organic market?

GH: It’s important. Will organic at some point become so commoditized that there will be private-label products? Absolutely. That will be a great day. You won’t see me crying over that. One of the problems with organics is that it comes at a little bit of a high price that a little bit out of the reach of the average consumer on a budget.

So, I welcome that day. In fact, I’d like somebody’s private label yogurt right this second.

BK: How did you build Stonyfield’s brand?

GH: One cup at a time. We are a classic word-of-mouth product. There’s an adage in the consumer product industry: “the least expensive consumer to acquire is the one you’ve already got.” The Holy Grail of consumer products is loyalty. We could never afford to disappoint a single consumer because an unhappy consumer is going to put in motion negative energy around your brand. We’ve pioneered what’s called guerrilla marketing, ways to reach people that are unconventional. Fundamentally, we can ship our products coast to coast, but it’s the last 18 inches—from their cup to their mouth—that really makes brand.

BK: Can you give us a ballpark estimate of your annual revenue and market share?

GH: We’ll do about $150 million this year. We’ve been the fastest growing—on a percentage of sales growth basis—yogurt company in America for the past decade with a compounded annual growth rate of 24%. We are presently at a 5% U.S. share, but are only in about 60% of the scanning supermarkets. We’re heavily in the East Coast, so we have a lot of upside left.

BK: How do your margins compare to your competitors?

GH: They’re pretty good. We’ve been steadily profitable for twelve years at rates that I know are unusually high in the dairy industry. We’re probably not top of the class, since a high percentage of our business is in organics and we’re constantly in the process of reinvesting. We’re a growth company. I do know that if we’re not top of the class, then we’re in best class. We don’t disclose our margins, but I do know that we’re growing our bottom line faster than others.

The proof of our margins is that Groupe Danone thought enough of our margins to pay a substantial valuation. BK: Can you describe the market?

GH: Number one is Yoplait, second is Dannon, third is a neck-in-neck race between us and Breyer’s, which is Kraft. In the Northeast market, we are number two or three. In your [New York] market, we are number three, but number one in large-size containers. In northern New England, we are number one. This gets back to this whole word of mouth strategy.

BK: How do you measure success as an individual, and how do you measure it within your corporation?

GH: You know, I have three little success stories. As you can tell from this discussion, I have great concern about the world they are inheriting. I measure success by evaluating whether or any given day, I have done something to help improve the world. My goal is that one day, my kids will say, “thanks for doing your part, Dad.” Right now, the way things are going, my kids will say, “what the heck were you guys doing?”

I set the bar pretty high, but I think we are where we are in society and we have to play the cards we’ve been dealt. We have to change everything about the way we relate to the planet and the cavalry we treat our bodies. The ultimate success at Stonyfield is changing the way big companies do business. I’m a disciplined manager and we run a disciplined ship here, and we will hold our numbers up against anyone else’s, and that’s crucial. So we measure by market share, profitability, ROI, and ROA. It’s crucial because I’m not going to convince anyone in business to adopt these practices without proving that they can make a buck doing it. The thing is that I can prove they can make a lot more than a buck, and that’s more likely to be successful using my way than any other way.

BK: Thanks for your time, Gary.

GH: Thank you. I’ll see you all in a few weeks.

The Small Investor’s Best Friend: Arthur Levitt

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institutions can give students a context for understanding this failure of buccaneer business leaders. Business schools can facilitate such insights through case studies, histories and perspectives.

ER: What is the best piece of business advice you have ever received?

AL: That’s a good question.

I picked up many great lessons from the people I have worked with. The lessons I have learned are those where I’ve learned the importance of distinguishing between quality and excellence on the one hand and what is ordinary and commonplace on the other. To recognize real quality and develop the critical skill is the best skill to bring to a business career. I’ve had five very different careers. The people I worked with led me towards a personal style of openness which has served me well. I am not the kind of administrator who plays people off against another. I never close my office door and encourage an environment of openness, dialogue and consensus.

ER: Is there anything you want to say to the current students?

AL: Yes. They should have a greater appreciation for their own abilities and a greater respect for the judgment and talent. They must be empowered to challenge. If I had a criticism of this generation it is their willingness to go along. I see it in the business community. People say this is the way it has been done and this is the way we will continue to do it. I would encourage the development of a generation of skeptical business people—skeptical about processes, skeptical about theories, skeptical about methods.

ER: Thank you very much, Mr. Levitt.

Please e-mail comments and suggestions to ERabinowich04@gsb.columbia.edu.