LEADERS

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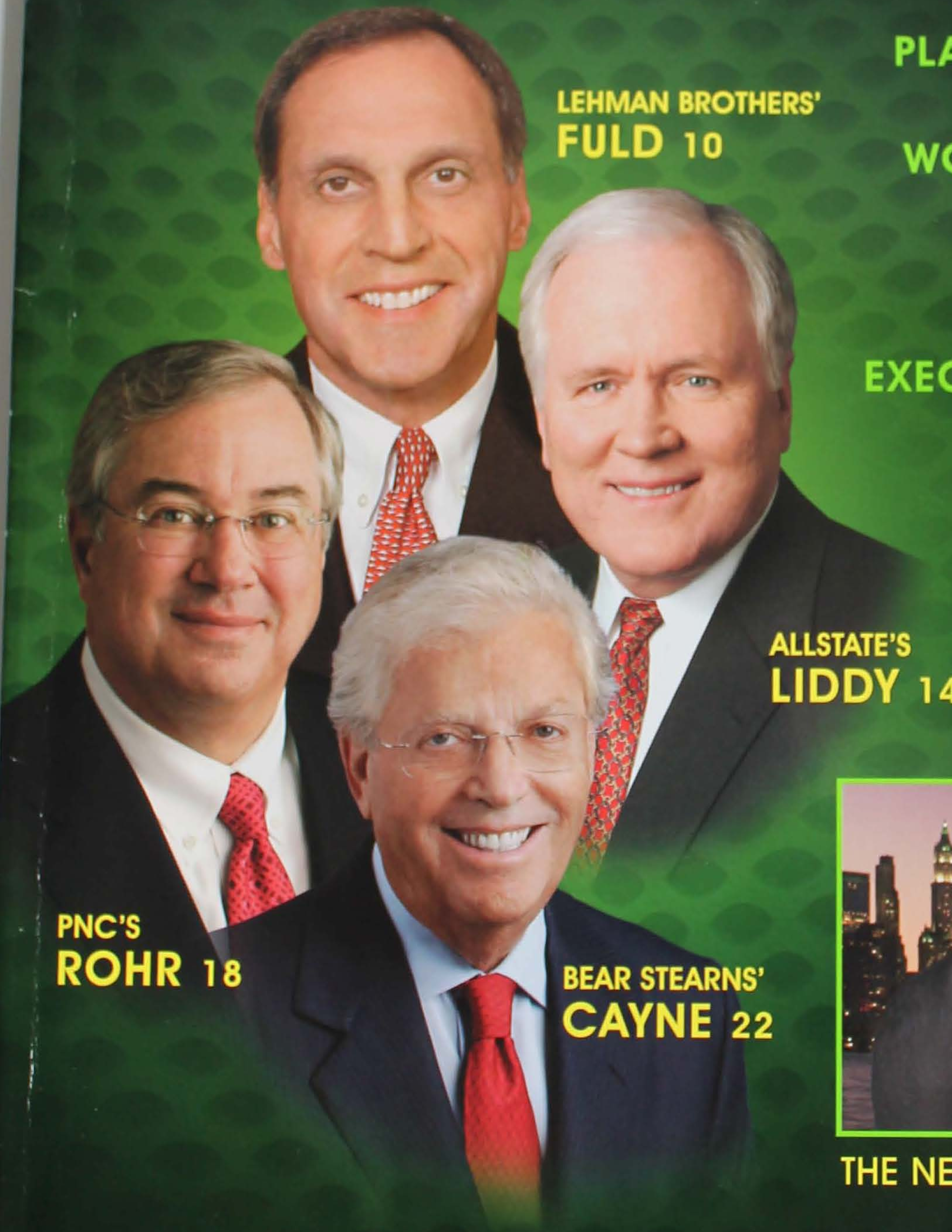

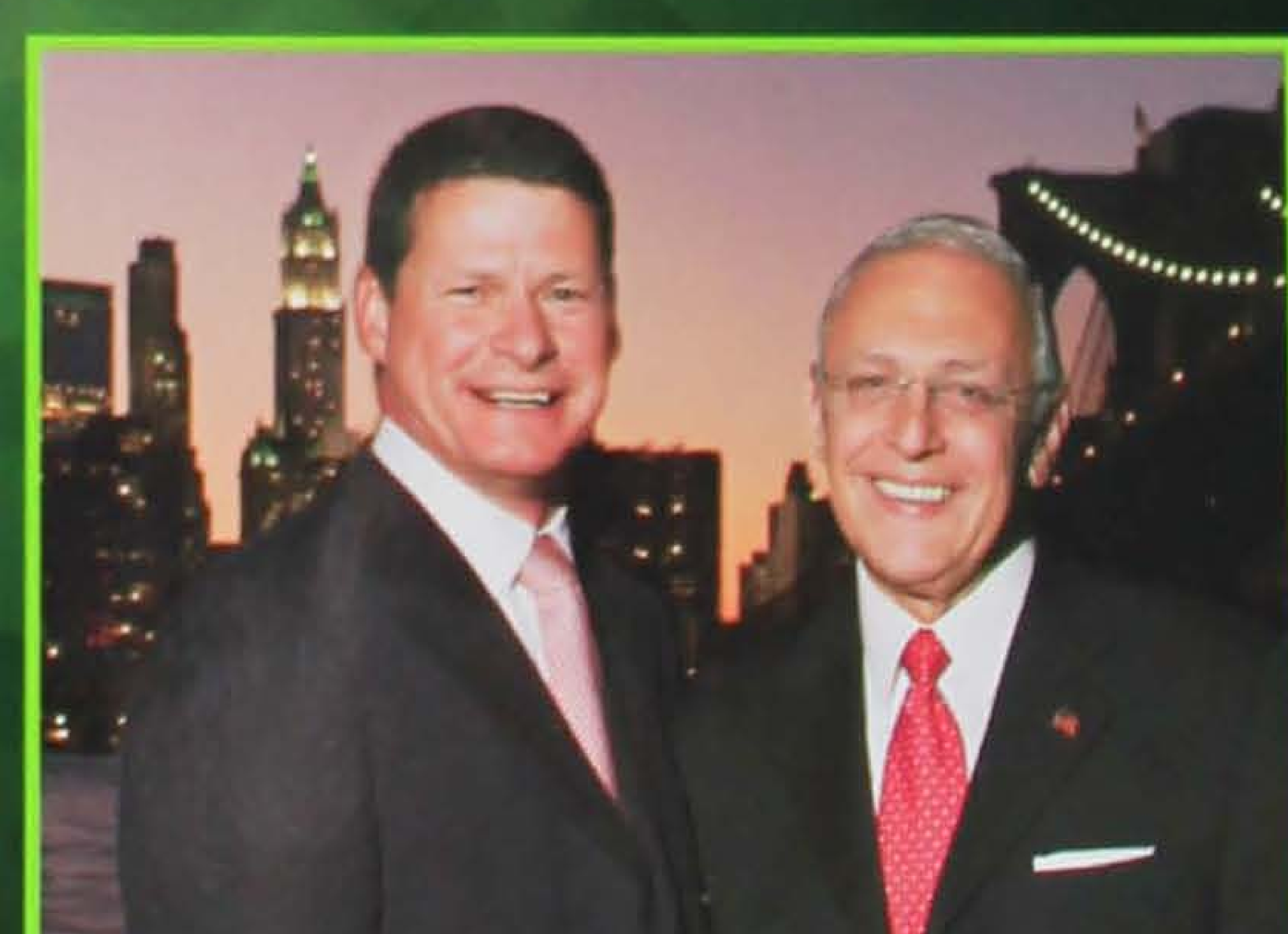

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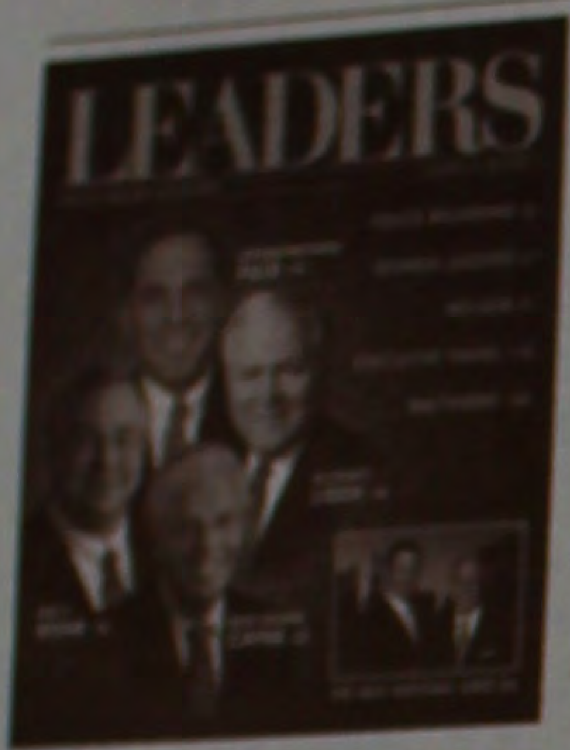
"Personality can open doors,
but only character can keep them open."
Elmer G. Letterman



On the Cover

Global markets may be buffeted by the ebb and flow of credit and liquidity, but the strongest companies will always survive, largely thanks to the enduring nature of their strategic visions.

Nowhere is this more true than in financial services, in the view of Dick Fuld, Chairman and CEO of Lehman Brothers, who highlights the firm's "continuity of results, of management, of strategy, of culture, and of everything else," as the reason for its success – and its foremost differentiator.

A strong and stable vision is particularly important in times of transition, believes Chairman Ed Liddy, who built "a can-do culture" at insurer Allstate after the company was spun off from Sears. "Our strategy was that we wanted to get better, bigger, and broader in our business," he recalls, and by repeating that message often, "people could understand it fairly easily."

Reinvention has always defined Bear Stearns' strategic vision, according to Chairman and CEO James Cayne, who points to a history distinguished by "a proven ability to reinvent the business to suit the ever changing needs of our clients." This approach is sustained by a culture "based on the principles of respect, integrity, innovation, meritocracy, and philanthropy," he adds, giving the firm "the strength and sophistication to compete on a global scale with anyone in the industry."

Similarly, philanthropy has been central to the PNC Financial Services Group's culture for decades, reports Chairman and CEO Jim Rohr. "When I joined PNC about 35 years ago, one of the first pieces of paper I was handed to sign was a United Way pledge form," he recalls.

In exclusive interviews that follow, Fuld (page 10), Liddy (page 14), Cayne (page 22), and Rohr (page 18) – shown here, clockwise from top – share their thoughts on the continuity of purpose as a key to long-term success.

The leaders of the new National Grid, Chief Executive Steven Holliday and Chairman Bob Catell, continue the discussion in an interview starting on page 26. According to them, the recent merger of KeySpan and National Grid was made easier by the closeness of the two companies' long-held values and organizational styles. "The same things that resonate with KeySpan resonate with National Grid," Catell affirms.

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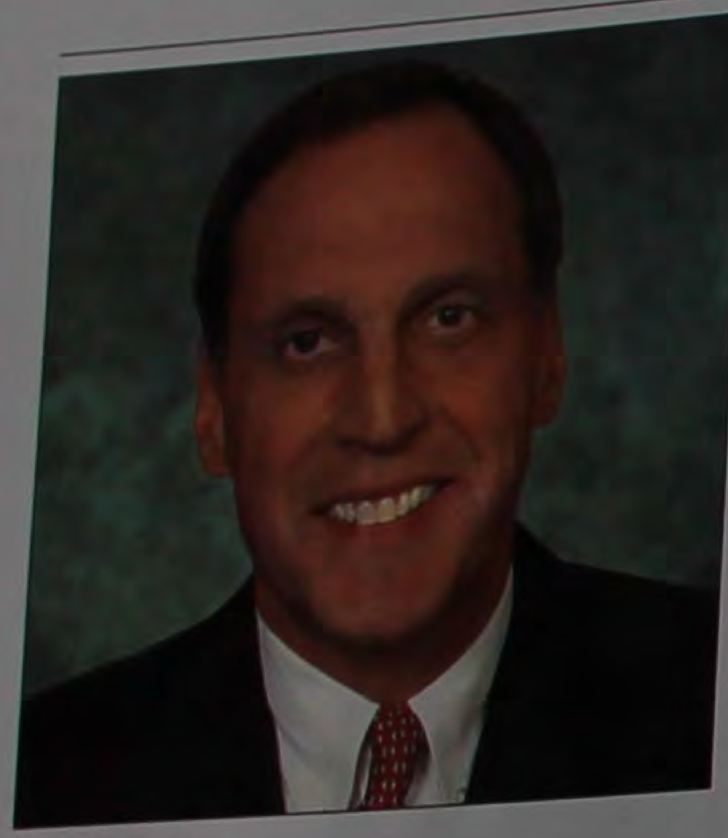
Risk and Leadership on Wall Street

An Interview with Richard S. Fuld Jr.,
Chairman and Chief Executive Officer, Lehman Brothers



Richard S. Fuld Jr.

EDITORS' NOTE *Dick Fuld joined Lehman Brothers in 1969, and proceeded to achieve positions of increasing responsibility, including Vice Chairman of Shearson Lehman Brothers, President and Co-CEO of the Lehman Brothers division of Shearson Lehman Brothers, and President and COO of Lehman Brothers Holdings Inc. He was appointed CEO in 1993 and Chairman of the Board of Directors in 1994. Fuld serves on the board of directors of the Federal Reserve Bank of New York and is a member of the executive committee of the board of directors of the Partnership for New York City. He also serves on the board of trustees of Middlebury College and NewYork-Presbyterian Hospital, as well as on the board of directors of the Robin Hood Foundation. The recipient of a BA from the University of Colorado and an MBA from the New York University Stern School of Business, Fuld is a member of the International Business Council of the World Economic Forum and the Business Council.*

COMPANY BRIEF *Founded in 1850, Lehman Brothers serves the financial needs of corporations, governments and municipalities, institutional clients, and high-net-worth individuals worldwide, and maintains leadership positions in equity and fixed income sales, trading and research, investment banking, private investment management, asset management, and private equity. The firm is headquartered in New York and operates through a network of offices around the world.*

Government and business organizations today seem to have a reputation for being arrogant. How has Lehman Brothers countered this and become "human friendly," not only to its clients, but also to the public in general?

If anything, it's part of our culture – who we are and how we came to be here. When we went public in 1994, I don't think anyone but us gave us a chance of succeeding. But we've been proving our skeptics wrong ever since. We've had some unbelievable momentum the past few years. But after every successful quarter and every successful year, I always tell my troops, "It's not over – not by a long shot." I also tell them that the one thing that is most likely to derail us is arrogance.

It was arrogance and infighting that cost us our firm 25 years ago, and we haven't forgotten that. Since then, our culture has been about working together – across businesses, across divisions – and putting the client in the middle. We call it, "One Firm." It's not about silos and it's not about P&Ls; it's about everyone working together with the same goal. It's about building partnerships – meshing gears – with our clients. They know we're here to work with them and not to compete against them.

As for the public in general, we take our social responsibility very seriously. Wherever we operate around the world, we realize we're part of the community. Whether it's children and schools, hospitals, or the arts, we want to do our share.

Social responsibility is something you've put on the front burner. The public doesn't hear much about that; you're pretty low-key about the good things you do. What is Lehman Brothers doing in that area?

We are low-key, and that's part of our character and part of who we are. We are very much dedicated to education. We're involved in the Harlem Children's Zone. We're also dedicated to hospitals and health care. There are a number of hospitals that we touch in New York, but we're not limited to the city. All around the world, in the different locations where we operate, we support hospitals and the environment, and a number of other worthwhile causes. In addition, we're very involved in diversity and the advancement of underrepresented groups.

We recently announced a ground-breaking partnership with Spelman College, the number one-ranked institution among all historically black colleges and universities in the United States. We're going to provide substantial funding support and help establish a new center for global finance and economic development. We'll offer new scholarships and provide financial internships for Spelman students. We'll also match students with mentors at the firm. It's the largest gift we've ever made, and it's one new initiative that I'm really excited about.

Overall, our social responsibility activities are very broad in scope. It's not just about the firm; it's about how our employees are involved in the effort, and about how many of our grant-making efforts are started by recommendations from our employees. The easy part is writing a check to support a charity or an organization. The more meaningful part is how our people stand behind these efforts to really give them some weight and some muscle. That's the stuff I'm really proud of.

How has Lehman Brothers changed since its days as an investment bank?

We are still an investment bank and very much a client-focused one. The difference today is that we are much more global and much more diversified. We have thriving businesses in equities, investment banking, and investment management that we did not have previously. We operate in more countries than we ever did before, and we bring in more international revenues than ever before – 50 percent of total net revenues in 2007. As for whether or not people understand who and what we are, I think some don't. Our clients understand who we are and what our capabilities are, because they see us every day and they see the ways we interact on the banking side and in capital markets. They see our private equity capability and our investment management capability. However, I think there are some investors and traders in the marketplace who do not necessarily understand who we are.

What will you do to clarify the brand for potential clients?

We continue to approach this as if we were our own client. If a client came to us with this situation, we would lay out a plan for them showing them how to inform more people. First off, what is the message that you want delivered? Second, to whom do you want it delivered? Third, how does it get to them? It's not just a one-shot deal. In our business, it's about continuity – continuity of results, of management, of strategy, of culture, and of everything else that has made us successful over the years and differentiates us. It's about making sure that people really understand, without having to take them through every transaction and every line of our balance sheet.

Which tactics do you employ to build the brand?

First of all, I don't think anything builds a brand quite like sustained results and success. Results usually speak for themselves, and I'm confident ours will continue to do so. If you look at our results since our IPO, it's hard to find a better story of sustained growth, diversification, and low volatility. That said, we will have to explain the different parts of our business and our strategy and culture, while delivering results that continue to prove our skeptics wrong. We need to continue to break out the different pieces of the business and take people through those pieces and explain how and where we make our money. We need to show them how they should think about us and look at us, going back to what we've done, how we've invested, how we've built the businesses, what the results are, and where we are going.

With regulatory changes and the economic growth of Europe, will the epicenter of finance ever move from New York to London?

It will never move to the extent that it shuts down New York. However, there are clearly some factors that have made it easier for companies to operate in other cities, whether it's about excessive, frivolous litigation or overly burdensome regulation. It's partly a reflection of how global capital and liquidity have developed around the world. To give two examples, the wealth boom in the Middle East has brought a lot of capital to London, and Hong Kong and China have become epicenters of large IPOs as global investors seek exposure to that market. Having said that, I think that people in New York and in Washington, DC, are addressing a lot of these issues – at least the controllable ones, such as our regulatory structure and legal climate. I believe they have a good handle on how to continue to keep New York – and the U.S. as a whole – wonderfully competitive.

Do you foresee more of Lehman Brothers' business moving to London or overseas?

London is already a huge base of operation for us, and its place of prominence on the world financial map is unquestioned. It is arguably the epicenter of the global foreign exchange business and a leader in capital markets product innovation. But it's not just London. Technology and economic growth have led to the emergence of financial centers around the world. Other places in Europe continue to get stronger and stronger; Beijing and Shanghai and some cities in India are clearly enjoying tremendous growth. There will be several big operating centers going forward – Hong Kong, Singapore, and one or two each in China, India, Australia, Dubai, Tokyo, London, and New York, and there are a couple other longer-term candidates as well.

What is your view of the pay gap between executives and employees? Is it widening?

There are some employees who make more than some of our executives. I read something the other day that suggested the gap in some companies between the pay of the number-one guy and the number-two guy was three, four, or even seven times. We don't have that here. Sometimes there's no gap between our top 13 on the executive committee and the people on our next level. Sometimes it even goes the other way. Our industry, and certainly our firm, is as meritocratic as any. We always aim to pay our people fairly and in line with their performance. It's hard to think of too many other places where anyone can come in, show the results, make a name for him or herself, and be paid accordingly – even more than executives in some cases. Add to that the equity ownership of our employees, and you can see how the firm's success has been shared across the board.

However, our most senior group, the executive committee is, in fact, responsible for how this firm runs every day. I say that because, whatever those people are getting paid, they're worth every dollar of it, as long as the firm continues to operate in a strong way. If the firm operates in a strong way and provides terrific returns for shareholders, the members of the Executive Committee should be compensated for it.

What about the gap in pay between male and female employees – is it still there?

We work hard at Lehman Brothers to ensure that there isn't a pay gap issue. As I said earlier, we are a meritocracy. We're in the business of hiring terrific people. We're trying to get the best people into each and every seat – people who, in their own way, can lift the tide of what this firm is doing; that's our job and our focus. That's our focus when we hire, that's our focus in development, and that's our focus when we promote.

Having said that, we have launched a very comprehensive effort to engage underrepresented groups and to make sure that everybody really understands the value of diversity and inclusion. In my view, this is terrific for the business. We're dedicated to hiring the best people and providing the most inclusive environment in the world.

One of our most important functions is talent management. You don't come here to get a job at a global investment bank; you come here because you trust that we will be the best custodian of your professional development.

Mergers and acquisitions activity was at a very high level for the past three or four years, but the credit crunch slowed things down. Is the party over for private equity? Will it get back on track, or do you see a trend for further reduction?

I don't think the party is over, but the nature of activity will change. There will be a difference in the kind of deals that are done, the size of the deals that are done, and how the deals are financed. I think there will be fewer deals of more than $10 billion financed with the past equity/debt ratios. A number of deals were financed because there was a huge amount of liquidity that was trying to find a return. It's not as if the liquidity left the market entirely; it's just seeking a different return. Our job is to help issue securities that will attract the volume of liquidity that's still sitting out there.

Within the current regulatory environment, are hedge funds good for the markets?

What the regulators are trying to do, regardless of who the market participants are, is to have the best practices around how markets and players operate every day. Are hedge funds good for the market? Yes, they are, for the most part. They provide a tremendous amount of liquidity and a huge amount of creativity and information to the marketplace. In some cases, there's sometimes more volatility even though there's more liquidity, which is not necessarily a bad thing. The regulators would really love to find a way to understand how the hedge funds operate every day. That's a more difficult task.

Are there more risks now than there were before?

If before is six months ago, no, I don't believe there are more risks today. I think the market has had a real wake-up call. I liken the last few month's experience to a pressure cooker – we let a ton of pressure out of the pot. Perhaps some people were surprised by the risks inherent in what they owned or how they understood their risk. Hopefully, with that awakening, they will not make the same mistakes again.

Within that context, is globalization a good thing?

Very much so, whether it's about the world being flatter or about investors having the right to invest their capital in the highest returning assets, wherever they may be. Now, with increasing connectivity, investors can move their money not just within a country, or within a continent, but anywhere within the world. That's a good thing.

How will the subprime mortgage crisis and housing value decline play out?

Many subprime mortgages feature two to three years of low interest or low payments and then reset to a higher rate, so subprime mortgages that were written in 2004 came due to reset at the end of last year. The ones that were written in 2005 will come due in 2008, and those written in 2006 will come due in 2009. We're obviously not going to know exactly how many of those borrowers will be able to make their payments. It's important to remember it is at the point when people are actually trying to sell or resell their homes that we would really start to see the chipping away at home prices. So it's hard to really judge the full extent of the situation, but it's not over yet.

What impact will climate change have on business and the economy?

Climate change is clearly a huge issue. It's not just about businesses – it's about countries. This is a much deeper and broader issue than just about how individual businesses react to climate change. At the end of the day, this is about risk management. It's about making sure that we don't wake up 20 years from now and say, "Oh my god. I missed it. The next generation is going to have to deal with it." For me, the question now is, what can we do to make sure that this is not a problem that gets carried over to the next generation?

Are you concerned about terrorism infecting the financial markets, infiltrating computers, the World Wide Web, and technology in general?

Our employees need to know how to partner with our clients and wear the Lehman colors, so that each and every day, a client knows that we're his or her partner and that we act with integrity.

I am, but my number-one concern regarding terrorism is about keeping my people safe.

Will there be a recession, and how will the write-offs affect the economy?

I think we've already seen a lot of write-offs. Could there be more to come? Yes, but when you talk about write-offs, it sounds like corporate write-offs. The big write-offs come with the individual homeowners, whose home values go down.

I think the economy is clearly getting weaker, because the amount of disposable income that consumers have has gone down. I don't think the average consumer has gotten a big lift from the stock market. With the prices of their homes down, they can't refinance and take money out. On top of that, they're spending more on fuel; they're spending more on health care; they're probably spending more on interest rates and mortgage payments; and they're spending more on food. That, by definition, will give them less money to spend on consumer goods, home improvements, etc., which I believe translates into a weaker economy. That's our current view, which could change, but it will certainly take some time for things to play out.

Still, you remain generally optimistic?

I am cautiously optimistic.

What are you doing to protect your own investments at Lehman Brothers?

We protect our own investments by doing smart credit analysis before we make the investment, and we make sure we understand the environment in which we're operating. For instance, we run a ton of what-if models, which are essentially risk-simulation models, so we understand how the valuations of the companies or institutions or properties that we invest in will react in the event of certain stress situations. It's all about risk management – everything we do, every single day.

What's the most important problem facing Lehman Brothers today?

As we continue to grow, and we are growing very quickly, my most important task is to make sure each and every employee clearly understands the culture of the firm – what this firm is all about. They need to know how we expect them to operate day to day, how they should interact with each other, and come together as a team. Our employees need to know how to partner with our clients and wear the Lehman colors, so that each and every day, a client knows that we're his or her partner and that we act with integrity. We have around 28,500 people, and a lot of them are young and new to the firm. I think the biggest challenge is how we touch them and get them to be a part of this culture.

You're a motivator?

I try to be.

With board responsibility becoming more important, how have you been able to work out a healthy relationship with your own board over a long period of time?

I guess it starts with trust. When you have a body of people who have integrity and experience, who are independent, who know exactly what their fiduciary responsibilities are, there are bound to be some tough questions. As the CEO, you have to be frank with them. Transparency is the cornerstone of a good relationship with your board of directors.

I report to the board – I'm accountable to them. That means I – along with the rest of our employees – am responsible for delivering results. That's why we've always tried to build a culture of risk management, of preserving as well as creating shareholder value, and of doing the right thing.

It's also why we've tried to create an ownership culture. When employees are shareholders, they think and act like owners. When employees think and act like owners, it makes a CEO's job a whole lot easier and the relationship with the board a whole lot better.

In the last few years there have been some high-profile CEO resignations. Does there need to be a reorganization of the way companies, their boards, and their CEOs think? If so, what would be the new rules for excellence in corporate governance?

I think there has already been a change in the way companies and boards think and operate – you could call it a cultural shift. Boards are more vocal and more apt to get tough with an underperforming CEO.

Boards are taking their responsibilities towards shareholders very seriously. They have a responsibility to preserve, as well as to grow, shareholder value. But it's not just financials. They're also thinking about everything that affects their brand and reputation.

I don't know if we need a brand new set of rules for corporate governance. But there's no doubting we need strong boards, with independent-minded directors and with people of integrity. That's probably more important than any single regulatory change.

Many young people have poor opinions of big business. How can this feeling be changed? What advice would you give to young people?

The advice I can give is this: It's less about which career path you choose and more about finding something to be passionate about. So I say, whether it's in business or anything else – whether you're a teacher, a fireman, a policeman, or working in the not-for-profit arena or in politics – whatever you're involved in, follow your own interests, but also understand how the world works. Read everything you possibly can and begin to connect the dots, because the world is linked. Today, the world is increasingly interconnected; the world is flatter. People are communicating across states, countries, and continents, and those kids who aren't reading – who aren't connecting the dots – will be at a disadvantage. ●