

Mike Petters
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Pat, thank you for that very kind and warm introduction. ...

I'm honored to be here and to be part of this distinguished group of speakers and part of this series. I think you've done something exceptional in reaching out and creating this series, and I'm honored to be part of it.

I think that as we talk through this, you'll see that I have a view that corporations don't spend enough time talking about the importance of leadership and how it is a competency that corporations should spend more time on. This is a great way to facilitate that, so I'm very appreciative of that. I'm also looking to be able to get to a point to a point where we can field some questions, so this will be a two-way communication.

Since I am going to talk about leadership, and particularly some of the questions around honor and ethics, I will put up a disclaimer at the beginning: This is a risky topic for any corporate executive to take on because hypocrisy is the mortal sin of leadership, and you don't ever want to have your words come back to you. We all try hard, so I hope you take that in spirit and go with that.

[Video]

[Company overview]

What I want to talk about are not the ships so much. I really want to talk about the people at the shipyard and how we make things work and then how I view the business side of this.

We have 19,000 people at the shipyard. That's down from over 30,000 that we had at the end of the '80s. Like a lot of defense companies, we've downsized by lay-offs as well as by attrition. We have a workforce today that is either very senior with lots of experience or very junior and just hired. We don't have a great middle ground in our workforce. So the challenge for us is capturing the knowledge of our senior, experienced craftsmen and making sure we can capture that and train our new folks when they come in before they leave. That's a big challenge for us, and my view is that's a big challenge for the entire industry as we go forward. We're working on a lot of ways to go to solve that problem. We feel leadership is a way to enable that process.

A lot of folks will come and sell you knowledge management tools and databases and software, but it fundamentally comes down to: How good is your leadership team?

We have about 2,000 folks in the shipyard who are on the leadership team and have people they are responsible for, so we work very hard on the issue of leadership.

Think about all the processes you have going on in your organization. Think about all the formal processes you have and all the informal processes, and think for a minute about which one

process is the most important of them all. Some will say accounting; some will say marketing. In my view, the most important process in your organization is the process that describes the relationship between a leader and her people. That process is one of the most informal processes we have. It is not well documented. It is not well trained. But the leader is the person that the people in the organization see and that represents the corporation. And if you can get 19,000 people all headed in the same direction, you've really accomplished something.

Since everything you're going to accomplish as a business starts with people, it's the leadership that's the enabling tool for making that happen.

Now why does that matter? Anybody hear of Enron?

I will give you another disclaimer: I am not an expert accountant. I am just a guy who has read a book about Enron and seen a movie about Enron and followed the trial. In my view, what happened at Enron – beyond all of the accounting gymnastics and beyond all of the other technical stuff that got all wrapped up there – is they had a failure in their leadership. The leadership did not set the correct tone at the top.

The first I had ever even heard of this was the day the Wall Street Journal reported that the CFO was sitting on both sides of transactions. Remember when that broke? I'm just a shipbuilder, but I don't know how you can sit both sides of a transaction and make that fair for all the people you're supposed to make it fair for. How can you represent the company if you're negotiating with yourself?

How could a leadership team actually stop and look itself in the mirror and say, "This is OK?" How can they do that? Well, I've thought about that long and hard because those are the kind of traps – those rationalizations that you go through as a leadership team -- those are the kinds of traps that you can walk into unwittingly if you're not on your guard.

I thought I would tell you a little bit of a personal story and show you -- this isn't the total cause, but this is one cause that we can be aware of.

When I first went to the Naval Academy, during Plebe summer, we were given two sorts of indoctrinations. We were indoctrinated into the honor code, and we were oriented toward the conduct code. Two very different things. The honor code was pretty straightforward. In those days, it was "A midshipman will not lie, cheat or steal or tolerate those who do." The conduct code, on the other hand, was a thick book, and it had rules and regulations in it. It had rules in it that would say, "You have to have your hair within quarter of an inch of the scalp." You name it, we had a rule for it.

The orientation that we received went something like this: The honor code was sacred. The conduct code, on the other hand, "Well, you're a Naval officer now, you rate what you get away with." The conduct code would say you have to be back in your barracks by 11 o'clock. Taps is at 11 o'clock. Going out over the wall, visiting the little campus out in Annapolis after 11 o'clock, was a conduct code violation, but it was not an honor code violation.

What ended up happening with this “You rate what you get away with” mentality is you develop a lot of “sea lawyers.” That’s what we would call them. These folks who would say, “Well, my hair actually *was* within a quarter of an inch of my scalp at that point in time.” They come up with all kinds of rationale. The fundamental thing was you didn’t get a haircut this week and you deserve the demerits. But you come up with some rationale and you rationalize it away so that you’re OK.

Now, the honor code at the Naval Academy has changed. They made it a much more positive statement. It doesn’t say what you won’t do – it says midshipmen are individuals with integrity and they will always tell the truth. Instead of saying, “You won’t lie,” they say, “You will always tell the truth.” They have now watered it down so you can’t say it in one sentence. It’s like three or four paragraphs, and I’m not sure that it’s easy to memorize, but there’s a definite distinction here between “You rate what you get away with” and some code of honor.

When you think about what happened with Enron, there was a situation there where you had some very, very smart people who were looking at ways to get around the accounting system. I don’t know if Ken Lay actually knew what was going on -- I really don’t know, and I don’t know that we’ll ever know – but I believe, based on what I’ve read, that Jeff Skilling knew exactly what he was doing. Because one of the things I read was that he actually said he would not take the job unless he would be given the privilege of “marking to market” in his accounting process.

I’m not an accountant, but I can tell you what that means: If I were to go and sell the Navy a contract for an aircraft carrier -- it takes eight years to build an aircraft carrier, and over the course of the eight years, we have accounting rules where we invoice the government, and we book our profit based on the progress we’ve made on the ship -- well, if we “mark that to market,” when I sign a contract for a \$4 billion aircraft carrier, I could recognize the profit in the quarter where I signed the contract. Before I’ve put the first hour of work into building the ship, I’ve recognized the all of the profit.

From what I understand, Jeff Skilling decided he would not be president of Enron unless he had permission to do that. That doesn’t make sense to me. How can you run a business where you’re going to book all your profit before you do any work? But they knew exactly what they were doing – at least he knew exactly what he was doing, because he wouldn’t have taken the job.

I think it’s because you have that mentality of “I rate what I get away with.” “If I can convince the SEC to let me do this, we’re going to make a lot of money. If I can convince our auditors to let me do this, we’re going to do OK. This is the right thing. This will keep the business going.”

The common sense view would be, “Wait a minute – what’s really right about this?” If you go and you look at how he dealt with people on his staff and the incentives that he put in place, the decisions that he made, he absolutely encouraged risk-taking. He rewarded those people who came up with more creative and innovative ways to go around what was written in the rule book. They actually rationalized it by saying they were creating a whole new way of doing business.

I don’t know that there are too many “whole new ways of doing business.” You need to make a product. You need to make it efficiently. You need to find a buyer. You need to come to terms

with what makes sense with that. That's not the way they were doing business. So "Rate what you get away with" is a problem. It's a huge problem. It's a huge problem for corporate America, particularly when we have rules in our accounting systems that beg you to test, that beg you to challenge and interpret and then be subject to second-guessing in your interpretations.

The leader's job is not to get all wrapped up in those interpretations. The leader's job is to step back and say, "What's right here? What's the right thing we ought to be doing? How do we separate the accounting dispute with the audit company from what's the right thing to do?" And if it turns out that the right thing to do is not prohibited by the rules, then let's take that forward and have a discussion with the folks that are out there that can help us solve that problem. That's the role of leaders. Leaders have the responsibility to step back and say, "What's the right thing to do?" And they absolutely have the responsibility to create a climate in their organization where people always are asking, "What's right? What's the right thing to do?"

One of the things we talk about at the shipyard when we get into these discussions – and they happen every day – we always ask ourselves, "Where's the high ground? What's the high ground in this issue?" Sometimes, you can't get to the high ground -- that's true -- but you can always approach it. And you need to always understand where it is and what the high ground position would be. And then you can make your deliberate decisions about what you're going to do.

As I said before, we have about 2,000 leaders. How do you instill a tone at the top? How do you infuse that throughout your entire organization? We tell our people that the job of a leader is very straightforward. The job of a leader is to put your people in a position where they can do their best work. Your job is to ensure that your people are successful. Your job is not to tell your people what to do and then have them do it for you.

If you're having them do it for you, you're going to be very limited. You're going to close the avenue of new ideas that will come from your folks. You won't have the opportunity for someone to stand up and say, "Mike, you're heading down the wrong path."

This is a fundamental change across Newport News -- a fundamental change for the leadership group -- and a lot of our folks are adapting to it very well. For some, it takes a little bit of getting used to. If you're in a large organization that's used to being "OK, now you're the director of something, that means everybody that works for you has to do what you say," if that's the way you've been brought up, it's kind of hard to shed those spots overnight.

What did we do to make that happen? We've created a bunch of seminars throughout the organization. We have a view that there are no new leadership problems at the shipyard. Every time you are facing a situation, you are not the first person in the shipyard who has seen it. Our challenge is to get you connected with someone who has dealt with this problem before. So we do leadership seminars and case studies where leaders work with leaders so they can help understand each other and how they might respond to particular issues. But they also have a chance to get to know more leaders in the company so they can pick up the phone and talk to folks on a day-in, day-out basis and ask for some help.

The beauty of all this is that we were lucky. Our founder had it right at the beginning. He said, “We will be build good ships -- at a profit if we can, at a loss if we must -- but always good ships.” And that was 120 years ago, and that still rings true today. It’s absolutely consistent with what we’re trying to do in moving our leadership team in the direction of searching out and taking the high ground, putting their people in places where they can be successful.

I encourage you to try that with your folks if you’re not already doing that. Certainly search out the high ground. That’s an important task for the leader of an organization -- to step back from the day-to-day trying to figure out “How do I get away with something?” “What’s the right thing to do here?”

With that, I’m going to go ahead an open the floor up to questions.

[Q&A]