

Building Trust

LEADING CEOs SPEAK OUT:
HOW THEY CREATE IT,
STRENGTHEN IT, AND SUSTAIN IT.



Frederic M. Poses

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THE CORPORATE NAVIGATION SYSTEM

During the high-flying growth decade of the 1990s, annual spending on mergers and acquisitions went from \$205 billion to more than \$3.4 trillion in 2000.

Some of the acquisitions were painful mismatches, some were well-thought-out and successful, with others still awaiting long-term proof. Corporate assets were bought en masse, merged into new companies, spun off whole or sliced, diced and sold off in pieces for quick cash returns.

Yet in all this horse-trading, there is one corporate asset that has never been bought or sold and never will be. That asset is integrity.

As the corporate scandals that emerged in the wake of the Enron collapse have reminded us, integrity is a priceless and fragile asset. It is also essential to the survival of any business.

This is not a new revelation. It's been true since the beginning of recorded commerce and probably even earlier. Then why is corporate governance in America a bigger issue today than it was in the days of the "Robber Barons" a century ago? How is it that some very bright business leaders in the early 21st century apparently lost sight of the connection between integrity and the growth or even survival of their companies?

There are no glib answers to these questions, and before I share my views on them, I think it's important to make clear where I stand on what's sometimes called the "apple question." Basically, that's the question of whether the well-publicized ethical lapses at some major corporations are the result of a few bad apples in the leadership ranks, or the product of a systemic fungus that infects the whole orchard of American business.

Having spent 30 years working in that orchard, I am more convinced than ever that the overwhelming majority of corporations and the people who work for them value integrity. Most people who lead corporations and the people who follow their leadership would do nothing to compromise their personal integrity or the corporate integrity of the companies where they work.

Then why have we seen the discouraging example of corporate governance scandals at some highly respected companies? And what can we do to restore the public's confidence in business?

I think the answer lies in navigation systems.

Like many vehicles today, our family car is equipped with a satellite-based navigation system controlled from the dashboard. When our family goes on a road trip, the first thing we do is program the navigation system by telling it where we want to go. It's up to us to get there, but the navigation system will literally tell us the best route to follow. It's an audible system that tells us in advance when it's time to turn and warns us to turn around if we're heading in the wrong direction—a pretty nifty system.

Every one of us is born with a personal navigation system that isn't all that different from the satellite system in an automobile. We don't program our personal navigation system with a computer, but with the values we learn. Some of those values are taught to us formally and others are learned through experience, but they're all part of our personal navigation system.

Such a system is not optional equipment. We've all got one, and it's the one part of us that gets more effective as we get older. Like the satellite-based system in a car, our personal navigation system can be ignored, but doing that increases the danger of getting lost.

My own personal navigation system uses a simple litmus test I learned years ago for evaluating the ethics of potential decisions. I ask myself whether the course of action I'm contemplating would be something I would feel comfortable explaining to our employees, or to our board, or even to my own family. And finally, I ask myself if I would be proud or ashamed.

If I don't get the right answers to those questions, then I'm not going in that direction. This test is one I've applied to many decisions

that, practically speaking, would not be of the slightest interest to most of our employees, our board or my family. Like most tests, of course, it's not foolproof. And the more complex an issue gets, the harder it can be to apply a simple test.

Yet such a litmus test, regularly applied, could have saved some corporate executives and their boards the shame of having their companies' names linked to accounting scandals and other forms of corporate greed. And I can only imagine the personal agony it could have saved the families of the executives involved.

The lapses in corporate integrity dominating the news today reflect situations where the personal navigation systems of individual business leaders failed. These systems, after all, don't come with a warranty. If they did, that warranty would have to include caveats that the effectiveness of the system can be impaired by excessive exposure to unrealistic financial targets, the ego of the executive star system, and to the plain truth that people's capacity for rationalization is infinite.

I'm not knowledgeable enough to diagnose the specific ethical failures at America's problem companies. I am absolutely certain, however, that the personal navigation systems of the top leadership at each of these companies broadcast an alarm signal which was ignored.

Why was it ignored? Part of that answer lies in the pressure to perform. It's pressure shared by most business leaders, and that pressure tends to be concentrated on numbers. With the stock price affected by a movement of one or two percentage points in sales or earnings, and with the compensation of many CEOs affected by the stock price, there is an ever-present pressure to produce the numbers rather than the results.

Some executives create artificial pressure by thinking they have to be perfect rather than human. They tend to forget that they, too, make mistakes like the rest of us. The important thing is not that you made a mistake but how you deal with it.

In truly great companies, though, CEOs have a sense of ownership that includes ownership of the pressure to perform. Those CEOs deal with reality. They acknowledge that they make mistakes, accept responsibility for disappointing results and rally their people to produce better results.

In the long run, companies with leadership like that produce the best results for investors and their own people.

While the headlines on corporate governance scandals usually feature the CEO, the foundation of a company's ethics is much broader and deeper. Most companies aren't directed by the personal navigation system of just one person, not even the CEO. Companies have corporate navigation systems made from the personal systems all employees bring to work with them each day. I know from experience that those people overwhelmingly want to be part of a company whose integrity and ethics are a comfortable fit with their own.

That's why so many companies, American Standard included, have adopted formal sets of values that employees can relate to and live by. These values are not a set of aphorisms designed to be framed and forgotten. In a successful company, the corporate values are the ethical navigation system that shapes the daily decisions and overall direction of the corporation and the people who give it life.

The set of values we have in place at the American Standard Companies unites a corporate community of people as diverse as any in the world. We are 60,000 people who work in three different businesses—Bath and Kitchen, Air Conditioning Systems and Services, and Vehicle Control Systems. We manufacture our products at 109 plants in 29 countries and market them in 50 countries.

American Standard people speak more than 20 different languages and represent all of the world's major religious faiths and ethnic groups.

Our common set of values helps link us together. In part, that's because the values we officially adopted in 2002 were drafted with participation from a broad cross-section of our people around the world. I personally believe our values are a good reflection of the personal values and priorities of most of our people. They reflect the way most of our people want their company to operate (*see Appendix*).

Yet, in a company of 60,000 people, occasional problems are inevitable. Even with the best of navigation systems, some people will lose their way. It would be naïve to think otherwise.

At American Standard, we are enthusiastic practitioners of Six Sigma quality techniques. Six Sigma is essentially a search for perfection, but even Six Sigma-level quality allows for three imperfections out of every one million opportunities. If total perfection is impossible when you're dealing with processes and products, it's certainly not going to happen when you're dealing with people.

By adopting company-wide values, though, you provide clear expectations of how you expect the company and its people to operate. Most of our employees find those values both helpful and reassuring.

Readers familiar with the Principles of the Arthur W. Page Society will also recognize the comfortable fit our values have with those principles, especially the Page Principles that counsel companies to “Tell the truth” and “Listen to the customer.” Since American Standard’s five values are so critical to the direction of our company, I’d like to share them here.

We are driven by customers. We succeed by exceeding customers’ expectations. Our commitment to premier customer service begins with understanding customer needs. It is realized through the design, manufacture and delivery of quality products and services, and the personal support we provide. Each contact with a customer is an opportunity to increase customer satisfaction and win new business.

We recognize the importance of our people. Our people built this business and are the key to its future. We are committed to creating a workplace that is safe, a workplace where diversity is valued, and a workplace that thrives on teamwork and leadership. We are committed to a workplace where individuals are treated fairly and with respect, where all people have the opportunity to expand their skills and take advantage of new opportunities, and where accomplishments are recognized.

We operate with integrity. As a company and as individuals, we do the right things and never compromise our values. We honor our agreements and are honest in our communications. Our relationships with co-workers, customers, suppliers, partners and the investor community are based on openness and opportunities for mutual gain. Our sense of responsibility extends to leadership in protecting the environment and good citizenship in the communities where we work.

We strive for excellence. No matter how good our products, services, processes and performance, we are dedicated to making them better. We strive for excellence in everything we do by being open to new ideas and better ways of working, and not being afraid to take risks. We recognize that each of us can add real value to our business. By approaching our daily work with a passion for innovation and a desire to learn and share that learning with colleagues, we all can make a difference.

We deliver on our promises. We set our goals high because we know we can do great things. We treat these goals as promises to our customers, our shareowners and ourselves. Our continued success depends on keeping our promises. Success is measured by the results we produce in customer satisfaction, sales, profitability, investor value and the scope of opportunities we provide for our people.

Our challenge is to use these values as guidelines on the job every day. We want to routinely shape our actions to conform to our values. Ideally, the values will keep us asking the right questions about how we're treating our customers, investors and our own people. We're still working on this, but I'm confident the effort will make us a better company.

While only one of the values mentions integrity specifically, they are all essential to the integrity of our business and its reputation.

The absence of scandal is not synonymous with integrity. True integrity means doing everything possible to live up to each of our values all the time. If we are not consistently trying to raise the level of what we can do for customers, investors and our own people, then we're not living up to the spirit of our values. That would be a lapse in our integrity.

Integrity is also the heart of a successful relationship with customers. Breaking implied or direct promises to customers is a lapse in integrity just as serious as overstating your quarterly revenues to boost your stock price. So we're spending more time and money listening to customers and trying to build our business around what they tell us about their needs.

Experience tells us that the responsibility of leadership is not to preach the corporate values to employees but to demonstrate their own commitment through action. We were reminded of that responsibility during the anxiety over the American invasion of Iraq. In the heat of the moment, two of our managers in America sent out e-mail messages expressing personal opinions that could be hurtful to our employees in the Middle East, Germany and France.

Our values say that we will treat all of our people fairly and with respect. So we tried to set an example by issuing a worldwide message taking issue with the offensive e-mails, apologizing to our international employees and advising them that the employees responsible had been counseled that their actions were not consistent with our values.

The positive side of that experience was the enthusiastic response our message generated from employees in the countries targeted by the offensive e-mail. These employees volunteered that our actions demonstrated that American Standard's values are taken seriously as a guide for operating the business.

Most people associate integrity with ethics and morality, especially after the revelations of ethics meltdowns in a few, now infamous companies. The fact that we are not one of those companies does not give American Standard or any other corporation in our position cause to be passive about issues of right and wrong.

Most people do, indeed, want to do the right thing. But the best intentions are no guarantee of the correct decision when it comes to ethics. In the complicated world of global business, people with high ethical standards and adherence to corporate values will find themselves with difficult decisions to make where the ethical choice is far from obvious.

At those times, a corporation has to provide the help people need. We have tried to do that through the creation of a company-wide ethics committee. Anyone with an ethical quandary can call a qualified member of the committee and get an expert opinion on what decision would be in keeping with our values. We also operate a 24-hour ethics hotline. All employees can call, anonymously if they wish, to share a concern about what they consider unethical behavior anywhere in the company. And that concern will get prompt attention.

Given the detailed corporate governance guidelines in recent legislation passed in the United States, corporations now have a full plate of legal requirements for assessing their behavior and reporting results. New rules and regulations were inevitable to help shore up public confidence in corporate America.

These rules and regulations raise the stakes for those who would compromise the integrity of their companies, but I'm not sure they resolve the problems of corporate governance. After all, speed limits don't stop speeding, do they?

Corporate integrity is preserved and expanded by the individual navigation systems of the people who work for a company. Their individual commitment gives meaning and energy to the corporation's collective values. Our people at American Standard are the ultimate

guardians of our integrity. They, in turn, enjoy being part of a company where their personal integrity doesn't have to be left in the parking lot when they come to work.

I don't think our commitment to integrity and ethical behavior is unique or unusual among American companies. If the corporate scandals of the last several years have taught us anything, however, it is the lesson that integrity cannot be taken for granted. The navigation systems of individuals and corporations can't be left on automatic pilot and still be expected to keep us on course.

Frederic M. Poses

CHAIRMAN AND CHIEF EXECUTIVE OFFICER
AMERICAN STANDARD COMPANIES, INC.

Frederic M. Poses is the chairman and chief executive officer of American Standard Companies, Inc. He joined the company in November 1999.

Prior to joining American Standard, Poses was president and chief operating officer of AlliedSignal, Inc., which has since merged with Honeywell. He joined AlliedSignal as a financial analyst in 1969 and was named general manager of the company's Home Furnishings Division in 1977. He was subsequently promoted to positions with increasing responsibility and was named president of the Engineered Materials Sector and executive vice president of the corporation in 1988. In October 1997, he was elected to the board of directors and named vice chairman of AlliedSignal, Inc. Poses was appointed president and COO in June 1998.

Before joining AlliedSignal, Poses spent two years on assignment in Peru with the Peace Corps. Born in 1942, he holds a B.B.A. from New York University.

He serves on the board of directors of Centex Corporation, Raytheon Company, National Center for Learning Disabilities and the 92nd Street YMCA. He also serves on the Duke University board of visitors. Poses resides in Manhattan with his wife and two children.

AMERICAN STANDARD COMPANIES, INC.

American Standard is a global manufacturer with market-leading positions in three businesses: air conditioning systems and services, sold under the Trane® and American Standard® brands for commercial, institutional and residential buildings; bath and kitchen products, sold under such brands as American Standard® and Ideal Standard®; and vehicle control systems, including electronic braking and air suspension systems, sold under the WABCO® name to the world's leading manufacturers of heavy-duty trucks, buses, SUVs and luxury cars.

The mission at American Standard is to “Be the best in the eyes of our customers, employees and shareholders.” To support this mission, in May 2002 the company launched a set of company-wide values. In December of 2002, as part of the company's values initiative, American Standard drafted an updated Code of Conduct and Ethics (*see Appendix*), which applies to everyone in the company, including officers and members of the board of directors.

American Standard traces its roots back to 1872 when John B. Pierce opened a tinware shop in Ware, Massachusetts. He would later found the Pierce Steam Heating Company, one of three companies that would merge in 1892 to become the American Radiator Company, which merged with Standard Sanitaryware in 1929.

Today, American Standard is headquartered in Piscataway, New Jersey. It employs approximately 60,000 people and has manufacturing operations in 29 countries. American Standard is included in the S&P 500.

For more information, visit: www.americanstandard.com.

Stock Symbol: ASD