



At American Express, CFO Gary Crittenden Takes a Contrarian Stance

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American Express in August announced that in 2003 it would start accounting for employee stock options as expenses on its income statement. But if the decision had been left to the company's chief financial officer, Gary Crittenden, it might not have been made.

Crittenden disagrees philosophically with the practice. "You're double-counting," he said during a presentation at Wharton last month as part of the school's leadership lecture series. His dissent matters because his employer is the world's leading issuer of credit cards and one of the 30 companies that comprise the Dow Jones Industrial Average.

Corporate income statements already provide diluted earnings per share — earnings calculated as if all unexercised in-the-money employee options were exercised, Crittenden pointed out. And that, he said, shows the transfer of wealth from shareholders to employees that option grants entail.

If the decision were his alone, "you would treat options as they work. They would be a deferred liability that gets marked to market." Under this method, a company would calculate the value of its unexercised in-the-money options each quarter and record fluctuations in the value on its income statement. "That captures the true economic impact," he noted.

By expensing options, New York-based American Express accepted the temper of the times. Since a spate of accounting scandals began with the bankruptcy of Houston-based Enron in December, dozens of companies have started expensing options. Critics have blamed employee options for the scandals. They say options give executives an incentive to boost their companies' stock prices in the short term, rather than make investments in long-term growth. Some even say that options motivate the sort of accounting chicanery of which executives at Enron have been accused. Option supporters insist they remain the best way to align the financial interests of a company's managers and its shareholders.

Expensing isn't the only change American Express has made in its handling of employee stock options. It's also curtailing its option grants in response to shareholder complaints. The company recently invited its three largest shareholders to a meeting to assess its performance. The shareholders let top management know that "they hated stock options," Crittenden said.

Their beef wasn't the accounting treatment. Instead, it was the amount American Express was spending to repurchase stock that it would turn around and hand to employees when they exercised their options.

While market watchers may see American Express cutting its stock buybacks, they won't see it doing a big merger or acquisition, Crittenden said. "We're not good at doing what Citigroup has done — buying companies, slashing costs. You have probably seen the rumors in the press that Morgan Stanley is going to buy us. Every time that gets reported our stock goes up a couple dollars. But if you look at Morgan Stanley's price-earnings ratio, it's impossible. The dilution would be too great."

In his wide-ranging speech, titled "Your Next Performance Review," Crittenden also offered tips for effective leadership. Citing the book *Level 5 Leadership: The Triumph of Humility and Fierce Resolve*, he



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said the best executives aren't those who browbeat employees, hog credit and court the limelight. Rather, they're "modest *and* willful, shy *and* fearless."

The book's author, Jim Collins, examined companies in the Standard & Poor's 500 stock-market index from 1965 through 2000 and identified 11 that had evolved from good companies to great ones. He then tried to tease out what made these companies better than others. His conclusion: Bosses with an unusual style.

"The leaders in these organizations had a yin and yang leadership style," Crittenden said. "They were driven to success yet somewhat shy and unassuming. They tried to deflect credit but were willing to accept blame." These sorts of leaders "recognize that their success is built on the success of a lot of people."

American Express has created a pay structure that tries to encourage that kind of management. For its executives, half of their pay is based on shareholder results, a quarter on their reputation with customers — "both internal and external" — and a quarter on their reputation with employees. "To succeed, you have to have a balanced approach. You can't get there by beating up on your employees."

Crittenden said that orientation enabled the company to deliver consistent growth in sales and profits, at least until 2001.

"Last year, we were hit by a 'perfect storm' of events. We had significant high-yield bond losses" — the company took an \$826 million earnings charge for bond losses in the second quarter — "and the Sept. 11 terrorist attacks happened across the street from our office. Our headquarters was destroyed." The 4,000 employees there were forced to disperse to six sites around the New York City area although they have since returned to their headquarters in lower Manhattan.

Crittenden, 49 and a graduate of Brigham Young University, began his talk by telling his audience about his first — and worst — client visit. During a summer internship at Bain & Co. in Boston, he spent his time studying whether a North Carolina company should invest in new machines for texturing polyester.

At summer's end, his manager invited him to fly to North Carolina for a presentation to the client. Thus began a series of events that Crittenden thought would end his career before it had started. His manager was supposed to meet him in his hotel's lobby the morning of the meeting. He forgot. A cab then took Crittenden to the wrong plant in the wrong town, using up \$25 of the \$26 he had in his wallet. He persuaded a car dealer to let him borrow a Chevy Impala by handing over his credit card — an AmEx, of course — and driver's license.

"So I'm rocketing along these country roads, and I realize I need gas." He stopped at a country store, offered up his last dollar and started pumping. "And the gas backs up and goes all over my suit." He did make it to the meeting, still perfumed with petroleum. And once there, he noticed people wrinkling their noses. "I thought my career was over. This is going to follow me for the rest of my life." His Monty Python-like travails didn't kill his career after all. Bain hired him when he graduated the next year from Harvard Business School.

And early on, he befriended a co-worker who would go on to become American Express' chairman and chief executive officer, Ken Chenault. "We commiserated about the lousy managers we had and how we both hated working for them," Crittenden said.

He spent 12 years at Bain before leaving to become senior vice president for operations at Filene's Basement, a Boston retailer, in 1990. "I was 37 years old, and I asked myself, 'When I'm 50, am I going

to want to fly to Cleveland to sell the next project?” Plus, he didn’t want to remain a generalist. “Consulting gives you great problem-solving skills. The negative is you’re not having the experience of making something happen.”

From Filene’s, he moved to Melville Corp., then Sears & Roebuck & Co. and then Monsanto Co. Crittenden joined American Express after Monsanto merged in 2000 with Pharmacia, a drug maker based in Peapack, N.J.

His speech at Wharton came three days after American Express reported its third-quarter earnings. The company earned \$687 million, or 52 cents a diluted share, for the quarter that ended Sept. 30, compared with \$298 million, or 22 cents a share, for the comparable quarter in the prior year. Its sales for the most recent quarter were \$5.9 billion, compared with \$5.7 billion a year earlier.

But the comparison is skewed because earnings for the third quarter of 2001 were depressed by one-time charges of \$352 million for restructuring and \$98 million for costs associated with Sept. 11. Take away those charges, and the company’s net income would have increased 15%.

The company’s strong performance came despite an anemic stock market and weak spending by businesses for travel and entertainment. In an Oct. 28 news release, the company attributed its strong showing to robust consumer spending.

Overall, American Express’ expenses were flat, with higher spending for marketing – up 31% – offsetting cuts in its work force. Employment decreased by 15%, to 63,200 people, compared with the prior year.

For Crittenden, who likens the CFO’s job to that of a financial air-traffic controller, the company’s return to form, after a tough 2001, was something of a vindication. “Consistency is one of the parameters of our company,” he said. “We’ve worked hard to deliver on our earnings commitments year after year.”

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