

NEWS

**SECURITIES AND
EXCHANGE COMMISSION**

Washington, D. C. 20549

(202) 755-4846



PUBLIC RELATIONS AND CORPORATE DISCLOSURES

An Address By

Ray Garrett, Jr., Chairman

Securities and Exchange Commission

SEPTEMBER 25, 1975

PUBLIC RELATIONS SOCIETY OF
AMERICA (LOS ANGELES CHAPTER)

MARRIOTT HOTEL
LOS ANGELES, CALIFORNIA

When I first got involved in the field of federal securities regulation, in 1954, the SEC and the public relations fraternity were really not speaking to one another. In 1958, when I was the chief assistant to the then SEC Chairman, Ned Gadsby, it took all of my persuasive efforts to cause him to go to New York to speak to a luncheon meeting of a New York public relations group. The senior career staff people at the Commission were against the idea as not worth the effort. PR practitioners and SEC people were so opposed in principle and practice that any effort to share views was regarded as a waste of time.

As for the value of that particular endeavor, the career staff may well have been right. The lunch was at Toots Shor's, as it was and where it was in those days. I have had nothing against any of Toots Shor's restaurants. In fact, I have had fine hours at them. But none of them has been famous as a gathering place of scholars or members of the learned professions, and the lunch I am referring to was not antithetical to the reputation of Toots Shor's establishment.

While the intervening years have been short in my memory, the world has turned over a few times. The vast difference in attitudes and atmosphere between that

gathering and this attests the fact that the world is different today. It is easy to question whether all the differences are improvements, but in the respect of our mutual areas of endeavor, they clearly are.

The public relations profession and the Securities and Exchange Commission have always been engaged in the same business, but for many years we never realized it. We were both devoted to the process of communicating information about companies to stockholders and investors generally plus, in your case, the public at large, including customers. We should have made common cause from the beginning, but we did not. We felt and acted as though we were natural enemies.

I suppose the basic trouble was that we approached the general subject from rather different points of view and with rather different objectives. So long as our objectives remained not just dissimilar, but inconsistent, conflict was unavoidable.

On your side, there appeared to be an intense devotion in only one direction. In the words of Johnny Mercer's wonderful lyric, your mission appeared to be "accentuate the positive; eliminate the negative; and don't mess with mister in between." I have no doubt that that is what you used to be hired for.

It was what your clients wanted. At least it was what the chief executive officers of your clients wanted.

There must be for the public relations profession something of the client identification crisis that is afflicting accountants and lawyers. Is your duty to the CEO, or other senior officers who hire you, or to the company which pays your fee and thus to its shareholders and investors? I have no doubt that fifteen years ago this was seldom, if ever, a crisis. No one seemed to question the right of the CEO to use company funds to retain PR talent to make him, personally, look good in the public's eyes. That was what a PR man was for, and there was often little concern for how he did it.

One does not need an investigative reporter to observe that such an attitude and practice are not peculiar to industry. The use of taxpayers', rather than shareholders', money for self-aggrandizement is not unknown in government circles. That does not make it right. And, of course, the evil is not limited to feeding the ego, and possibly the further ambitions, of the boss. It extends to the effort to make the company, or the government department or agency, and its prospects look as rosy as possible by overstating the good news while obscuring the bad. Obviously, the head man looks better if his company or office looks better, but this is somehow less gross, and therefore probably more insidious and harmful, than the more personal ego trip on company funds.

It is easy to rationalize that shareholders, like taxpayers, are happier if they think that everything is going well and will be even better in the future, and if they believe that affairs are in the hands of a great man. They surely are. That is they would be if it were true. But today, more than yesterday, the effort to generate such comfortable impressions, when not supported by the facts, is fraught with great dangers, and not just under the Federal securities laws. Collectively, we have been burned too often and too severely. The national mood has changed. We do not want to be flim-flammed into believing that everything will be wonderful and that affairs are in the hands of some infallible genius. Anyone who has been around a few seasons knows that this is most unlikely to be true. He is no longer interested or even much surprised if everything does not turn out as hoped. He is apt to be satisfied if only the boss does not turn out to be a crook. And he resents being expected to swallow hokum.

The public relations profession is sensitive to moods -- that's part of its expertise. And I think there is evidence that the more sensitive and thoughtful practitioners are responding to the change. In the process, deliberately or not, they are coming closer to making common cause with the attitudes of the SEC and the demands of the Federal securities laws.

The SEC, on its part, moved into the whole subject of communications with investors from a different point of departure. Our traditional posture has been to accentuate the negative and eliminate the positive -- at least from formal, written material filed under our laws.

This lugubrious approach to life and company affairs dates from the beginning and is peculiar to securities regulation. It has no doubt been overdone and is easily parodied. We all know the somber, liturgical disclaimers. "There can be no assurance that a heavier-than-air machine can be made to fly, or that if it can, anyone will want to buy one, or if someone wants to buy one, he will be willing to pay enough to make production profitable." Or suppose General Eisenhower's D-Day order had to be filed with the SEC. "The officers who planned this assault, including myself, have never before planned anything like this. In fact, I have never commanded any troops in combat. The airborne and other methods being employed have never before been tried by our Army. The weather forecast is only slightly favorable and such forecasts have a high degree of unreliability. Therefore, there is no assurance that any of you will reach Normandy alive, or, if you do, that you can secure the beach." And so on.

Or imagine the New Testament restated as an S-1.

My favorite comment on this aspect of SEC disclosure patterns came very early in the game from a wise professor in 1940... He thought that the gloom and doom approach of SEC disclosures was impeding capital formation, especially for new ventures.

"The point [he wrote] may possibly be made clearer by an admittedly imperfect analogy. One might raise the question of the probable effects upon the marriage rate throughout society if before a marriage could occur there had to be 'full disclosure' by both parties concerning their previous actions and behavior. Now it is doubtless true that in many instances such full disclosure would prevent imprudent marriages. On the other hand, it is at least conceivable that a requirement of 'full disclosure' would also have the effect of forestalling an even greater number of marriages which would turn out successfully.

"The parties would be in a sense 'warned off' by having certain facts brought forcibly to their attention. If one accepts the view that a high marriage rate is desirable he might well hesitate to urge the desirability of a 'full disclosure' provision in order to prevent injudicious marriages even though there seem to be a large number of the latter annually. In the writer's opinion, the similarities between marriage and capital investment are probably greater than might at first appear. A certain irrational optimism is perhaps a prerequisite to both."

How did the SEC practice develop this style? Why have we seemed to be so insistent that no one ever expects that anything good might happen? Why, among other things, do we seem to assume that investors are such idiots that they would believe the upbeat stuff if we permitted it?

This is no occasion for an elaborate answer, but I can observe that it all began with the processing of registration statements (including prospectuses) for new offerings to the public. Since the Securities Act and SEC review are directed primarily to the written offering material, and since even in 1933 it was well understood that most selling would be done orally, I am sure that the thinking was that we had better get all of the negative material in the written prospectus, because we can be certain that all of the positive material, and more, will be conveyed to investors by salesmen.

Of perhaps greater importance, the Securities Act imposed personal liabilities for misstatements and omissions in prospectuses which were wholly new when all this began -- and frightening. They are still frightening. So prospectuses, from the beginning, were drafted mainly by lawyers as documents they could defend in court. Much has been said about how few persons actually read prospectuses. This is bound to seem academic to the lawyer working on one, because he knows that the one person in the world who will read the prospectus, and read it most thoroughly and critically, is the plaintiff's lawyer when the value of the securities declines.

contrary, the Commission has always favored written material that people can read, and has often said so, although not always with great success.

Not long ago I was discussing, with some public relations men, our release suggesting a method for permitting projections of earnings to be included in filed documents. The persons I was talking to objected most strenuously to our proposal as being far too complicated and calculated to cut off the flow of information altogether, especially by the smaller company, because of the fear of stumbling into a violation of our complex requirements and also because of the expense and trouble of complying with our proposed conditions.

We have, incidentally, received a great many objections from concerned people about this particular proposal, and we are taking some of these objections very seriously. I can't tell you exactly when or how we will respond with a new proposal, but I think I can state with confidence that the proposed rule as published will not be adopted in that form.

Returning to my theme, however, the interesting part of the conversation was the quiet admission by the public relations men that one reason they objected strenuously to our proposed requirement that any projection be followed by the filing of a Form 8K was that such a requirement would put the whole matter into the hands of the legal department and out of the hands of the public relations department. I do not know how

widely this view is held, but it was a surprise to me. We had never thought of our proposal in those terms -- that any matter requiring the filing of a form with the Commission was to be controlled by the legal department whereas communications not requiring the formal filing were left to the hands of the public relations department.

While I am hesitant to intrude into that kind of inside office politics, if such a policy actually prevails in any company, I must say that it seems to me unfortunate. Legal responsibility for disclosures does not arise solely because information must be reflected in a document filed under our law. With the all-encompassing sweep of Rule 10b-5 and cognate provisions, there is no more "free writing" by companies to the public or to their investors in any meaningful sense. Therefore, unfiled communications or releases may present legal questions that should receive the attention of lawyers. On the other hand, filed documents should also be good communication vehicles and should not be written, on the whole, solely to meet minimum legal requirements. Accordingly, many, if not all, filed documents could benefit from the attention of the public relations department.

Insofar as communication with investors is governed by our requirements, we are constantly striving for the right balance. It is difficult to achieve. Whatever we do, or if we do nothing, we face criticism on the one hand that the

information that we require is not really the sort of thing that investors need and that they are not, in fact, adequately informed by these materials. On the other hand, there is the persistent complaint that we require so much detail that the average investor is swamped and cannot digest the data and does not even try. Both of these complaints have some validity and it is obviously difficult to satisfy them both.

One important aspect of the problem is that we are not dealing with a homogeneous audience or body of consumers of filed information. The persons whom we seek to have informed vary from the shrewd professional analyst, fully capable of using almost any data that he receives, to the uninformed or disinterested investor who will probably not read anything furnished him except a forecast of earnings per share. No disclosure system can completely satisfy both types or the many variants in the middle. This has led to a policy which we describe as differential disclosure, meaning that certain information is consciously intended for the hasty, unsophisticated investor, while certain other information is consciously intended for the professional. This has not been well received in all quarters, but I think it is a line of development that offers some promise of greater satisfaction of the needs of a greater variety of people.

Today increasing emphasis is being placed upon the total cost to American business, and therefore ultimately to American

consumers, of government regulation in general. While in a technical sense we do not admit that the disclosure requirements of the securities laws constitute regulation, they do constitute a governmentally imposed burden that must be examined in terms of costs and related benefit.

We agree with this philosophy, but we find it exceedingly difficult to apply in this particular area. When we propose something like more detailed quarterly reporting by registered companies, and with respect to the larger companies, some auditor involvement, the response of many businessmen is that this will cost too much. We know it will cost something, but it is not easy to come to a reasonable estimate as to how much it will cost. Those that object to the proposal on other grounds, are tempted to exaggerate the projected cost, and we know that too, although we are hardly in a position to come up with any precise estimate of our own.

Even if we do come to some reasonable view as to what the cost in general might be, we are totally incapable of putting any number on the dollar value of the benefits to be achieved. Since virtually every disclosure requirement for the last 40 years has been met with the loud objection in many quarters that it will cost too much and nobody will use it, there is a natural tendency on our side to meet such objections with some skepticism. However, particularly in view of the climate of today, we are making

an especial effort to weigh carefully the cost-benefit aspect of our proposals. But I must admit that it is not easy to do.

Another persistent objection to our requirements is that nobody uses them. Nobody reads annual reports. Nobody reads prospectuses. Nobody reads proxy statements. We, therefore, are engaged in a silly kind of game that benefits only bureaucrats, lawyers, financial printers, etc. If we really thought this were true, I suppose the proper logical response would be for us simply to go out of business, although something might be said for the restraining effect of furnishing disclosures to the government and a public file, even if they were seldom referred to.

Naturally, we do not believe it is true, but we have never had an adequate base of empirical data to determine what use is, in fact, made of our materials and by whom and how often. Some firms engaged in stockholder relations services have occasionally made informal surveys and reported the results, but those that I have seen appear to be in conflict. Some suggest that nobody reads the annual report whereas others indicate that the annual report to shareholders -- not the annual report on Form 10K -- is the best-read document in whole disclosure process. Certainly, it is the most accessible to the most investors. I was therefore interested to read the study by Mr. Marc J. Epstein called "The Usefulness of Annual Reports to Corporate Shareholders," which is a statistical analysis of investor attitudes and desires concerning annual reports.

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The cover of Mr. Epstein's book displays a trash basket full of annual reports. I am not sure that that cover fairly represents Mr. Epstein's conclusions concerning the usefulness of annual reports. However, to the extent that it does, the reason that those annual reports ended up in the trash can, according to Mr. Epstein, was not that investors were not interested, but that they found the annual reports too difficult to understand and did not contain information useful for investment decisions.

Mr. Epstein found that only 15 percent of the shareholders surveyed relied on annual reports as the most important basis for investment decisions. Moreover, of those who did use annual reports in investment decision making, only 14 percent found the annual reports "very useful," and over 26 percent stated, in effect, that annual reports were not useful at all. On the other hand, over 82 percent of the respondents felt that there was a need for them to analyze the annual reports and wanted the companies to send out annual reports rather than pay as dividends the money which could be saved by not sending them out.

I do not want to go into a detailed analysis of Mr. Epstein's study; however, I would like to cite some of his conclusions as to what investors believe is important in annual reports and in what areas they believe improvement is necessary. Not surprisingly, the income statement and balance sheets are the items shareholders most often read somewhat thoroughly and find most useful. On the other hand, the items shareholders read least and found the least useful were footnotes to financial statements, the auditor's report, and the essay and pictorial sections. The items the shareholders had the most difficulty in understanding were the footnotes to financial statements and the funds flow statement. The items with respect to which they most wanted to see further explanation were the funds flow statement, the balance sheet, and the income statement.

It was heartening to me to see the strong interest demonstrated by shareholders included in Mr. Epstein's survey in receiving informative and comprehensible annual reports. Of course, I recognize, as does Mr. Epstein, that many shareholders who felt in theory that it was important to receive and analyze an annual report might not, in practice, actually read their annual reports very thoroughly. Nonetheless, I think it is significant that such a preponderance of shareholders expressed strong interest in corporate annual reports.

Earlier I indicated that I thought that it would be unfortunate if there was a prevailing attitude that matters that had to be filed of the Commission should be controlled by the legal department, but communications not requiring formal filing were left to the public relations department. I think it would also be unfortunate if this tendency for annual reports to be prepared by public relations and marketing personnel indicated a tendency to exclude the financial and legal personnel from the preparation process. For one thing, what I said earlier about plaintiffs' lawyers reading prospectuses applies to annual reports too. For another thing, I think it would be too bad if annual reports came to be viewed by the corporations issuing them as, to put it in Mr. Epstein's words, "an advertising tool rather than a vehicle to facilitate financial reporting generally and reporting on the stewardship function of management specifically."

More important than any technical requirements we might impose on management as matters of regular disclosure, is surely the total attitude displayed by companies, the total image, if you will, created in the mind of investors and the public with respect to our companies. Here we have a major problem for the free enterprise system that deserves the most ardent attention by everyone concerned with preserving that degree of private control over economic activity that we still have.

The economic problems as well as the social problems that we face in the foreseeable future are formidable enough challenges to our collective wisdom and ability to work together even in an atmosphere of mutual trust. The frightening thing today is the increasing evidence of lack of mutual trust on the part of far too many of our citizens toward business in general and big business in particular.

It has been commonplace for businessmen for many years to complain that there is too much general ignorance of how business works and how our economic system works, that there would be greater understanding if there were simply greater knowledge of these basic facts of life. When one reads the results in public opinion polls among college students and faculty members, for example, that express the opinion of the ordinary person questioned to the effect that most businesses average a profit of 30 percent on sales, and like surveys, one must agree that ignorance is indeed widespread and profound.

But the problem is not just ignorance. It is suspicion and, in some quarters apparently, hatred. There are no doubt many reasons for this emotional state toward business, not all of which are new or causes for alarm. But when one sees the attitude so often expressed these days in the media, as well as the bills submitted and published remarks of some members of our Congress, one can only conclude that the disaffection is widespread. Unfortunately, some events of

recent months, and recent years, have tended to shatter the faith even of those who heretofore had been strong to assert that almost all businessmen are honest and well-intentioned.

Parenthetically, I should observe that the dissatisfaction with the present state of affairs, manifested by some members of Congress, is not limited simply to business. My own Congressman, Abner Mikva, has introduced a bill for the self-destruction of administrative agencies like ourselves. As a means of celebrating the bicentennial, Mr. Mikva's proposal is that the SEC, along with similar agencies, automatically goes out of existence on July 4, 1976, unless in the meantime the agency can convince Congress that its continued life is worthwhile. This is not the kind of careful surgery that one might hope would be applied to remedy weaknesses in the regulatory system, and I don't suppose the bill has much chance of passage, but it certainly is a vivid indication of strongly felt dissatisfaction.

Regulatory agencies also obviously have a communications mission with respect to their functions and desirability. We will not meet this demand solely by communications techniques, if our actual performance is not seen on the merits to be in the public interest and worth the cost, both the direct cost in money, and the indirect cost in the demands and inhibitions that we impose upon persons subject to our jurisdiction. Good performance must come first, but it may not in itself be enough.

So, too, with business. All of the most skillful PR campaigns in the world to persuade American citizens that businessmen in general are performing as they should, will not suffice if in fact they are not. But here, again, performance alone may not be enough. The message and the intent must be conveyed.

I remarked earlier that public relations specialists are experts in sensing moods, and I think it is the mood of the times that is bringing us closer together. The SEC in its legal requirements for company disclosures has always, in effect, emphasized candor. It may be that we were more quick to emphasize candor on the down side than on the up side, but on the whole, frankness and completeness have been our message. However it might have been in the past, I know that today certainly the more thoughtful and farseeing members of the public relations profession sense also that what investors and the public want today is candor. They want to know that they are being told the truth. There may be some element of post-Watergate over-reaction in wanting too much truth, especially of a grubby and intimate nature about persons of prominence, and too much readiness on the part of the media to harp on the insignificant personal failings of prominent people, and this may be corrected in time. Whether it is or not, the message that our companies, collectively and individually, must get across to our citizens, is that they are leveling

with investors and other persons concerned with their performance. People can accept the fact that performance is not always perfect, the market goes down as well as up, not all plans succeed. They don't want anybody to insult their intelligence by pretending otherwise. What they do want to know is that the persons that are managing our companies are doing the best that they can, that they are honest, that they are as able in their respective fields as may be reasonably expected, that they are looking out for the interests of investors, but that they are also concerned with the effects of their activities upon our environment and our society.

In more philosophical terms, business management must demonstrate its responsibility and accountability. Even when performance is good, our society will not permit power of the sort possessed by our major business enterprises to continue without being responsible and accountable to someone. Historically, this has been to the stockholders, and while the stockholders of a large company may run to hundreds of thousands of persons, constantly changing in membership, and thus appear more as an abstraction than a concrete body of persons, the idea of accountability to the stockholders is absolutely essential to the legitimacy of the economic power possessed by our companies. If our companies

