# CHAPTER 18
# COMPANIES

BUSINESS BEATS BASICS

# COMPANIES

## INTRODUCTION

Groups of unrelated individuals have been pooling capital and sharing risk – and profits – for hundreds of years. Many historians point to the Dutch East Indies Corporation in the Netherlands as the first public company. In 1602 the company announced in their charter "All the residents of these lands,… may buy shares in the Company." There was no minimum or maximum amount required and every Dutchman was invited to invest. When the initial public offering (IPO) closed on August 31 that year, 1,143 individuals had invested in the company – including the co-founder's maid. Individual shipowners in the 1600s faced tremendous risks in ferrying cargo thousands of miles in rickety wooden ships. By banding together in a legal entity they reduced their individual risk should one of them lose an entire ship and cargo to the sea.

Companies today are more strictly regulated than they were in the 1600s, especially public companies that are allowed to sell shares to individuals, but the general structure and concept of "the company," as a legal entity formed by a group of individuals to engage in a business enterprise, has remained mostly unchanged up until the present day.

Today, a company can be organized in a lot of different ways for both tax and financial liability purposes, often determined by the industry the business operates in. Companies can be either publicly or privately owned and the structure and ownership of the company often determines the financial rules and regulations the company must follow. Private companies have considerably more privacy about their operations and fewer financial regulations and requirements than public companies.

One of the most important regulatory obligations of modern public companies, at least from the perspective of the business journalist, is to disclose details of their operations on a regular basis. They are required, under penalty of law, to tell the truth to the public, i.e. their shareholders. These documents are easily available online and can tell you a lot about the companies you are covering.

In this chapter, we'll dive into the different types of documents you can use to cover public companies and how to find them, as well as tips for avoiding common pitfalls while covering any kind of company and some important terms you'll need to be familiar with.

# PUBLIC COMPANIES

When it comes to business journalism, there is no substitute for digging into the source financial documents. The Securities and Exchange Commission's (SEC) EDGAR website contains a trove of corporate information, ranging from employment contracts for top executives to details about lawsuits to pending government investigations. Investigative journalists also tend to analyze these documents for trends over long time periods to see the evolution of business strategies. These corporate documents include:

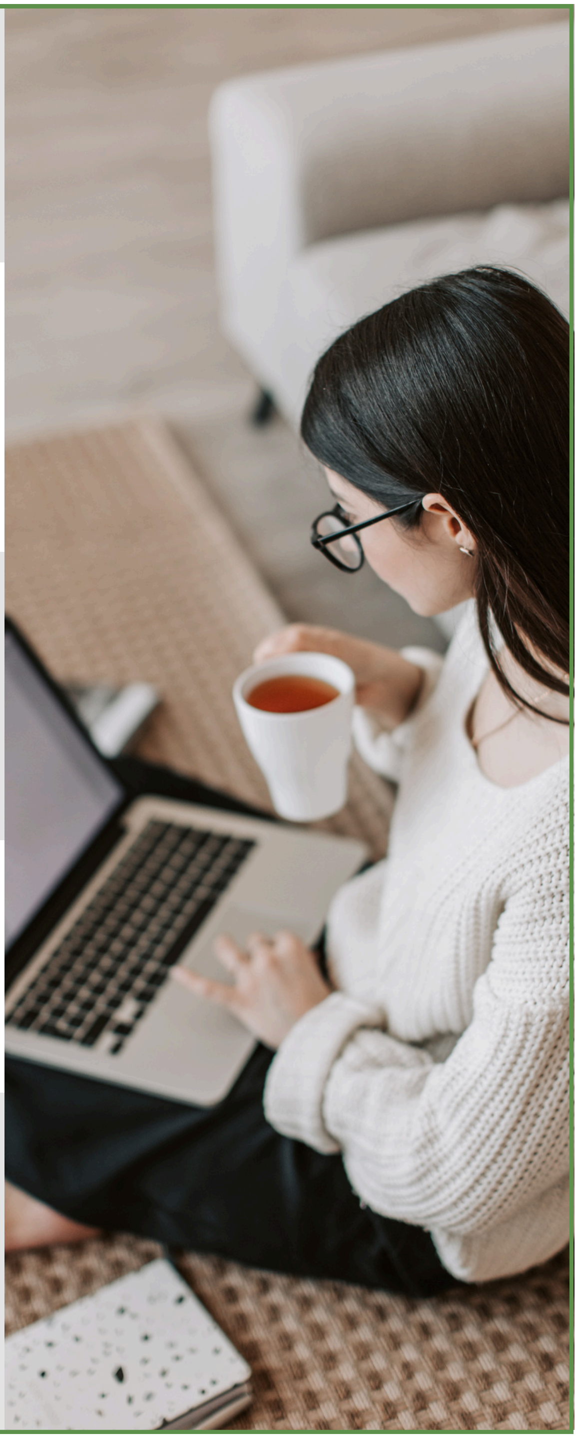
The **8-K, or "current reports,"** contain breaking news on market-moving events. Pro Tip: Press releases may offer a narrow or distorted view of an issue that's more fully explained in a quarterly or annual filing. For more information on 8-K filings, see Chapter 19.

The **10-Q, or quarterly filing,** contains financial statements, details on lawsuits, investigations, and emerging risks. Pro Tip: See how "risk factors" have changed over time by comparing the current report to the prior quarter or previous years. For more information on 10-Q filings, see Chapter 20.

The **10-K, or annual report,** contains audited financial statements, employment contacts, and details about properties. Pro tip: The good stuff is buried in the footnotes. Read the financial statement footnotes, and compare the notes to previous years. For more information on 10-K filings, see Chapter 20.

The **S-1 and related filings** spell out a company's initial stock offering and provide a public glimpse of their finances. Pro tip: See the distribution of shares to corporate insiders, and determine who will control the company after the stock offering.

The **proxy statement, or Def-14,** contains details on executive pay, biographies of directors and officers, and special executive perks. Pro tip: Look for housing allowances, security expenses, and gym memberships in the footnotes for the CEO's executive pay package. For more information on proxy statement filings, see Chapter 21.



These filings can reveal a lot about a company. The SEC's EDGAR database is free and relatively simple., but there is a lot to cover regarding each type of filing, so be sure to check out the chapters on each for useful guides and resources.

# PRIVATE COMPANIES

There are thousands of companies listed on the U.S. Stock Exchange, but some eight million firms are privately held. Small and privately held firms employ more than half of the workforce and account for more than half of the country's economic output. Learning about the ownership and operations of private companies can be difficult and time-consuming, but some basic details can be discerned more easily.

## WHERE TO BEGIN

Start with the business charter and property tax records. What is the address of the person who incorporated the company? You can look it up with the Secretary of State's office, which usually has a corporate records division. Does this name match the person named on the property tax records? Find the property owners through a county assessor's office, then check the tax records, which sometimes can be in a separate tax collector's office. See if the names match the people who incorporated the company and the people who paid the taxes. If not, find out why.

## GOVERNMENT AND PUBLIC RECORDS INTERSECTION

Next, determine where this business intersects with the government, and you can find the relevant records. For example, restaurants are regularly inspected by the health department, and banks are inspected by the state banking commission. Most states have occupational licensing boards and commissions in order for some occupations – such as hairdressers, real estate agents, and doctors – to operate legally.

All of those records are considered public, allowing you relatively easy access if you know where to look. A useful portal to public records websites is: publicrecords.onlinesearches.com.

**The U.S. Occupational Safety and Health Administration**
**osha.gov**
OSHA keeps detailed records about inspections, workplace accidents, injuries, deaths, and similar incidents. You can search by company name, state, city, or zip code.

**The National Labor Relations Board**
**nlrb.gov**
Investigates employment disputes. Cases can be reviewed by company name, region, and other details. These cases contain significant details about a company's operations.

## INVESTORS

Some startup private companies sell securities to outside "accredited" investors (such as banks, insurance companies, or sophisticated investors) through venture capital, private placements, and similar arrangements. In many cases, you can learn some basic details about the amount invested and the names and addresses of the company's senior management. You can find these Form D filings on the SEC's EDGAR website or on FormDs.com, which breaks down the filings by major city.

# TIPS & TRICKS

When it comes to reporting on the finances of private companies and nonprofits, the piles of paperwork and legal jargon can be daunting. Taking the time to do some research can make all the difference. Here are our top five tips for reporting on private companies and nonprofits:

## MAKE FORM 990S SEARCHABLE

For nonprofits, these mandatory forms will offer valuable insight into how the company conducts pay and benefits, which will offer a whole lot of story possibilities. You can find most 990s through a website called GuideStar, but you probably won't be able to search a file if it's been scanned. Try asking the nonprofit for an electronic copy directly or simply convert scanned PDFs into searchable PDFs.

## GO BEYOND GOOGLE

Finding background is one of your most important jobs as a reporter, and prior research will help you form better questions and, ultimately, write a stronger story. Start by searching through the company or organization's own website, then move forward to corporate records and official city documents. Look for lawsuits, lobbyists, patents, and any OSHA scores before publishing your story to prevent any missed legal troubles.

## KNOW EACH SEASON'S IMPACT ON THE ECONOMY

With each season comes different busy months for various nonprofits. Winter, for example, is a profitable season for snow removal contractors and clothing companies. Spring welcomes a boom in business for those who cater to allergy assistance, agricultural groups, and restaurants that boast outdoor seating areas. Be prepared by making contacts with these nonprofits and private companies ahead of time so you can get your story when it is timeliest.

## FOLLOW THE SMALL BUSINESSES

Report on local entrepreneurs and nonprofits and see where they are headed, what they are selling, and where they still have room to grow.

## LOOK AROUND YOUR HOUSE AND IN YOUR WALLET FOR STORY IDEAS

Sometimes finding a story can be as simple as looking at your surroundings. Some of the largest nonprofits and private companies make their mark in your home and wallet in the form of pet care, home cleaning, and loyalty programs. Loyalty programs also offer insight into where consumers are spending and where they are looking to save.

# ADDITIONAL ANGLES

## BROKERS AND MONEY MANAGERS

You can learn whether registered stockbrokers and money managers have been arrested or fined for misusing investors' money by checking the BrokerCheck database (brokercheck.finra.org), which is maintained by the Financial Industry Regulatory Authority (FINRA), an industry regulator. The database holds records on more than 630,000 current and former professionals and some 4,700 firms. The records show employment history and can provide clues about whether someone was forced out of a company. They provide details on investor complaints and, in some cases, details from arbitration proceedings.

In addition, FINRA and the SEC publish lists of brokers and investment managers who were penalized for wrongdoing. The FINRA monthly lists and the SEC's administrative proceedings are available online. Learn more about researching stock brokers by looking at this detailed tutorial.

To investigate investment companies, look at state pension meeting documents, which can unlock details of these secretive companies such as investment information, company demographics, hirings, and firings. States with the larger pension plans tend to release more information.

## OPEN RECORDS REQUESTS AND FOIA

The federal Freedom of Information Act (FOIA), created in 1966, is an indispensable tool for any reporter to learn how the government operates and interacts with businesses. FOIA requests can provide invaluable insight about communications between government officials and corporate executives, or politicians acting on their behalf.

The Reporters Committee for Freedom of the Press (rcfp.org/foia) describes the latest developments involving state and federal open records laws. The Reporters Committee created the iFOIA tool to help journalists file more effective open records requests. However, not all state laws are equal, and the National Freedom of Information Coalition has a good guide on how to navigate specific laws by state.

For your best chance at a successful open records request, start by trying to see who else has covered a similar issue. Work to narrow and focus your request. Spend a little time browsing the FOIA webpage of the agency in question to see what has been released. Then pick up the telephone to speak to the FOIA officer about what you are seeking – or better yet, visit in person. This outreach and research can save days and weeks of waiting and will minimize frustration.

# TERMS TO KNOW

For the definitions of even more financial terms beyond what is included here, try the Investopedia dictionary.

### Beneficial owner
For all practical purposes, the holder(s) or owner(s) of shares in a company. Various circumstances can make an individual or company the beneficial owner of shares that they do not technically own under the law, such as under various trust arrangements, or when a parent controls shares owned by a minor child.

### Central Index Key (CIK)
A unique number assigned by the SEC to each company filing documents with the agency.

### Change of control
Various scenarios under which the control of a company changes hands, including by sale, merger, hostile takeover, proxy battle, or other circumstances in which members of the existing board of directors no longer hold a majority of the board's seats, or existing shareholders no longer hold a majority of shares outstanding. However, for a variety of purposes — e.g., executive severance agreements — different definitions may apply (including turnover of less than a majority of directors or shares).

### Closely held
Describes a company whose shares are held by one or a small group of shareholders. Such shares are typically not traded on a public exchange.

### EBITDA
Earnings Before Interest, Taxes, Depreciation and Amortization. Often used as a rough estimate for cash flow. EBIT is Earnings Before Interest and Taxes, making it roughly analogous with operating income.

### Equity
Broadly, ownership, usually partial ownership (holding equity in a company or partnership). Most often used to refer to the shares of publicly traded companies, as in stock-based pay (equity compensation) or stock investments generally (equities).

### Golden parachute
Severance-pay package awarded by a company to an executive after the company is acquired or taken private.

### Hostile takeover
The acquisition of a public company by another corporation or individual either without the knowledge or against the wishes of the acquired company's management. This is done by acquiring more than 50% of the voting shares issued by the company.

### Independent director
A director who meets specific independence standards, primarily those set by the New York Stock Exchange, the Financial Industries Regulatory Authority, and similar organizations. Typically excludes recently retired or departed executives, family members of current executives, major stockholders, and individuals who do substantial business with the company on whose board they sit. However, it doesn't preclude all outside relationships with a company or its management.

### Insider trading
Technically, any purchase or sale of a company's stock by an executive, director, or major shareholder, but most commonly used to refer to illegal transactions, e.g, ones made with knowledge of material, non-public information that could affect the share price.

### Insider transaction
A term generally used for legal insider trading. These transactions generally must be disclosed by filing a Form 4 or Form 5.

### Issuer
A company that has sold stock to the public; generally used in securities regulations and related material.

### M&A
Shorthand for mergers and acquisitions. A merger is when two companies combine into one, while an acquisition is when one company buys another company. In reality, the vast majority of M&A deals are the latter -- a fact that is often obscured in typical M&A press releases.

### Material
Essentially, another word for significant. Investors usually consider information "material" if it could affect the stock price substantially once it is generally known. But materiality isn't always well defined, and there can be considerable gray areas.

### Non-employee director
Any director not actually employed by the company on whose board they sit on at a given time. This can include former executives, relatives of current directors, and others who don't meet independence tests.

### Performance shares
Typically, restricted stock that vests only after certain performance hurdles are met. Those hurdles can include stock-price targets or other company results, such as net income, revenues, etc.

## Phantom shares

Similar to restricted stock units, in that no actual shares are issued when the award is made. Often, phantom shares are settled in cash, or may be settled in cash or stock, at the option of either the executive or the company. Can sometimes also be called hypothetical shares.

## Poison pill

A feature designed to make it harder for an outsider to take control of a company against its board's wishes (e.g., by buying up a lot of stock). They typically inflate the number of shares held by existing shareholders if an investor buys significant amounts of stock without the board's support.

## Present value

The value today of a stream of payments in the future. If a pension promises a 50-year-old executive $1 million a year for 10 years starting at age 65, it has some value today, although that value is less than $10 million. A present-value calculation determines that figure by making assumptions about interest rates, inflation, and other factors.

## Principal officers

Typically, the chief executive officer (CEO), chief financial officer (CFO), president and chief accounting officer (CAO), but different companies may use different titles. The term overlaps with, but isn't necessarily the same as, the proxy's Named Executive Officers.

## Qualified plan / Non-qualified plan

A qualified plan is an employee benefit plan that is eligible to receive federal tax breaks, generally because the plan benefits a broad cross-section of workers, rather than just top executives and other highly paid employees.

In contrast, a non-qualified plan is a benefit plan that isn't qualified under federal tax law, meaning that it doesn't benefit from the same tax exclusions as a 401(k), traditional pension, or similar plans.

As a result, to avoid tax costs, companies typically set up non-qualified benefits as hypothetical accounts. Instead of actually setting money aside (e.g., for a deferred compensation plan or SERP), they simply keep a paper record of what the account should be. This usually makes no practical difference for an executive.

However, if the company becomes insolvent, these IOUs are unsecured debt, meaning the executive must wait in line with other creditors in the bankruptcy process. (By contrast, 401(k) and pension accounts have dedicated assets that may not be used for other purposes, even in bankruptcy.)

## Record date

The cut-off date for voting at an annual meeting. Those holding shares on the record date may vote.

## Registrant

Typically, the company that makes a filing with the SEC (e.g., a proxy or 10-K filing). More technically, the entity whose shares are registered for sale to the public, thus triggering SEC reporting and other obligations.

## Related-party transactions

Any of a number of specific or general relationships among a company, its directors, and its executives. These can include family relationships (e.g., a CEO's son-in-law working for a subsidiary of a company), business relationships (e.g., a director whose law firm does legal work for the company), and other contractual relationships (e.g., a company that leases a CEO's personal jet for business purposes).

## Repricing

A reset of the strike price of a stock option or related derivative product that often results in transforming an unusable option (i.e. one with a strike price higher than the prevailing price of the underlying asset) into one that can be exercised for a profit. Typically rare and frowned upon by investors and corporate governance experts because doing so has adverse accounting implications for companies.

## Restatement

Reissuance of a company's prior financial statements because of serious errors in the originals.

## Restricted stock

Shares of stock that have certain restrictions attached to them, typically a prohibition on selling or transferring them before a certain date.

## Risk factor

A disclosure by a company, generally in a 10-K or 10-Q, that warns investors of potential risks to a company's business or stock. Officially, these are supposed to be specific and non-routine risks, but many companies try to include every imaginable eventuality.

## RSUs

Restricted stock units. Similar to restricted shares, except each unit represents the right to receive one share at a future date, rather than actually constituting a share in and of itself.

## SARs

Stock Appreciation Rights. The right to receive the difference between a company's share price on two dates — usually the date of issue and some date one or more years in the future. May be payable in cash or stock, depending on the award's terms. Similar to a stock option.

## Say on Pay

An up-or-down vote on executive pay that most companies are required to put before shareholders on a regular basis. Failing a Say on Pay vote, or even coming close to failing one, is akin to a vote of no confidence by shareholders.

## Schedule 13 filing

A report disclosing ownership of 5 percent or more of a company's shares. Must be filed within 10 days of crossing the 5 percent threshold, and is amended periodically as the shareholder's stake rises or falls significantly. Schedule 13D filings can indicate an activist shareholder intending to take action to influence management or the company's direction; Schedule 13G filings tend to be less dramatic.

## Shareholders' equity

Essentially, what would remain of the company if all assets were liquidated and all liabilities paid off — what the shareholders ultimately own.

## Shares outstanding

The total number of shares issued.

## Stock options

Any of several financial instruments, used to compensate executives and other employees, that are ultimately valuable to the recipient only if the company's share price rises. Most commonly, stock options are awarded with a strike price (typically the stock price at the time of award), a vesting period (typically one to three years), and a term (most often 10 years). Once an option has vested, the recipient may exercise it, which involves paying the strike price and receiving in return the share price at the time of exercise; the result is that the option recipient receives the difference between the two amounts. So if options on 100 shares are awarded to an executive when the underlying stock's price is $8 a share, and the executive subsequently exercises the options when the stock price is $10 a share, he would receive ($2 x 100 =) $200. Once an option expires, it cannot be exercised and is worthless. (Note that stock options awarded to employees and executives are similar to, but distinct from, the kind of equity options that are traded in markets such as the Chicago Board Options Exchange, or CBOE.)

## Strike price

The fixed price at which a stock option or similar instrument is set to buy or sell; typically the price of the underlying stock at the time the option was issued.

## Tax gross-up

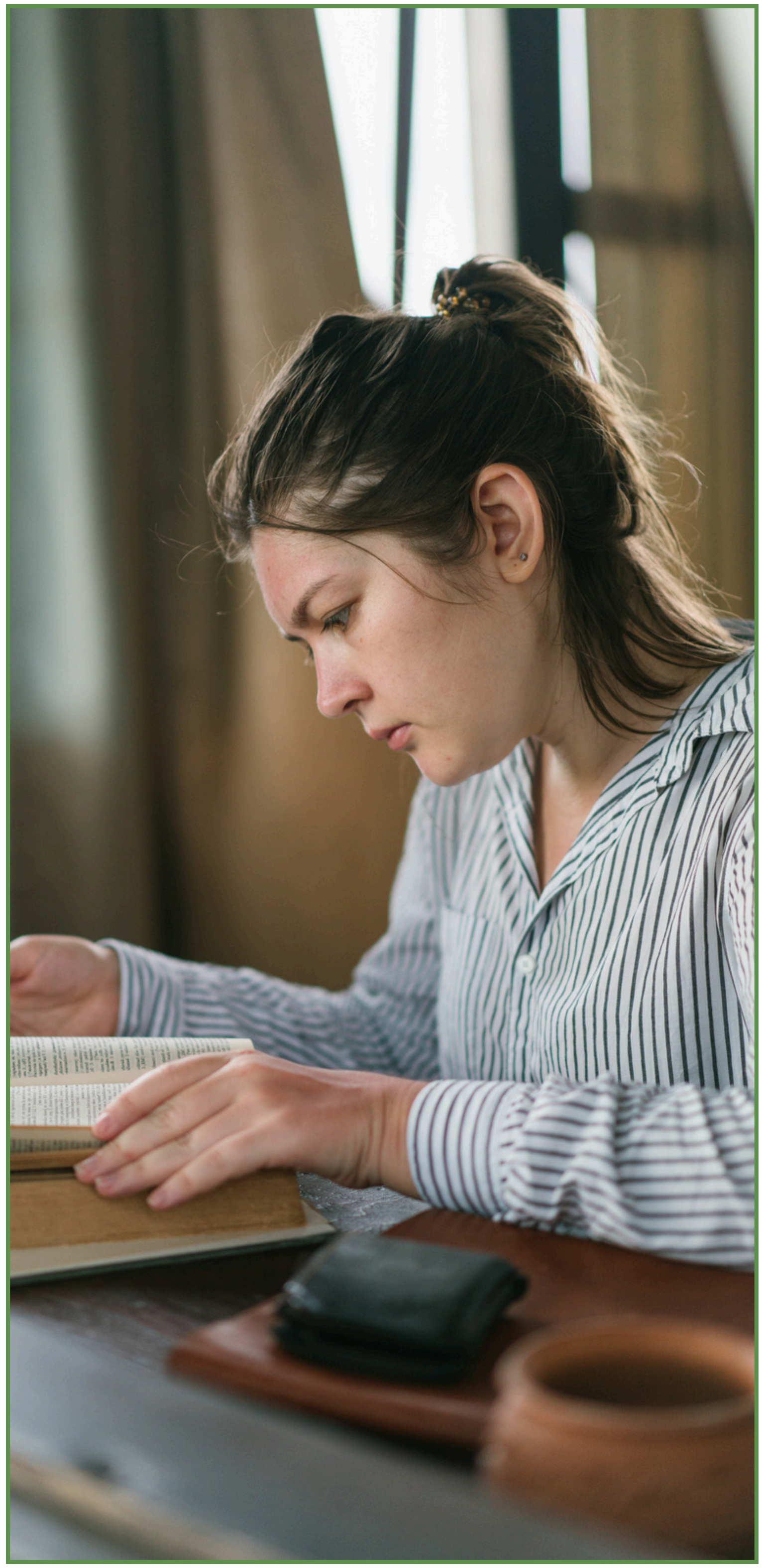
An additional payment meant to compensate the recipient for taxes paid on an initial payment or benefit (as well as the additional taxes owed for receiving the gross-up).

## Underwater

Negative in value. The value of the stock or asset has fallen below what it was originally purchased at.

## Vest

Full rights pass to the recipient. Usually used in reference to stock options, restricted stock, RSUs, and similar instruments. While such an award is "unvested," the recipient can't cash it in or sell it; once it vests, all restrictions generally lapse.



**This chapter is based on the "Beats Basics" Companies section, originally published in 2014 and written by Rob Wells, a University of Arkansas journalism professor and a longtime business journalist at several publications, with supplemental material from Theo Francis, a financial and investigative reporter for The Wall Street Journal.**