The Corporation in Society

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The Corporation in Society

Fundamental Questions:

• As a corporate board member, to whom are you responsible?

• Is the corporation an institution to be developed to serve society?

Or:

• A collection of assets organized to maximize returns to investors?

• If the latter, what is the appropriate time frame over which to measure returns?
The Corporation in Society

• Limited liability corporations are chartered by society, as represented by government officials.

• Corporations have the ultimate obligation to serve society by creating lasting value.

• Violations of that charter result in:
  • Revocation of their charter (e.g., Arthur Anderson, Nationalization in France; Google in China)
  • Regulations and laws limiting its freedom to operate (e.g., Dodd-Frank, Minder Law in CH)
The Evolution of Capitalism

Society is demanding a new form of capitalism that benefits all stakeholders

From:
Entrepreneurial Capitalism
Managerial Capitalism
Financial Capitalism

To:
Shared Value Capitalism

When stakeholder interests get out of balance, capitalism is at risk of self-destruction, as in 2002 & 2008 and 201?
Capitalism Is Facing Imperative For Renewal

<table>
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<tr>
<th>Era</th>
<th>Entrepreneurial Capitalism</th>
<th>Managerial Capitalism</th>
<th>Financial Capitalism</th>
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<td>JJ Astor</td>
<td>Alfred Sloan</td>
<td>Carl Icahn</td>
<td>Paul Polman</td>
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<td>Failure</td>
<td>Doesn’t scale</td>
<td>Gets too bloated</td>
<td>Alienates the 99%</td>
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<td>Drivers</td>
<td>No creation of opportunity beyond Founder</td>
<td>Management complacency</td>
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<td>Drivers</td>
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<td>Drivers</td>
<td>Land grants</td>
<td>Adoption of technology</td>
<td>Management complacency/ Self-interest</td>
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New Phase

- Financial crisis
- Millennial focus on Mission
- Globalization
Creating “Shared Value”*

• The ultimate goal for global companies is to sustain success by creating value for *all* its stakeholders

• This includes:
  • Clients, customers & beneficiaries
  • Employees
  • Owners and investors
  • Local government & communities
  • NGOs with stake in organizations

*The idea of “Creating Shared Value” was first proposed by HBS Professor Michael Porter in HBR, January 2011.
Sustaining Growth and Performance

Mission-Driven Values-Centered Organization

Motivated Employees

Innovation and Superior Customer Service

Increased Customer Satisfaction

Shareholder Value Increases

Profit Growth Increases

Revenue Growth Increases

Reinvest
With societal expectations for companies rising and trust declining, should companies shift from considering local governments and communities as their stakeholders to becoming:

“Stakeholders in Society”*

This notion dovetails with Prof. Porter’s ideas on “Creating shared value,” i.e., companies should look at their mainstream business as contributing to societies all over the world.

*This idea was proposed by Prof. Klaus Schwab of the World Economic Forum at Harvard Kennedy School on March 27, 2014.
Challenges to Board Governance

Are external challenges to board governance strengthening or weakening the board’s ability to govern the corporation and provide effective oversight of management?

Examples for discussion:
• Elimination of staggered boards
• Direct nomination of directors
• Majority and cumulative voting
• Say on pay
• ISS and Glass – Lewis
Board Leadership

Which leadership model is preferable?

• Independent board chair; CEO not on board
• Independent board chair; CEO on board
• Chair & CEO, with independent lead director
Board Time Management

How should boards allocate their time?
• Financial results and projections
• Updates on current events
• Strategy and long-range planning
• Succession planning and organization changes
• Risk management
• Audit reviews
• Legal and regulatory reviews
• Public responsibility and serving society
• Open discussions with management
Activist Challenges

- What is the appropriate role of activist investors demanding changes in strategy or financial structure to produce near-term value accretion?

- Examples:
  - PepsiCo
  - eBay
  - P&G
  - Target
  - Allergan
  - JC Penney
  - DuPont
  - Kraft

“I believe in running the company for shareholders that are going to stay, rather than ones that are going to leave.”

- Warren Buffett, Oct 16, 2013
Case Study: Battle for Allergan

Valeant making hostile bid for Allergan, cutting R&D from 17% to 3% and tax rate from 34% to 3%. Has raised its offer five times from $150/share to $200. AGN increased shareholder value 10X in 15 years, and performing well. (+187% in 1 yr. vs. +18% for Valeant) Proxy vote scheduled for Dec. 2014.

Allergan P&L:

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<th>Stand-alone</th>
<th>Merge w/ Valeant</th>
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<tbody>
<tr>
<td>Revenues</td>
<td>$10.0 B</td>
<td>$10.0B</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>17% 1.7</td>
<td>3% 0.3</td>
</tr>
<tr>
<td>Other X</td>
<td>53% 5.3</td>
<td>53% 5.3</td>
</tr>
<tr>
<td>Oper Profit</td>
<td>30% 3.0</td>
<td>44% 4.4</td>
</tr>
<tr>
<td>Tax</td>
<td>34% 1.0</td>
<td>3% 0.1</td>
</tr>
<tr>
<td>Net Income</td>
<td>20% 2.0</td>
<td>43% 4.3</td>
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Dealing with Activist Shareholders

1. Have clear strategic focus and stick to it
2. Analyze your business as an activist would
3. Have your external advisors lined up in advance
4. Build board chemistry by being transparent with board about challenges and vulnerabilities
5. Perform near-term against stated goals
6. Don’t dismiss activist’s ideas out of hand
“I don't know what your destiny will be, but one thing I do know:

The only ones among you who will be really happy are those who have sought and found how to serve.”