Rick Wartzman Remarks
Vienna Nov. 15, 2012
Are We Really Building a Movement to Counter
"Maximizing Shareholder Value"?

Thanks very much. It's a pleasure to be with you today.

I'm Rick Wartzman, the executive director of the Drucker Institute in Claremont, Calif., a social enterprise that seeks to make people more effective, organizations more responsible and work more joyful.

We do this by turning Peter Drucker's ideas and ideals into tools that are both practical and inspiring.

And we do this because, as Drucker so often reminded us, society is only as strong as the organizations within it.

It is with last notion in mind—the idea of building healthy institutions so that society, in turn, is itself healthy—that I'd like to spend a few minutes now exploring a topic that I've been chewing on a lot lately:

Are we really building a movement to counter "maximizing shareholder value"?

For those of you paying especially close attention, you'll notice that the title of my talk has changed from what you'll find in your programs. Originally, I was planning to focus on "How to Cure Our Managerial Myopia."

But as I read the abstracts submitted in advance of the Forum, I realized that what I had to say on that particular subject was very close to what Adrian Wooldridge was planning to say—and, indeed, just did say moments ago.

Now, Peter Drucker might have called an attempt to echo Adrian's considerable insights "creative imitation," noting that the creative imitator "does not invent something new." Rather, he "perfects and positions" something that already exists.

Yet given how difficult an act Adrian is to follow, I decided this was an utterly foolish strategy to pursue; the odds of me perfecting what my colleague from *The Economist* has just laid out are very small indeed. And so I decided to head in a new direction—and I hope you'll indulge me in doing so.

So, back to: "Are we really building a movement to counter maximizing shareholder value"?

The truth is, I'm not entirely sure. The signs out there are mixed.

Yet we do know quite a bit about how movements gain traction, and it's with these factors in mind that I'd like to briefly share where I think we stand in terms countering the widespread greed and shortsightedness that brought on the global financial crisis and Great Recession.

To begin, though, we should have no illusions that we're up against an incredibly powerful force.

In fact, in the words of Johns Hopkins University's Steven Teles, "maximizing shareholder value" has become a key part of "the most successful intellectual movement" that we've seen at the intersection of law and economics in the past 30 years.

The result: As Cornell's Lynn Stout acknowledges in her wonderful book *The Shareholder Value Myth*, "Shareholder-primacy ideology still dominates business and academic circles."

"Fifty years ago," Stout points out, "if you had asked the directors or CEO of a large public company what the company's purpose was, you might have been told that the corporation had many purposes: to provide equity investors with solid returns, but also to build great products, to provide decent livelihoods for employees, and to contribute to the community and the nation. Today, you are likely to be told that the company has but one purpose: to maximize its shareholders' wealth."

In many ways, it's no wonder. As the "maximize shareholder value" movement gained steam through the 1980s and '90s and into the 21st century, so did executive pay, especially in the United States.

Here you can see that spike in median total compensation for large-company CEOs documented, in millions of constant U.S. dollars.

As we look to change things, we shouldn't underestimate how hard it will be to get executives to side against their own narrow self-interest. As the American writer Upton Sinclair famously observed: "It is difficult to get a man to understand something, when his salary depends on his not understanding it."

It can <u>even</u> be difficult to change things, however, when a top executive is deeply committed to generating profits with purpose.

Consider, for instance, PepsiCo CEO Indra Nooyi, who has a compelling vision for her company to sell more and more nutritional foods and drinks—not just fare loaded with salt and sugar. As much as any CEO I know of, Nooyi embodies Peter Drucker's view that it is the function of all businesses "to satisfy a social need and at the same time serve themselves by making the resolution of a social problem into a business opportunity."

But Nooyi also demonstrates, as much as any CEO I know of, how immensely difficult it can be to pursue such noble ends. While she has pushed PepsiCo to reduce the fat and sugar in many of its current products, while adding whole grains, fruits and vegetables to some of its offerings, investors have been demanding that Nooyi pay more attention to the company's core products: Pepsi soft drinks and Frito-Lay chips—the not-so-good-for-you stuff.

The pressure on her has been palpable. And earlier this year, though PepsiCo's board said it was standing by Nooyi and her team, directors also stressed that the company was [AND I QUOTE] "committed to maximizing shareholder value."

So, where does this leave us?

Are we on the cusp of generating a counter-movement of our own? What does it look like? And where will it go?

In his bestselling new book, *The Power of Habit*, Charles Duhigg tells us that sociologists and historians have identified a three-part process, which shows up time and time again when it comes to successful movements.

First, Duhigg says, a movement starts because of the social habits of friendship and the strong ties between close acquaintances.

To illustrate, he tells the story of Rosa Parks, who on Dec. 1, 1955, deep in the American South, in Montgomery, Alabama, did a remarkable thing. Parks, who was black, refused to give up her seat on a public bus to a white rider. Parks was then arrested. "At that moment, though no one on that bus knew it, the civil rights movement pivoted," Duhigg writes.

Notably, Parks was not the first black person to be arrested for violating Montgomery's bus segregation laws. But what set her case apart, as Duhigg sees it, was her extensive personal network. A highly respected member of the community, "Parks' many friendships and affiliations cut across the city's racial and economic lines," Duhigg says. Word of her civil disobedience quickly spread, and Parks's personal ties ensured that her action resonated and carried meaning.

Political scientist Jo Freeman makes a similar point in her work, "On the Origins of Social Movements": "Masses alone do <u>not</u> form movements, however discontented they may be," she writes. "If [people] are not linked in some manner . . . the protest does not become generalized" and often "dissolves completely."

"If a movement is to spread rapidly," she adds, "the communications network must already exist. If only the rudiments of a network exist, movement formation requires a high input of 'organizing' activity."

So, how can we get organized?

Certainly, there is no shortage of intellectual ferment out there. Many leading management scholars (David Cooperrider, Michael Porter, Rosabeth Moss Kanter, Gary Hamel, Jim Collins, Roger Martin and others) are, each in their own way, pushing to reframe capitalism and move our economy and society away from a shareholder-is-king mindset.

The question, as I see it, is: Where is the center of the movement? What do we even call it? Is it Martin's "Customer Capitalism"? Or Porter's "Shared Value"? Or Moss Kanter's "Vaguard Companies"? One of my Drucker Institute colleagues, Lawrence Greenspun, has floated the catchphrase "Comprehensive Profit."

One idea for creating a center comes from author Steve Denning: He cites the way that 17 software developers came together at a ski resort in Snowbird, Utah, in 2001 to create the Agile Manifesto, which has inspired many people working in the software industry to do things differently.

"Granted," Denning says, "the agile movement is still evolving. But there has been huge progress. Tens of thousands of organizations around the world are developing software in a better way—better for the organization, better for the developers and better for the ultimate user.

"One reason why this happened," Denning believes "is that the Agile Manifesto created a kind of banner . . . that all of the people present could subscribe to, while still continuing to pursue their own individual variations on the theme. The individual activities were transformed into a large scale global movement, because the participants saw themselves as part of something larger."

So far, though, we've yet to find our Agile Manifesto.

Meanwhile, a center of sorts may be forming under the umbrella Conscious Capitalism. The group, whose members agree to "adopt a higher purpose that transcends profit" and explicitly manage their businesses "for the simultaneous benefit of all of their interdependent stakeholders," recently held its sixth annual CEO Summit.

But the truth is, Conscious Capitalism remains a fairly small organization, and many of its most active members—companies like Whole Foods and the Container Store—are relatively small themselves.

The second step for forging a movement, according to Duhigg, comes because of the so-called “weak ties” that hold groups together.

After Rosa Parks’ friends took the necessary steps to exert their influence, Duhigg writes, “people who hardly knew Parks decided to participate because of a social peer pressure . . . that made it difficult to avoid joining in.”

The good news for us is that corporate executives seem to be especially susceptible to such peer pressure.

Peter Drucker called it a “bandwagon psychology.” "If a fellow CEO on the golf course says, 'We are using this, and we wouldn't do without it,' you have to do it too," Drucker explained.

He likened this herd mentality among corporate leaders to when he was growing up here in Vienna, and “everybody felt the need to be psychoanalyzed.”

“And there was a time,” Drucker added, “when every child older than 4 years had to have his tonsils out.”

There is no shortage of major companies that do espouse--and, most important, more often than not do adhere--to principles and practices that go far beyond a simplistic “maximize shareholder value” mantra: Procter & Gamble, Johnson & Johnson, Starbucks, Unilever, Google, Amazon, Costco, Toyota and many, many more.

These are companies that, as Peter Drucker wrote in *Managing for the Future*, “do not attempt to maximize shareholder value or the short-term interest of any one of the enterprise’s ‘stakeholders.’ Rather, they maximize the wealth-producing capacity of the enterprise.

“It is this objective,” Drucker said, “that integrates short-term and long-term results and that ties the operational dimensions of business

performance—market standing, innovation, productivity and people and their development—with financial needs and financial results. It is also this objective on which all constituencies depend for the satisfaction of their expectations and objectives, whether shareholders, customers or employees."

We need to find more ways for the heads of these Drucker-like companies to put greater pressure on their peers—by highlighting their example, by giving them opportunities to speak out, and by standing by them (as thought leaders and customers and, yes, as shareholders) when their longer-term orientation bumps up against those with a shorter-term horizon.

We must also do more to get out the facts. As Roger Martin has made clear in his research, "shareholder value" hasn't been very good for shareholders.

In fact, he found, returns to shareholders were better in the period before the shift to shareholder-value capitalism than after.

Other studies have reached a similar conclusion.

The third vital step in creating a movement, Duhigg indicates, is for the movement's leaders to "give participants new habits that create a fresh sense of identity and a feeling of ownership."

In the case of Rosa Parks and civil rights, "Montgomery's citizens learned in mass meetings new behaviors that expanded the movement," Duhigg writes. Specifically, they learned the techniques of non-violent protest: organizing, sit-ins, marches and other forms of demonstration.

What tools and techniques can we leverage?

Roger Martin has pointed to some potentially potent ones, including changes in securities law that would keep executives from issuing earnings guidance and trying to manage—and massage—Wall Street's quarter-to-quarter expectations.

Or how about eliminating the use of stock-based compensation as an incentive, given that it has largely had the opposite effect of what was intended?

But beyond taking things away, we're going to need to offer new frameworks, as well.

In the 21st century, "we will have to learn to establish new definitions of what 'performance' means in a given enterprise, and especially in the large, publicly owned enterprise," Drucker himself advised. "We will have to learn how to balance short-term results—which is what the present emphasis on 'shareholder value' amounts to—with the long-range prosperity and survival of the enterprise. . . . We will have to develop new measurements."

Some are trying. For example, Directors & Boards magazine—working with Ernst & Young, SAP and the consulting firm Brand Velocity—has been promoting a new set of controls around what is called Value Risk Management, an approach that seeks to give corporate leaders the sophisticated measurements they need to go beyond simply assessing and navigating financial risk and, instead, help them drive real value across the enterprise through the development of new products, talent and technology.

Still, adoption is slow.

At the same time, we must guard against the manipulation of any new measurements that are devised. I, for one, worry that companies will tout their allegiance to a higher purpose—and not just profits—but that in many cases this will amount to mere lip service or be a calculated PR stunt, in the same way that companies today engage in "greenwashing" so that they don't appear out of step with the environmental movement.

We must also give more consideration to the role our business schools play in perpetuating a shareholder-is-all point of view. A good number of MBA programs have become more enlightened in recent years—but certainly not all of them.

“Think of . . . the MBA who comes in on the first day,” Thomas Donaldson, a business ethicist at the University of Pennsylvania’s Wharton School, remarked at last summer’s Aspen Ideas Festival, during a session titled “Does Maximizing Shareholder Value Endanger America’s Great Companies?”

These young people “bring with them . . . a kind of common-sense conception of responsibility, of purpose and so on,” Donaldson continued. “What happens in the next two years? Well. . .we teach them how to calculate net present value, how to do regression analysis. We give them . . . capital asset pricing. All of these tools interestingly enough assume—although . . . very few say it out load—that the sole function or purpose of the firm’s financial success is for the owners.

“By the time (the students) leave, what's happened? In effect they have had some of (their) common-sense notions trained out of them. It's death by neglect. . . . And we haven't provided them any story to replace it.”

So, are we building a sustainable movement or not? On the one hand, it’s pretty uncertain, bleak even.

“It is hard to know yet whether this new movement (to get beyond shareholder value) will have legs,” the *New York Times*’ Joseph Nocera suggested recently in his column.

“Measuring chief executives on the basis of their companies’ stock prices is easy to understand—that was always part of its appeal,” Nocera wrote. “Those who want to change that . . . have struggled to come up with breakthrough ideas that would be similarly appealing. Besides, shareholder value is so deeply entrenched, it will be difficult to dislodge.”

And yet, there is also cause to be more sanguine. I suspect we’re all encouraged on some level, or we wouldn’t be gathered here.

After I wrote a piece recently questioning whether we are truly at the dawn of a movement to counter “maximizing shareholder value,” Steve Denning responded with these comments:

“What is cause for confident optimism,” he said, “is that there is an intellectually coherent alternative to shareholder capitalism that also happens to be more profitable than shareholder capitalism. Although there are many factors driving this movement forward, it’s the economics that will ensure its success.

“As a result, it’s now not a question of whether; it’s a question of when.”

Here’s hoping that Denning is right. If so, Peter Drucker will surely look down, smile on us all and say: “It’s about time.”

Thank you very much.