

Memo to CEOs: Put shareholders second

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Paul Polman, the CEO of Unilever, thinks American-style capitalism is broken, and he blames, in good part, the cult of shareholder value that has been all the rage since the 1980s. Since taking the helm in 2009 of the Anglo-Dutch consumer products giant that owns Ben & Jerry's ice cream, Dove soap and Lipton tea, Polman has eliminated quarterly profit reports, refused to give earnings guidance to analysts and informed hedge funds that they will not be indulged.

He has railed against the theories of economists and biz-school gurus like Milton Friedman, Michael Jensen and Lucian Bebchuk, the high apostles of shareholder power and democracy. "The very essence of capitalism is under threat as business is now seen as a personal wealth accumulator," Polman said recently. "We have to bring this world back to sanity and put the greater good ahead of self-interest."

His views make him an outsider, a rebel, one who allegedly is out of touch with modern management theory. Corporate bosses are beholden to shareholders first because they are the owners, and, as the cliché goes, possession is nine-tenths of the law. All the rest of the so-called stakeholders—employees, suppliers, retirees, local communities—can take a number.

If anything, the obsession with "maximizing" shareholder value has taken on the status of a major religion, so much so that shareholders who have owned a stock for a week—hedge funds, for instance—are demanding instant spoils.

In 2010, hedge fund manager extraordinaire David Einhorn of Greenlight Capital scooped up the first of his now 2.4 million Apple shares and, dazzled by the company's treasure chest of liquid assets—more than \$121 billion (all currency in U.S. dollars) at the end of fiscal 2012—launched his gunboats. Apple CEO Tim Cook at first paid little attention to Einhorn's demands. But he finally relented earlier this year, pledging \$100 billion to shareholders in the form of share buybacks and dividends by the end of 2015. Welcome to the "financialization" of a company that had a history of putting innovation first, shareholders second.

Besides Polman, a few other brave souls are highlighting the mistake of rewarding the quick-buck artists. Martin Lipton, the Wall Street corporate lawyer who pioneered the poison pill, decried Einhorn's (and his ilk's) lunge for "short-term profit without regard to the impact on the company's long-term prospects." William Lazonick, of the University of Massachusetts Lowell, and Lynn Stout, of Cornell, argue that corporate bosses and investors should resist the tyranny of activist shareholders and their demands for instant gratification.

Lazonick thinks that the priorities of modern American corporations—and by extension their Canadian equivalents—are so wrong on so many levels that they are jeopardizing national competitiveness and welfare. The trend to reward shareholders with lavish buybacks benefits the sellers, not the long-term owners, and deprives companies of the resources to fund R&D, train employees, make acquisitions and engage in other activities to improve productivity and competitiveness. Buybacks inflate the stock price, all the better to reward the executives who

have tied their pay to share options and bonuses. “With a system that permits top corporate executives to be rewarded by stock-market speculation and manipulation,” he asks, “what need do they have for innovation and job creation?”

If shareholder primacy is not recognized, might they buy real estate, sovereign bonds or gold ingots instead? But Lazonick argues that some shareholders are less deserving than others. Activists like Einhorn were very late arrivals to the Apple success story—the shares have gone from about \$4 in the late 1990s to some \$500 recently. He was not one of Apple’s early private investors, who took the biggest risk, nor did he buy into its initial public offering in 1980, the only time the company tapped public investors. Neither he nor any other investor invented the fundamental technologies that made the iPod, iPhone and iPad possible—the Internet, lithium-ion batteries, microprocessors, signal compression, GPS and so on. The laboratories of various American defence, energy and spy agencies are responsible for most of those innovations. Lazonick’s point: If anyone deserves special treatment, it is the taxpayers who funded the research exploited by Apple, not the hedgies.

And putting shareholders second can have the unintended consequence of making them rich. Unilever’s please-all-stakeholders approach has sent its shares up 67% over five years, handily exceeding the returns of the FTSE 100 index. Until last year, Apple’s performance had dazzled investors for a decade. Ditto Warren Buffett’s Berkshire Hathaway, where quarter-by-quarter gains were never pursued. In 2009, Jack Welch, the former CEO of General Electric and poster child of shareholder performance, seemed to recant. “Shareholder value,” he said, “is the dumbest idea in the world.”