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Discussion Paper

Closing Address: Indra K Nooyi, Chairman & CEO, PepsiCo

Michelle Edkins, Managing Director, BlackRock:

Performance with Purpose initiatives are helping to make PepsiCo a model for how global businesses should conduct themselves today. Corporate Responsibility magazine named PepsiCo as one of the world’s 100 best corporate citizens. They’re the only food and beverage company to be on EthoSphere’s list of the world’s most ethical companies for seven consecutive years, and they have been listed on the Dow Jones World Sustainability Index for six consecutive years.

I’ve had the privilege of getting to know Indra and her team, and I can say they truly believe that strong corporate governance is the foundation for financial integrity, investor confidence and superior performance. Indra’s membership on the Advisory Board of the John L. Weinberg Centre for Corporate Governance demonstrates her personal commitment to the issue. Please join me in welcoming to the stage Indra Nooyi.

Indra K Nooyi, Chairman & CEO, PepsiCo:

Thank you, Michelle, and good morning, everyone. The International Corporate Governance Network is such an important organisation and thank you for all you do to raise the bar on good corporate governance around the world. And Michelle, BlackRock and your contribution to the field are second to none. You have helped shape and define what world class shareholder engagement looks like, and have helped move the profession beyond the traditional governance issues, to look at a corporation’s overall contribution and impact on society and the environment. Thank you for your vision and leadership, and for inviting me to speak with you today.

What I want to do today is to share with you my thoughts on sustainable capitalism, not as a representative of all CEOs in the business community as a whole, but from my point of view as a CEO of a large, iconic US-based global company. Sustainable capitalism, a lot has been written about this topic. It’s been the subject of many forums and many prestigious think tanks and academic institutions. Some people have lauded the concept. Many have criticised it. And many companies have actually struggled to deliver on this notion. What is it and why is it so difficult to deliver on?

When I think of sustainable capitalism, I’m referring to private enterprise that manages itself for a certain level of returns, balanced with duration and sustainability of these returns. So, manages itself for level of returns, coupled with duration and sustainability of these returns. It is business that balances stakeholder concerns with shareholder needs, and most importantly, it is business that recognises that, wherever it operates, it does so responsibly.

I want to talk today about some of the barriers holding back corporations from being the drivers of sustainable growth that there could be, both in terms of growth in shareholder value, along with a sense of the broader society in which they operate. And, finally, I want to talk about the responsibility we have as leaders of corporations, governance experts, Investment Analysts and investors, and what we can do to work together to create the kind of business environment that is so needed today.
I thought I might begin by telling you a story which began in the early 1950s. It concerns two men, both of whom were called Charles E. Wilson. The two Charles E. Williams ran two of the country’s largest corporations. The first Charles was nicknamed Electric Charlie because he was the CEO of General Electric. The second was known as Engine Charlie because he was the CEO of General Motors. Now, General Motors in those days was truly an iconic American company.

During World War II, Engine Charlie’s General Motors had secured the largest Government contract of any corporation. And after the war’s end, GM controlled 50% of the domestic automobile market and employed over 600,000 people. So, when President Eisenhower needed to select a Secretary of Defence, Engine Charlie seemed like the natural choice, an uncontroversial choice, if I may add. But then came the confirmation hearings, where Engine Charlie was asked by the Senate Armed Services Committee if he, as the Secretary of Defence, would be prepared to make decisions that were in the national interest, but were adverse to General Motors’ interests.

Charlie responded with one of the most infamous political gaffes ever. “What is good for General Motors,” Wilson reportedly said, “is good for America.” “What’s good for GM is good for America" became a cultural proof point, indicative of a sort of arrogance of the business community. But here is the irony about it. Engine Charlie never said that. In fact, he had said exactly the opposite, and I quote, “I cannot conceive of a situation where America’s interests and General Motors’ interests do not align,” he told the Committee, “because for years, I thought that what was good for the country was good for General Motors.” These words, stated back in the 1950s, are profound. “What is good for the country is good for General Motors.”

So, what I want to do is pick up on this theme and explore what is good for our country, our home. And it’s important that we start with the United States because what catches on here generally has influence around the world. I think we can all agree that any successful economy has to have economic growth and security. And this is only possible with a thriving private enterprise that generates strong returns then constantly renews itself to sustain these returns for the long-term. In short, private enterprise that manages for the level and duration of these returns. For a country to be able to thrive, plan and invest in important priorities like infrastructure, education and healthcare, it has to have the confidence that both the level and duration of returns from private enterprise will be coming.

As companies, we all know how to manage for level of performance. We have quarterly financials, constant share price updates, and financial dashboards that show us the level of performance at any given moment. And it can be very tempting to put all our energy and resources into maximising the level of returns in the short-term. But the country also needs private enterprise to manage for the long-term. And this is the challenge for business leaders, to effectively balance both the level and duration of performance, in an environment that perhaps does not fully appreciate the need for this balance.

And this is no easy task. Managing for duration means that you do not generate wealth and opportunity today at the expense of others, or at the expense of future generations, shareholders and society alike. It requires adequate levels of investment by every company in areas like long-term research and development, people training and development, and organisational renewal so that companies can address all challenges they face to operate successfully in today’s volatile, global, highly-competitive, uncertain environment. It also means worrying about a company’s impact on society. A company that keeps its cost down by deliberately dumping its waste into a nearby river may be delivering the levels of profit a company needs in the short-term, but it’s certainly not delivering on duration, because somebody else has to pick up those costs to society.
So, as leaders of private enterprise, I think we need to ask ourselves, how are we doing? Are we delivering on what the country needs? Are we delivering on this notion of sustainable capitalism? Unfortunately, I am not sure the answer is a resounding yes. In fact, I can say with a great degree of confidence that, despite the awareness of the incredible long-term challenges we’re all facing, the pressure, scrutiny and focus on the short-term has never been greater.

I think of my own company. It was over 100 years ago the Pepsi-Cola company was founded and modern day PepsiCo, created through the merger of Pepsi-Cola and Frito-Lay will celebrate its 50th anniversary in 2015. But today, even companies that think of their history in terms of decades, now too often think of their future in shorter increments of time: months, quarters, even weeks.

There are a number of reasons for this, which you know as well as I do: corporate culture, human nature, a magnified and growing social media, valuation bias, and incentive structures, to name a few. And then, there is the issue of the sometimes short-termism of capital markets.

As publically traded companies, we, of course, have a fiduciary responsibility to our shareholders, all our shareholders. And good corporate governance practice is grounded on meaningful dialogue and engagement with all our shareholders. But there are many different kinds of shareholders. Some share the viewpoint of Engine Charlie, that corporations which act in the interest of stakeholders and society are, in fact, maximising shareholder value. They invest in companies they believe in and engage in dialogue when there are concerns. But, more importantly, they see what is good for the company as synergistic with what is good for larger societal interests, especially those that relate to their business. There is absolutely no question that business and society are interdependent.

And then, there are shareholders who see things a different way. John Bogle, Founder and former CEO of Vanguard, describes the common situation where owners become short-term renters of stocks, and when the momentary price of stock takes precedence over the intrinsic value of the corporation itself. They believe that companies should be run to maximise short-term profits solely for the shareholder. And the focus here is on the short-term shareholder, not other corporate stakeholders’ interests or constituencies. This short-term pressure and more importantly, lack of attention to the long-term consequences results in a situation where corporations may not always make the optimal trade-off decisions for the long-term viability of the company.

Now, I want to give you an analogy to think about this. Think of when you’re driving. You spend most of your time looking out through the windshield with an occasional glance down to the dashboard to see how far you’ve travelled or how quickly you’re moving. Imagine spending the whole journey staring obsessively at the dashboard. You know what would happen if you did? You would very quickly crash. And I think we can all agree that, in recent years, we have seen a serious crash, one that will go down in history.

Today, we are still recovering from the collision that resulted from our excessive focus on the dashboard, and that was the collapse of the financial system. And, because that failure was in part due to poor governance oversight, the immediate response to prevent another collision was to create a ton of regulation. We saw it first with Sarbanes-Oxley and then we saw it again with Dodd-Frank.

Now, I don’t want to get into a debate about Dodd-Frank with a room full of corporate governance experts. But I do want to make one important observation. The law is over 2,000 pages long. My General Council here pointed out to me that one major law firm published a summary of the Act which ran over 100 pages, a summary of the Act. He also
noted that the Act requires over 200 rulemakings and studies to be conducted by almost a dozen different agencies.

So, we have to ask ourselves, is that really proportionate? Does this complexity help anyone? Does it make mainstream companies like PepsiCo, which had nothing to do with that financial crisis, does it make us better? And I’m often reminded of my own home, and I bought it several years ago. We had lots of problems with the roof. What had happened was that the previous owners, every time there was a hole in the roof or more than one hole, instead of ripping out the roof and putting a new one, put a new roof on the house. So when we bought the house, there were seven roofs and the foundation of the house had begun to fall apart.

It seems to me that’s what we’ve done with regulation. We seem to have created the worst of all worlds. The bureaucracy is large and complex, and in many instances, ineffective. I think we have a heavy roof and the foundation of our house is being shaken. Now, I’m not saying regulation is unnecessary, please don’t get me wrong. Something had to be done at that time. But we cannot solely look to Government and Governmental regulation to encourage or even ensure good behaviour. I think good governance is certainly a better option than trying to regulate where there will almost always be loopholes and where regulation almost always lacks innovation.

So, if regulation isn’t the answer to the questions I raised, what is? As a CEO for a publically traded company, I’m going to tell you that change needs to begin at home. We need to break out of the trap of short-term thinking ourselves. And this was, of course, much easier said than done. And I remember the words of Gandhi, who once said, “There is more to life than increasing its pace.” Well, I don’t think he watched real time global news, minute-by-minute financial updates and Tweets, which all report the content of a meeting even before it’s finished. I bet you’re tweeting, too, right now. But some short-term holders of the stock judge the company leadership based on extremely short-term actions and results. And then, 24/7 media amplifies even the smallest bits of information, and all this forces corporate leaders to be constantly on guard. For some, faced with these pressures, there’s precious little time to pause and reflect. There is little time to think about the strategic choices that will ensure the growth of sustainable shareholder value.

Many organisations like the Conference Board and the Business Roundtable for Corporate Ethics, just to name two, have pointed out the short-term thinking bias. And I think most of us here today would agree that it has become the normalised and accepted behaviour among too many corporate executives. It’s a deeply entrenched business culture today.

Perhaps you saw the study published in the Journal of Accounting and Economics which showed that 78% of managers said that they would reject an NPV positive project if it would lower quarterly earnings below expectations. So, do you invest in a new solar project or a new R&D facility, or do you pump that capital into a campaign that will give you a short-term bump in earnings? Balancing short and long-term, setting future-focused goals, being responsible and considerate in risk-taking, can sometimes feel like we’re swimming against the tide. And, because of this, changing corporate culture cannot be done one company at a time. We need a system-wide solution.

So, how can we infuse long-term sustainable thinking into the senior-most ranks of the corporate world and into boardrooms? I have five suggestions. First, I think CEOs and Boards have to be held accountable for prudent management of a company, delivering adequate short-term returns while investing appropriately for the long-term. We have to find a way to judge the performance of companies using a balanced scorecard, which incorporates both short-term financial measures and long-term business sustainability measures. This is not easy, because the scorecard should not compromise the competitive
strategy of the company. Or it shouldn’t create reporting requirements that are onerous and sometimes not so useful. But the need for a balanced scorecard that is made public is badly needed; suggestion one.

Second, I think environmental and social sustainability considerations need to be integrated into all aspects of the company. A company should not have a sustainability strategy separate from its business strategy. Together, you cement the long-term viability of the company, vote for the shareholders, as well as societal interests related to the business. The sustainability strategy, the environmental and social sustainability strategy should be an integral part of the company strategy. The Scientists in the R&D labs, the Marketers designing ad campaigns, the Procurement Officer sourcing raw materials should all understand the implications their decisions have on the environment, society, and therefore, the long-term viability of the company.

This is not easy. It means changing cultural norms. It means changing incentive structures. It means oversight at the Board level. It means regular and meaningful dialogue with stakeholders and shareholders. And it means constant communication of values and expectations to all the employees in the company. And it also means that we need a better scorecard. We need a scorecard with trusted, comparable, verifiable indicators of our impact to society and the environment.

The majority of publically traded companies in the US now publish a sustainability report, many in accordance with the guidelines established by the Global Reporting Initiative. And, of course, we’ve seen great results. As corporate governance professionals know, transparency is the driver of change in and by itself. The process of identifying your greatest impacts and putting that information in the public domain creates internal awareness, which actually leads to change.

And our GRI report will be published later this summer, and we look forward to using this as an engagement tool with some of you here in the room today. But frankly speaking, here’s the problem. Corporations have no consistent standard on how they report on environmental, social, and to a lesser extent, governance issues. We’re establishing our own rules, to be honest, which in many ways has its appeal because every company’s different. But in doing so, it makes it very challenging to benchmark with competition, and almost impossible for Financial Analysts to look across industries and work with the data into the evaluation models.

More importantly, this subjects every company to the whims of NGOs who might mean well, but use the lack of consistency to create noise around their own individual causes. This lack of rigour around reporting means this information is sometimes treated as an afterthought, often referred to as simply non-financial information. But, as we all know, these issues can have significant financial consequences downstream.

Third, we need stronger market incentives for long-term loyal investors. I wonder if short-term traders looking to exploit movements in the stock price should have the same considerations as shareholders who are investing in the long-term viability and success of the company. How do we sensibly balance the two opposing interests?

The Aspen Institute has put forth some concrete proposals on what this could look like, things like revising the capital task provisions, maybe on a descending scale, to encourage longer-term shared ownership. Sounds like a pretty appealing thought.

We may also want to look at the way finance professionals are evaluated and incentivised. When their bonuses are tied to short-term returns, they pass this pressure on to
corporations. And a good deal of balance has to be engineered into the incentive structure of Portfolio Managers and Analysts.

Fourth, some Governmental body, along with the accounting profession and business representatives, have to go back and look at all the regulation on the books to remove redundancies and toothless but time-consuming rules. It’s time to give corporate leaders more time to run the company and create value and not just focus on bureaucracy.

Finally, if CEO compensation has become such a lightning rod, let’s all agree on the best way to reward and incentivise corporate leaders then let’s stop the debate and criticism. Let’s allow the CEOs to do their work. I know most of you in this room have spent a lot of time thinking about these issues. Many of you have written on this topic and have your own suggestions on how to address it. But despite the research and attention it has received, achieving sustainable capitalism appears a bit elusive.

Why haven’t we seen more action? I think the primary barrier is defused responsibility. Who can take the lead? No one particular company can step out alone without the risk of being disadvantaged versus his peers. And while the sustainable investment community is growing, and now we have about 30 trillion in invested capital represented by signatories of the Principles for Responsible Investing, I understand that many companies do not perceive meaningful differences in how they are evaluated by the markets.

So, we clearly need an integrated collective approach. You’re certainly not going to solve all these issues today, but I do want to leave you with two thoughts. One is a suggestion and the second is a request. First, it is time for the accounting community, in partnership with the business community, to develop a truly balanced, integrated scorecard, one which addresses financial performance, the long-term health of the business, then identify the environmental, social and governance issues that are most material by industry sector and create reporting rules and requirements around them. We need information that’s trusted and meaningful to the investor community, as well as other stakeholders, that also helps companies objectively evaluate their performance against peers.

I understand there’s a relatively new organisation called SASB, which stands for Sustainability Accounting Standards Board, working on this right now. I know we have to be careful in asking for more disclosure requirements because we have so many already. But I think initiatives like this are worth pursuing. Common disclosure in this area will be good for investors. Keep it up. But even the best reporting in the world won’t make a difference if the demand isn’t there from those who analyse and influence the market. Incentives to take a long-term approach to evaluating company performance coupled with training on how to incorporate ESG evaluation models is badly needed. So, all of you in ICGN, we are counting on your support to do just that.

Now, my request for all corporate governance professionals in the room. You have a crucial role to play, especially during the upcoming proxy season. Can you help infuse a longer-term point of view while evaluating companies? And while voting is critically important, can we all take a page out of Michelle’s book, and always try for honest and thoughtful engagement with companies? Just a thought.

So, let me close by bringing back Engine Charlie. He was prescient back in the 1950s. I think it’s time to have the spirit of Engine Charlie whispering in our ears. Thank you.