FP COMMENT

TERENCE CORCORAN

A CEO fix we don't need

In the view of Harvard's Michael C. Jensen, Toronto management dean Roger Martin is a "brilliant strategist." Coming from Mr. Jensen, one of the greatest business theorists in the history of corporate America, that praise might be welcomed at Research in Motion, where Mr. Martin is a director. So far, though, there have been few signs of that brilliance at RIM and no public acknowledgment that the dean of the Rotman School of Management at the University of Toronto has added anything to RIM's strategy or management.

We have, however, seen plenty of Mr. Martin in another corporate dimension, one where Michael Jensen is somewhat less impressed. In the wake of a leftist think-tank's compilation of Canadian CEO compensation earlier this week, Mr. Martin was quick to join the wave of moralizing and offer his view that CEO compensation needs radical reform. Among other things, he proposes abolishing stock options, one of the major sources of high CEO compensation.

Outlawing stock options, says Mr. Jensen, is a "really stupid idea."

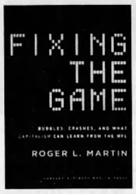
Outside Canada, Mr. Martin has recently received a wave of attention over his last book, *Fixing the Game: Bubbles, Crashes, and What Capitalism Can Learn from the NFL*. The book, published last April, received a shot in the arm recently when Steve Denning, a former World Bank operative and now a management/leadership guru, wrote a laudatory review in *Forbes* magazine. According to Mr. Denning, *Fixing the Game* is "a brilliant new book ... that explains why the private sector's 35-year addiction to 'maximizing shareholder value' has been disastrous for shareholders, for employees, the personal lives of executives, for the economy and for society at large."

The book itself, a thin volume of 200 smallish pages of loosely packed type, lays out a spectacular claim. There's a need, says Mr. Martin, to explore and rewrite the mission statement of corporate governance and "the theories that underpin American capitalism."

> Our theories of the fundamental goal of corporations and the optimal structure of executive compensation are fatally flawed and have created stock market upheavals. Acting on those theories, we have built structures into our capital markets that threaten the future of American capitalism.

According to Mr. Martin, the core theory that is destroying American capitalism is the one that directs corporations to "maximize the return to shareholders" and that places "shareholder value maximization" as the "singular goal" of corporate management. And, according to Mr. Martin, the man most responsible for installing shareholder-value maximization as the guiding light of American capitalism is ... Michael C. Jensen.

The origins of the shareholder theory, says Mr. Martin, is a 1976 paper by Mr. Jensen and William Meckling in the *Journal of Financial Economics* titled "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure." As Mr. Martin tells it, this paper single-handedly transformed U.S. corporate thinking, realigned corporate objectives and prompted a mass move to the use of stock options as management incentives. Stock options, over time, became the source of an elaborate corporate game in which executives and the players in the capital markets



fleeced the system, destroyed value, and created crises.

To fix the system, Mr. Martin calls for a repurposing of corporate America — and presumably corporate Canada, including RIM. Instead of maximizing shareholder value, which leads to corrupt manipulation of earnings to satisfy the "expectations market" driven by Wall Street and hedge funds, Mr. Martin proposes that corporate managers replace monetary goals and focus instead on a broader set of goals, the prime objective being "delighting one's customers."

On how to maximize customer delight, the title of a chapter in *Fixing the Game*, Mr. Martin digs into an extended football analogy. The NFL forbids players and coaches from betting on the outcome of their own games — which is what stock options promote in the corporate world — leading Mr. Martin to propose that American capitalism should come under

> Roger Martin attacks the straw dog of share value maximization

the "moral equivalent of an NFL commissioner" to weed out shareholder-maximizing behaviour and protect the "real" value and objectives of corporate America.

> To help companies focus on maximizing customer delight rather than shareholder value, we should fundamentally redefine the obligation of the company relative to its shareholders. Currently, the obligation is to maximize shareholder value, defined as increasing the share price from its current level to the maximum extent possible. This obligation should be changed to one consistent with the ... credo, which is that shareholders should realize a "fair return."

All of this is too much for Michael Jensen, whom Mr. Martin claims created the shareholder maximization model and who serves as a straw man throughout *Fixing the Game*. Said Mr. Jensen: "I have never said — and if I have I was being stupid — that a corporation should be run for its stockholders." Indeed, a review of some of Mr. Jensen's extensive writings on corporate theory failed to produce any evidence that he promoted maximization of shareholder value. Even the 1976 paper cited by Mr. Martin as the seminal work that changed the course of history does not propose installing shareholder value as the prime corporate objective.

As Mr. Jensen sees it, and with good reason, Mr. Martin has misrepresented his views on corporate theory. Even worse, however, is that the corporate theory Mr. Martin espouses as an alternative is no better — and may be even worse — than the shareholder-value one he wants to demolish.

Mr. Jensen sees the Martin alternative to the straw dog of shareholder value as just another rehash of the "stakeholder theory" of corporate governance, a set of ideas that have waxed and waned in popularity over the last three decades.

The stakeholder theory holds that corporations should focus on satisfying a wide range of constituencies or stakeholders: customers, employees, communities, shareholders, suppliers, bondholders, governments — the list, in effect, is limitless. In Mr. Martin's book, the first focus should be on customers and "delighting" them with fabulous products and services.

The trouble with Mr. Martin's stakeholder approach is that it offers no basis for management decision-making. In his 2001 book, *A Theory of the Firm: Governance, Residual Claims, and Organizational Forms*, Mr. Jensen said "proponents of stakeholder theory offer no explanation of how conflicts between different stakeholder are to be resolved. This leaves managers with no principle on which to base decisions, making them accountable to no one but their own preferences."

In an interview, Mr. Jensen said managers "cannot focus on any single constituency. You have to make trade-offs amongst them all. You cannot ignore a signal one of those constituencies." But a corporation needs a financial objective as a guide, and that financial objective is to maximize the long-term value of the company. Not the share value at any point in time, but the value of the company as a whole over time. Mr. Jensen defines value maximization as current total firm market size, including the sum of the market values of the equity, cash flows, debt and any other claims against the company.

These financial measures may not be concepts that the average person or even manager can grasp, but the financial measures — including profit maximization within a competitive environment — are the goal posts for management. Like Mr. Martin, Mr. Jensen has used football analogies: "Defining what it means to score a goal in football or soccer, for example, tells the players nothing about how to win the game; it just tells them how the score will be kept. That is the role of value maximization in organizational life."

Some edited excerpts from my interview with Mr. Jensen appear nearby. He is clearly well aware of the abuses of options in CEO compensation systems and has written extensively about the problems and solutions in management compensation.

As for the stakeholder model and Mr. Martin's *Fixing the Game* call for abandoning stock options, curbing hedge funds, refocusing corporate priorities and imposing taxes on short-term gains in the stock market, Mr. Jensen sees it all as wrongheaded. "Roger is a guy who is smart enough to get this and I don't know why he's gone off in that direction, other than it goes down like pap" in populist circles and within the social butterfly class that has never given up on stakeholder capitalism.

One wonders, also, whether stakeholderism is what RIM shareholders are looking for.

INTERVIEW

Stakeholderism would destroy more value

Edited excerpt from Terence Corcoran interview with Michael C. Jensen, professor of business administration, emeritus, Harvard University Graduate School of Business Adminstration.

Q *Roger Martin, in his book Fixing the Game, calls for an end to the corporate focus on shareholders he says you created — and which he says is destroying American capitalism - and replace it with a focus on customers.*

A Frankly, it's bulls--t. Roger is getting a lot of attention with this populist message — and some of what Roger is complaining about I actually like. I'm attracted to his characterization of "the expectations market," which is an unbelievably corrupt game that has been going on for a long time between top managers and the capital markets. Managers have been manipulating earnings to meet market expectations. Jack Welsh [legendary CEO of GE] basically spent his entire career manipulating market expectations. It represents a fantastic lack of integrity that results in an enormous amount of value destruction.


NEW YORK TIMES
Harvard's Michael Jensen

But there's an unbelievable naiveté involved in what Roger and a growing crowd of people at *Forbes* are doing in attacking what I call value maximization and substituting what is essentially stakeholder theory. It goes to the very heart of what it means to be able to make principled decisions. This idea that you can run the company for customers is unbelievably naive.

Q *Roger Martin calls it "delighting the customer." What's wrong with that?*

A If that's all you're going to focus on, you're in deep s--t. Think about making any particular constituency happy. If you provide them with what they like — employees with better wages or bonuses; customers with higher equality products and lower prices; or the capital markets with better share values — you've trade-offs to make.

How in the world do you go about making trade-offs between all of those stakeholders to get it right? Roger and company are right that if you focus only on the shareholder you would be sure to not maximize value. You can't do it. If you focus only on your customers, you will destroy value.

If Roger Martin gets his way, there will be more value destruction. Roger is a brilliant strategist, but when it comes to corporate compensation he doesn't know what he's talking about.

Get dirty and avoid vaccines

Lawrence Solomon

'We can't suggest we become dirtier and expose our children to more bacteria," said Dr. Moshe Ben-Shoshan of the Division of Allergy and Clinical Immunology at Montreal Children's Hospital. Our determination to prevent disease may lead to more allergies, he believes, but if so, it would be worth it. "If the price of having fewer allergies is more infection, I don't know any parent who would expose their child to more infection."

Dr. Ben-Shoshan, lead author of a study just published in the *Journal of Allergy and Clinical Immunology*, is both wrong and wrong-headed. Wrong because parents in their thousands, perhaps hundreds of thousands, willingly expose their children to infection. Wrong-headed because he has no basis to assert that dirt and bacteria hurt children more than they help them. Evidence abounds to the contrary.

The parents that Dr. Ben-Shoshan seems entirely unaware of include those who have made headlines throughout the Western world. "Playing chicken: Some parents want children to catch chicken pox," read a *Vancouver Sun* headline. "The return of the measles party," announced the UK's Guardian: "Popular in the 1950s before mass immunization, the measles party is making a comeback. If you're worried about media reports of the measles, mumps and rubella (MMR) vaccine causing autism, then you can join a network of parents who are trying to infect their children naturally with these diseases." Those networks are now easier than ever to find thanks to social media, as visitors to the Facebook page, "Find a Pox Party in Your Area," well know.

The parents leery of vaccines and other medications for normal childhood diseases are among a large majority: 89% of parents, according to a University of Michigan poll, cited vaccine safety research as their No. 1 health-care priority, followed by concern over the safety and benefit of medications. Many parents — about one-fifth — have questioned or refused a vaccine for themselves or their children, despite the immense pressure from health authorities to submit to medical dictates: In most jurisdictions, unvaccinated children are denied the right to attend school.

Dr. Ben-Shoshan, along with the majority working in his field, claim that concerns over the benefits of vaccines and antibiotics are dwarfed by the benefit of saving children from contracting serious allergies. Perhaps they're right. But they have no way of knowing, because their mindset stems from faith, not science. Take HPV vaccines, which are now being widely administered to boys and girls as young as age 9, to prevent cancers that may be sexually transmitted in future. As of September, according to the Centers for Disease

> The hygiene hypothesis perceives unintended results: more allergies

Control, a U.S. government agency, the vaccines have led to the reporting of over 20,000 adverse effects, most of them considered "non-serious," which means the patients did not need hospitalization, did not face a life-threatening illness or succumb to a permanent disability, and did not die. But some 1600 reports were considered serious, including cases of Guillain-Barré syndrome, a rare neurological disorder, and scores of deaths. The CDC says these "serious events may or may not have been caused by the vaccine."

Parents are concerned, as much about the immediate consequences of vaccines as about their future consequences, about which little can be known. And why wouldn't parents be concerned? The same health authorities that insist the benefits outweigh the risks have no explanation for the apparent epidemic of allergies, autism, asthma, immune disorders and learning disabilities that afflict ever-more Western kids.

But increasingly, the authorities do offer an explanation — the hygiene hypothesis, the view that today's obsession with Purell, anti-bacterial soaps, antiseptics for minor scratches and other drivers toward a sanitized environment has unintended consequences. "We've developed a cleanlier lifestyle, and our bodies no longer need to fight germs as much as they did in the past," explains Dr. Marc McMorris, a pediatric allergist at the University of Michigan Health System. "As a result, the immune system has shifted away from fighting infection to developing more allergic tendencies."

Third World countries without this sanitization obsession don't have our levels of food allergies, asthma, and autism and even within developed countries, allergic reactions depend on demographics. Dr. Ben-Shoshan's survey found that Canadian-born respondents were twice as likely as immigrants to suffer from food allergies, and that people in homes whose respondent had graduated from a post-secondary institution were almost 2½ times as likely to have a sesame allergy, twice as likely to have a tree nut allergy, and 63% more likely to have a peanut allergy.

It should come as no surprise to any scientist that a sanitized environment can be dangerous, as can be medical procedures that change the human body's chemical balance. Our bodies are ecosystems for trillions of microorganisms that, each doing its own thing, somehow keep the body's impossibly intricate circulation, muscular, hormonal, digestive, skeletal, respiratory, and nervous systems in balance and functioning. We have thousands of known species of bacteria in our bodies with more being discovered every year. For the great majority of these species, we have no inkling of their functions. Blasting our bacteria with blunderbuss antibiotics, or bludgeoning other systems in the human ecology with equally blunt weapons such as vaccines, will almost certainly cause collateral damage, some of which may not be known for decades to come.

Who has an incentive to curb needless or even harmful use of vaccines and medications? Not the government health bureaucracies that enlarge their influence with each new dictate that they deliver. Not the medical research establishment that depends on grants from the health bureaucracy. Not the pharmaceutical companies that lobby for and then profit from government mandates that require their products be used. In the case of vaccines, a $30-billion a year global business, the pharmaceutical companies have even been exempted from any liability whatsoever in the U.S. market in the event that their products debilitate or kill.

The only people with an overwhelming incentive to protect children are parents. Dr. Ben-Shoshan and his cohorts will be hearing more from them in the years to come.

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