
CAPITALISTS ARISE

We must preserve Free Enterprise Capitalism

The Free Enterprise Engine

1. Made America the leading economic and military power in the world
2. Built America's Middle Class as the largest economic market in the world (1945-1975)
3. Miraculously, lifted hundreds of millions from abject poverty to a more humane standard of living

Today, the Free Enterprise Engine is at Risk



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Relevant Context

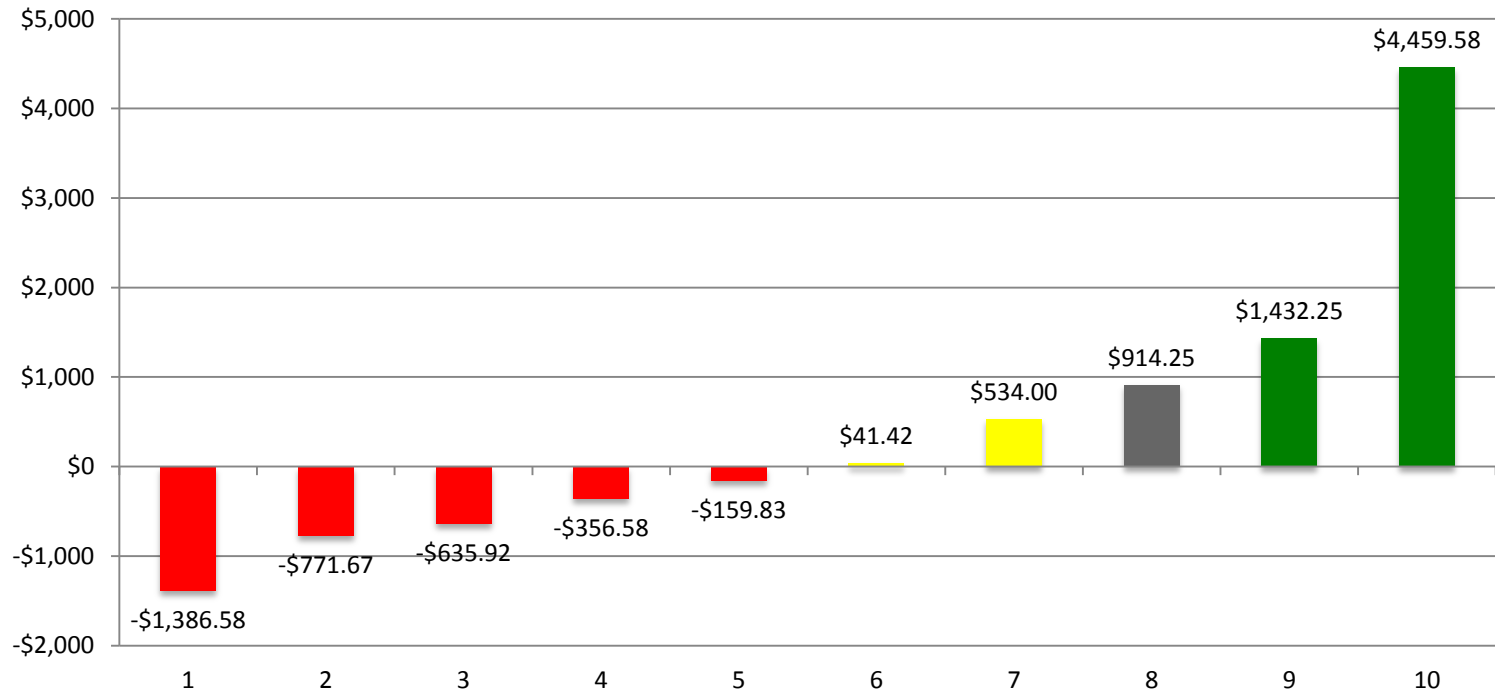
Inequality

- a) The nature in inequality
- b) When income inequality becomes a problem

Income and Wealth Inequality

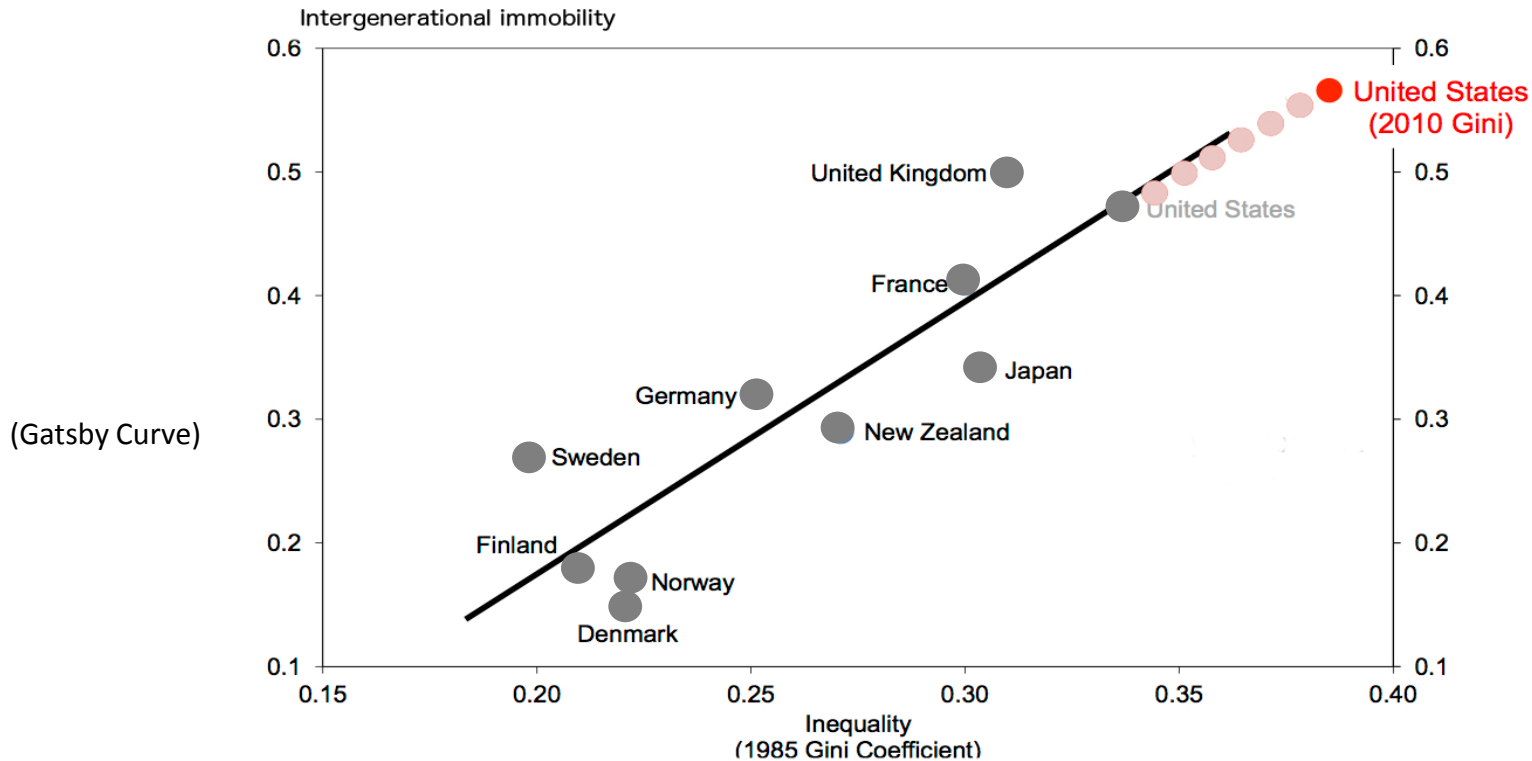
How Real, How Big?

After Tax Monthly Surplus Income By Decile, 2014



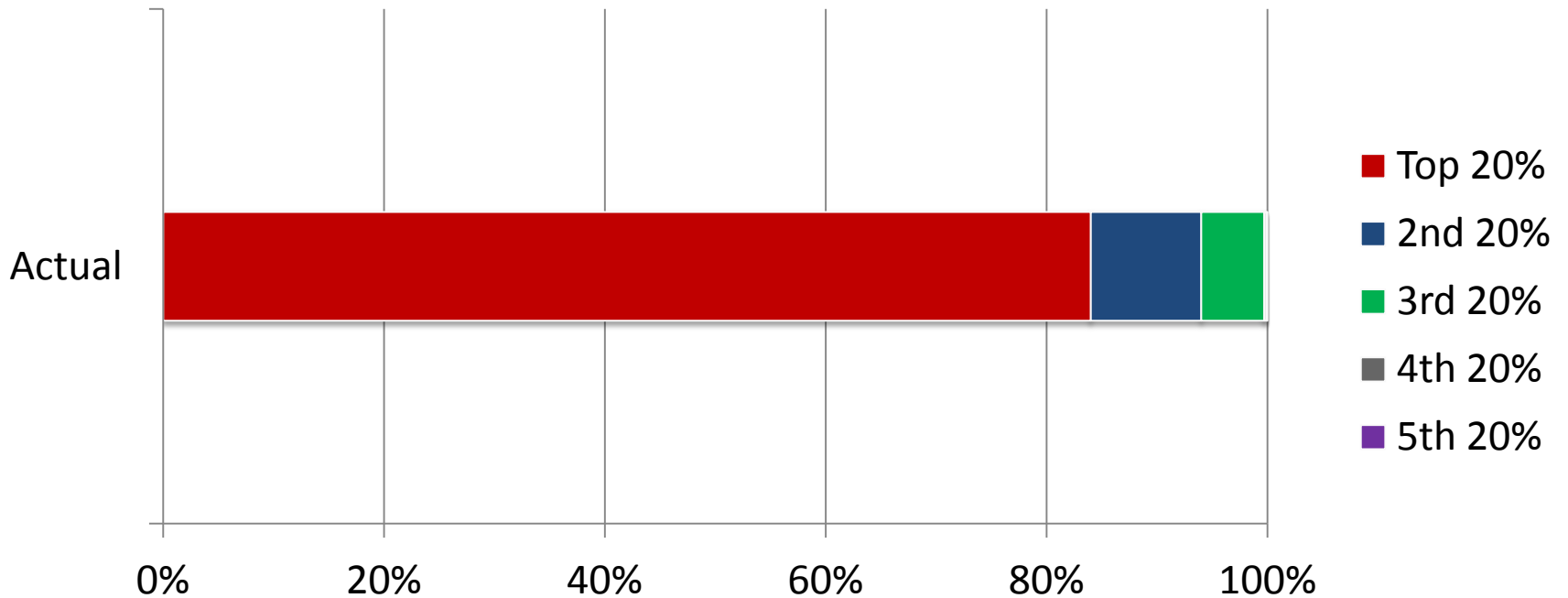
Source: Calculations Based On BLS CES 2014

Social/Economic Instability



Source: Corak (2011), OECD, CEA estimates

Share the Wealth in America



Socio Economic Consequences

1. Disastrous Education (Real Estate Taxes)
2. Dropout Rates/Poor Preparation for College/Cortisol
3. Virtually Non-Existent Early Education
4. Single Parent Homes
5. Lack of support for youth's ambition and hard work
6. Drug/Alcohol Abuse
7. Crime
8. Lack of Jobs/High Unemployment
9. Anger, dissatisfaction, humiliation for many employed but who cannot attain a decent standard of living
10. The creation of a grossly undereducated citizenry. Bad news for democracy
11. Dramatic drop in life expectancy

Current Version of Free Enterprise is not Helping All Americans

1. Middle Class is gone
2. Upper Middle Class barely hanging on
3. For most, the Creation of an India-style Caste System
4. At the top: A classic Plutocracy
5. The Net Result: The creation of grossly unequal opportunity for most of our citizens

Conclusion

1. Without intervention, the problems will accelerate
2. Our current situation is morally wrong
3. It is unsustainable
4. The risk if status quo continues:
 - a) Punitive Taxation
 - b) Social Unrest
 - c) A decrease in our freedoms; a diminution of Democracy
 - d) A rejection of free enterprise as a growth engine
5. Finding solutions: An urgent imperative
6. Business can and must lead the way

The Causes of Inequality

1. Technology (friend and foe; Walmart and Amazon)
2. Globalization (friend and foe)
3. Poor Education
4. Decades of Unwise Political Decisions
5. Loss of Unions' Bargaining Power
6. Failure of Unions to stay relevant
7. Financial Crisis: Loss of Jobs
8. Shareholder Primacy

Modern American Business was Built by Free Market Capitalism (But what is the “Market”?)



The Modern American Corporation (The Key Stakeholders)

1. The Customers
2. The Employees
3. The Shareholders
4. The Corporation Itself
5. The Communities in which it does business

At its best, Free Enterprise Capitalism was fair and responsible to the needs of all 5 key Stakeholders

- a) 1980 Chamber of Commerce definition of the role of business includes:
 - i. Creating Jobs
 - ii. Paying Employees fairly

Johnson & Johnson Credo

We believe our first responsibility is to the doctors, nurses and patients, to mothers and fathers and all others who use our products and services. In meeting their needs everything we do must be of high quality. We must constantly strive to reduce our costs in order to maintain reasonable prices. Customers' orders must be serviced promptly and accurately. Our suppliers and distributors must have an opportunity to make a fair profit.

We are responsible to our employees, the men and women who work with us throughout the world. Everyone must be considered as an individual. We must respect their dignity and recognize their merit. They must have a sense of security in their jobs. Compensation must be fair and adequate, and working conditions clean, orderly and safe. We must be mindful of ways to help our employees fulfill their family responsibilities. Employees must feel free to make suggestions and complaints. There must be equal opportunity for employment, development and advancement for those qualified. We must provide competent management, and their actions must be just and ethical.

We are responsible to the communities in which we live and work and to the world community as well. We must be good citizens – support good works and charities and bear our fair share of taxes. We must encourage civic improvements and better health and education. We must maintain in good order the property we are privileged to use, protecting the environment and natural resources.

Our final responsibility is to stockholders. Business must make a sound profit. We must experiment with new ideas. Research must be carried on, innovative programs developed and mistakes paid for. New equipment should be purchased, new facilities provided and new products launched. Reserves must be created to provide for adverse times. When we operate according to these principles, the stockholders should realize a fair return.

Free Market Capitalism Gets High-Jacked

1. Business becomes a major contributor to income inequality
2. “Shareholder Primacy” is eroding market value
(Maximize short-term shareholder value)

At a Macro-level Today's TSR are Engineered

1. Stock Buybacks
2. Excessive Dividends (36% of Net Income)
3. Hoarding Cash

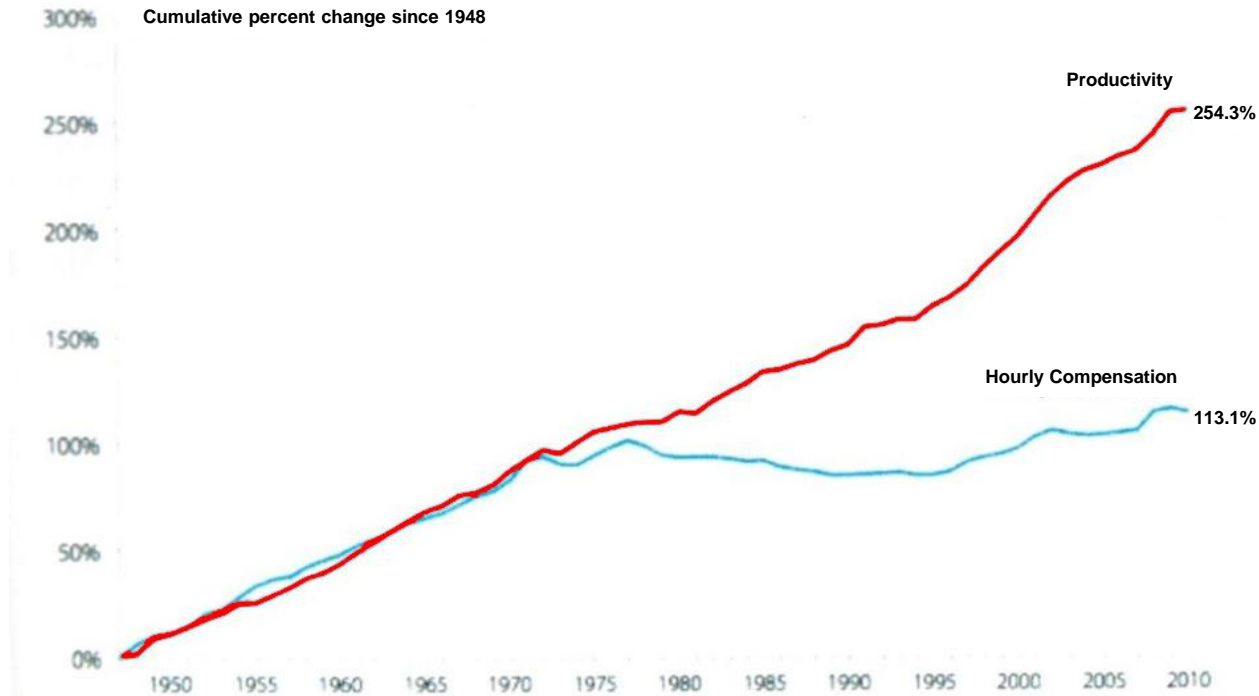
The Evidence of the Failure of Shareholder Primacy

Corporate Profit Margin at All Time Highs



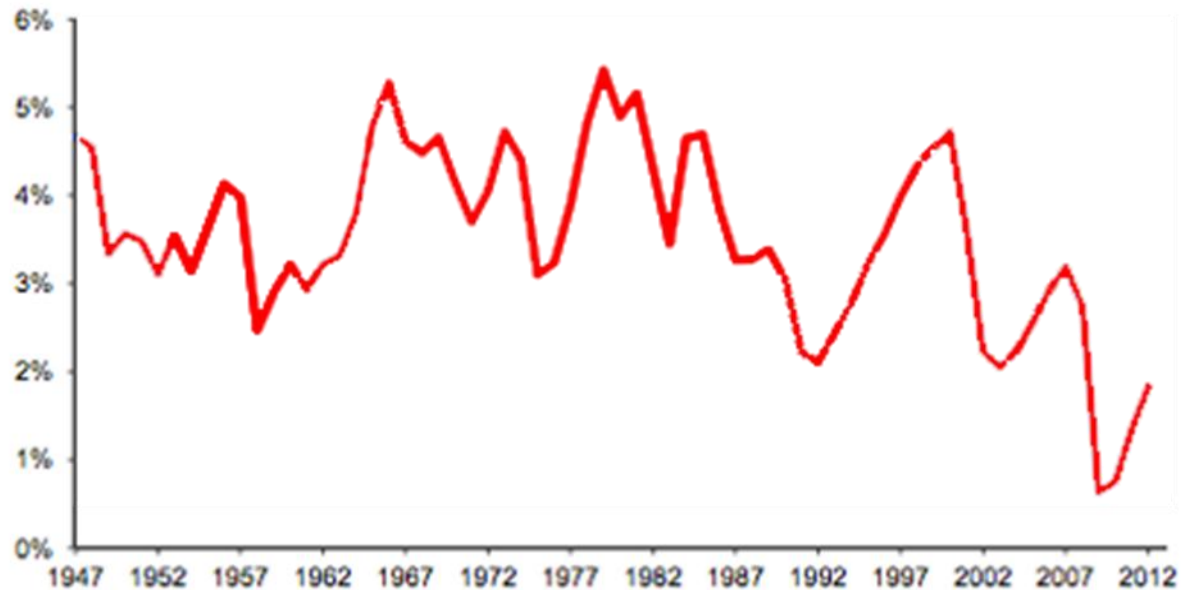
Productivity and Wages (The good and the ugly)

Growth of real hourly compensation for
production/nonsupervisory workers and productivity, 1948-2011



Note: Hourly compensation is of production/nonsupervisory workers in the private sector and productivity is for the total economy.

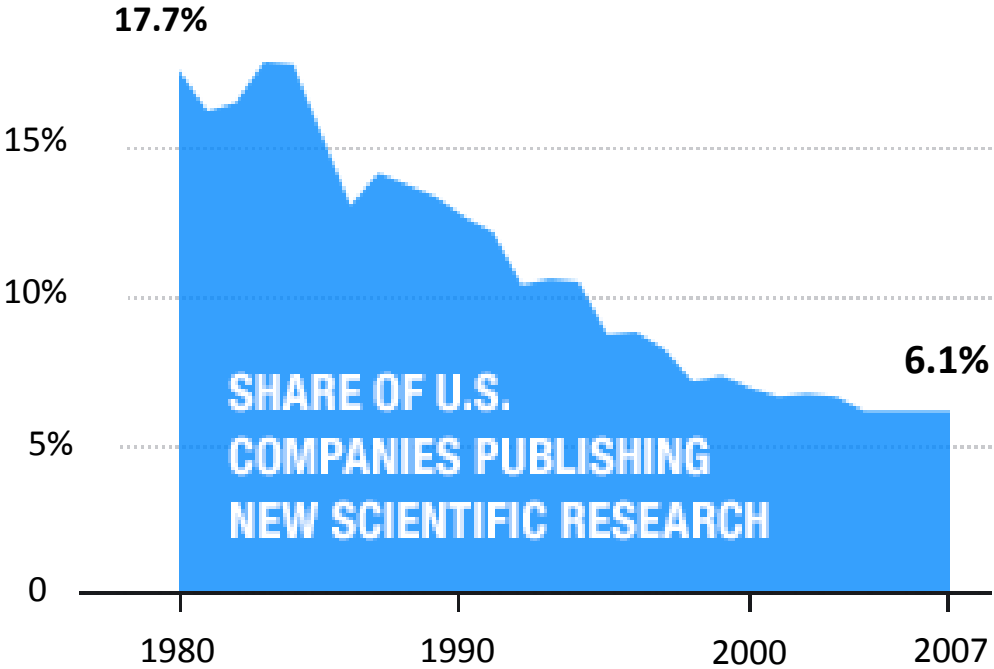
Business Investment (as % of GDP)



As of September 2014
Source: BEA

Conference Board: 40% of CEOs reported they forego R&D, training program, etc. to meet quarterly earnings

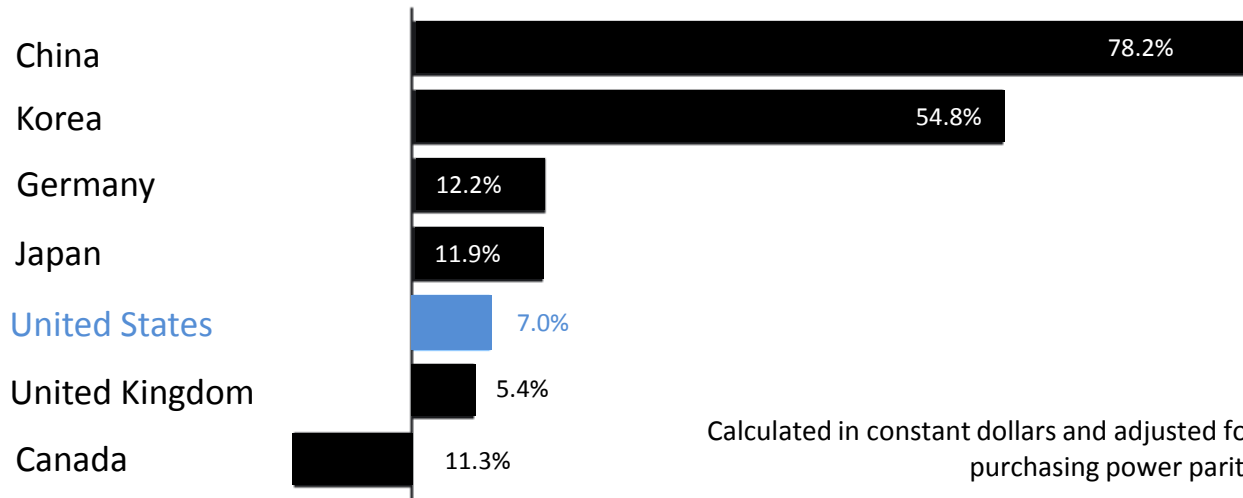
Share of US Companies Publishing New Scientific Research



Source: OECD; Duke University

Change in Business Expenditures on R&D, 2009-2013

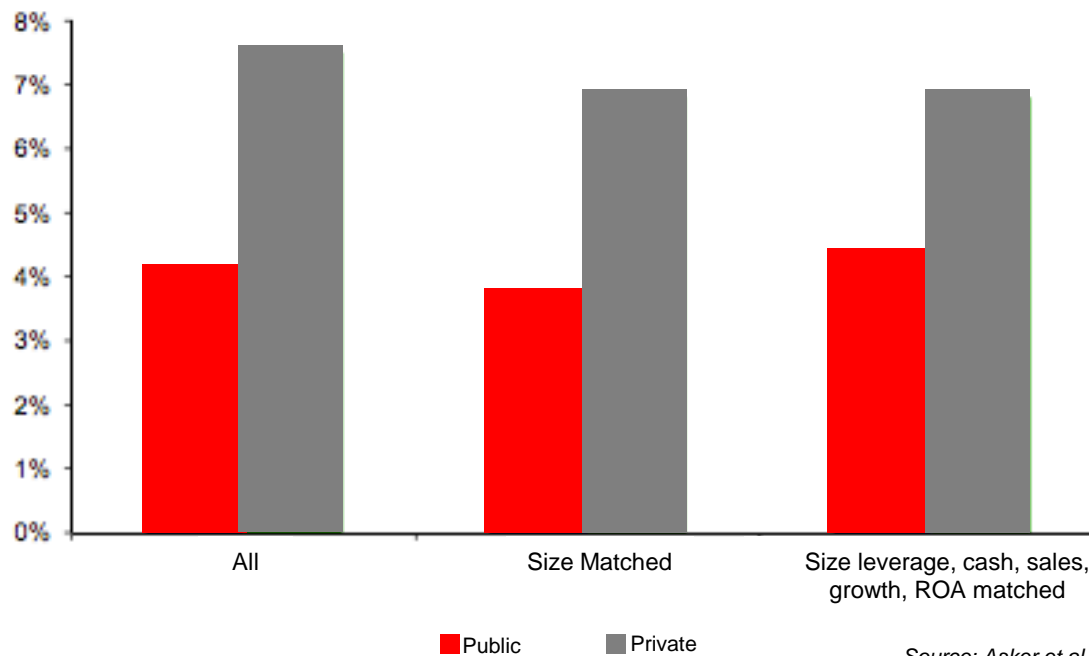
Change In Business Expenditures On R&D, 2009-2013



Source: OECD; Duke University

Private vs. Public Return on Assets

**Exhibit 11: Private Firms vs. Public Firms Investment Rates
(% of total assets)**



Source: Asker et al.
Based upon Compustat universe

To Enforce Shareholder Primacy

CEO's get paid extraordinary amounts

- 1945-1975 Ratio: CEO to Average Employee **20 to 1**
- Today's Ratio: North of **400-600 to 1**

Deliver or get fired:

- CEO tenure – under 4 years
- CMO tenure – under 2 years

Justification for Short Term Shareholder Value Maximization

Shareholders are a Corporation's owners and entitled to maximum returns at any time
(Quarterly)

But, Is the Shareholder an Owner?

- Most Shareholders behave like renters
- Shareholders immune from all corporate liabilities
- No law suggests the shareholders are owners of a corporation (they, of course, have rights)
- Preponderance of legal opinion:
 - *The Corporation Owns its own assets* (Lynn Stout)

Shareholder Activist Analysis: Positive Role

- A vital governance role to correct under-performing companies
- Work constructively with managements
- Warren Buffet: Our favorite holding period is forever
- In rare occasions: Takeover: Fix and hold

The Negative Role of Activist Terrorists (The Business Terrorists)

- Strip and Flip
- Message to Management:
“Manage Like an Activist”

TODAY ISSUE

Short Termism vs. Shareholder Primacy

THE WAY FORWARD IN BUSINESS

The Way Forward for Business

1. Preserve Free Enterprise (Market) Engine
2. Change the behavior and culture of shareholder primacy
3. Managements', Boards' Fiduciary Responsibility must be to optimize the interests of all five stakeholders

The Way Forward for Business (cont'd)

Employees

1. Recognize that employees are the real “Value Creators” in the 21st Century
2. Pay employees fair wages: share in the rate of productivity and innovation increases
3. Treat employees with dignity and respect
4. Support increases in minimum wages to a “living wage”
5. Invest in Employee training and retraining
6. Empower and reward employees to “delight” customer experiences, increase productivity, drive innovation

The Way Forward for Business (cont'd)

The Corporation

1. Invest in creativity and innovation (give brands sustained differentiation and relevance)
2. Hold Management accountable for long term plans and milestones
3. Hold Management accountable for measuring the strength and value of brands (BAV)
4. Invest in Brand Building
5. Invest in RD to:
 - a) Develop new businesses and new jobs
 - b) Remain globally competitive
 - c) Leverage the positive forces of technology

The Way Forward for Business Shareholders to Win in the Long Term

Firms of Endearment

Data from *Firms of Endearment* show that FOE companies are doing rather well

Annualized Returns (10/1/98-9/30/13)			
Annualized Performance	15 years	10 years	5 years
US FOEs	21.17%	17.69%	20.24%
Internal FOEs	18.53%	19.86%	20.46%
S&P 500	5.32%	7.55%	9.98%

Just Capital

2010 – 2015
(Russell 1,000 Index)

Most Just 100 Companies:	13.6% Return
The Other 797 Companies:	9.9% Return

Enlightened Businesses Leading the Way



Longer Term Government/ Private Industry Partnerships

1. Create New Jobs: Use technology to create jobs
2. Education:
 - a) Best in the developed world:
 - Secondary Schools
 - Higher Education
3. Provide early education for all children
4. Trade School System
5. Reduce unproductive regulations; make rules all predictable

Overall Summary

1. The level of income inequality which leads socio-economically to loss of opportunity must be eliminated.
2. Sustained societal stability and progress can only come from the vast citizenry employed and fairly compensated.
3. Adequate safety net in transition is essential.
4. Business must take the lead short term. Importantly because it can act, Business has the most to gain and the most to lose.
5. The solution: Pay higher wages; create more jobs, re-imagine education.
6. The ultimate objective:

EQUAL OPPORTUNITY/THE AMERICAN DREAM

Overall Summary (continued....)

A Collaborative Effort To Make Change Happen:

- CEOs
- Boards of Directors
- Equity Holders
- Pension Funds
- Enlightened Labor Leaders
- Media

An Important New Principle Emerges:

Business Success and “Community/Nation”
success are connected

They Can Only Thrive Together

The Barriers to Success

- **Ignorance**
- **Arrogance**
- **Greed/Job Security**
- **The Myth of Collective Security**
- **Courage**

THE FUTURE

1. Business acts now, with urgency
2. Business and Government collaborate on more just, more fair, more productive society
3. Democracy is preserved and strengthened
4. Human values and morality matter
5. America's Best Days are ahead.