Who needs Dodd-Frank to do the right thing? Not PepsiCo, says Indra Nooyi

The Year in Governance
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Who needs Dodd-Frank to keep on the right path?

Not PepsiCo. People don’t want businesses they can trust because they have been ‘made safe’ with regulation. They want businesses they can trust because they are trustworthy.

By Indra Nooyi

The Weinberg Center was established just as the issue of corporate governance gained new significance and resonance following the collapse of some big business players. Back then, the collapse was due to accounting fraud driven by a focus on short-term thinking and high-risk behavior.

But now, we stand in the shadow of an even bigger crisis, one that led to an almost complete collapse of the financial system. So the questions that we have to ask ourselves today are these: Why did we not learn enough from the last crisis to prevent this one? Why did the Sarbanes-Oxley regulation not prevent this? And have we learned any hard lessons from this crisis that will prevent the next one?

It’s not all about regulation

Let’s take the matter of regulation first. At PepsiCo, we don’t think of regulation as a barrier to our work. Of course, bad regulation can be obtrusive. But good regulation ensures that the rules of the road are followed by all the drivers. And if you’re a good driver, that makes life easier. It’s also true that in the aftermath of a terrible financial crisis policymakers do need to act. They need to show they are not asleep at the wheel. Action is needed to restore confidence.

The response to the accounting scandals a decade ago came with the Sarbanes–Oxley Act. The Act was accused of being too complex, too much of a burden, regulating all the wrong people, at great expense of both time and money. You know the debate very well. But it seems like we are having it again — whether we want to or not — only this time it is regarding Dodd-Frank.

I am sure I’m not the only one who is tired of the cycle of scandal followed by regulation that we seem destined to repeat every few years. The Dodd-Frank debate today has a disheartening echo of Sarbanes-Oxley a decade ago.

I don’t doubt that something had to be done. Confidence in the integrity of capital markets was at a low ebb. There was no way that policy makers could just stand idly by.

I won’t discuss the benefits and disadvantages of Dodd-Frank other than to make one important observation. The new law is over 2,000 pages long. Larry Thompson, former deputy attorney general and PepsiCo general counsel, pointed out to me recently that one major law firm published a 117-page “summary” of the Act. He also noted that the Act “requires 243 rulemakings and 67 studies” to be conducted by almost a dozen different agencies. We have to ask ourselves: Is this really proportionate? Does this complexity help anyone? Does it make companies “better” somehow?

This is the vital point. We cannot regulate ourselves into “better” business behavior. Regulatory complexity doesn’t suddenly make people more trustworthy and create impulses to do good. In short, we in the corporate world cannot look to regulation to encourage — or even ensure — good behavior.

Look inward

That brings me to my second point. I wholeheartedly believe that the only effective way of improving corporate governance is by improving corporate culture. This has to come from within, from the way we conduct ourselves. Businesses cannot keep looking to their regulatory environment to dictate their behavior. They have to look inward — to their moral compass.

Tough regulation, financial penalties, even criminal charges all have their place. Wrongdoing has to be punished, of course. But none of these sanctions will be as consistently effective as a strong moral compass and a company’s own ethical frame-

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work. This means changing our cultural norms. It means changing what is acceptable behavior in the boardroom right down to the shop floor. Now, of course, changing behavior is much harder than changing legal or governance structures. But it can be done. Part of this equation is how a company balances its short- and long-term business goals and how it conducts itself externally.

Let’s focus first of all on what happens behind closed doors. That term, in itself, should be banished. A company must act as if there aren’t any “closed doors.” It must operate in total integrity and transparency. So let me take you behind the doors of PepsiCo.

**Drivers of our behavior**

We have a Values statement that is upheld by six Guiding Principles (see box on page 10). This tells everyone inside and outside of the company what we stand for. All of our business decisions follow these principles. Our associates, from the moment they join our company, know exactly what values they must uphold.

In addition, we have a worldwide Code of Conduct policy. Simply put, this means doing business the right way: operating responsibly with integrity and with high ethical standards. The Code of Conduct provides guidance for dealing with other employees, customers, suppliers, our shareholders, the public, and our competitors in an ethical and appropriate manner. It includes everything from our antibribery policy to guidance on political donations, human rights, and insider trading. And it is translated into about 40 different languages so every one of our nearly 300,000 associates can read it. We expect each
and every one of them to live by it. Annually, we require a group of associates to attend training, either in person or online, and certify that they have read and agree to abide by it. In 2010, more than half of our global associates participated in this training and certification.

Last, we have our “speak up” line. This is a 24/7 hotline. We have a dedicated telephone number in nearly 60 countries, available via Internet and collect call, so associates can raise concerns about any business situation that may be inconsistent with our code of conduct, our values, our policies, or applicable law. The calls to the hotline can be made anonymously and we handle them confidentially. We have a strict non-retaliation policy and there is no stigma attached to calling because our principles and code of conduct are communicated regularly and in a way which makes it clear that we have no tolerance for people who don’t uphold our values.

All of these things — our Values, our Principles, and our Code of Conduct — are on our website for everyone to read. And we give them to everyone who applies for a position with us. It’s how we make sure we attract the right people from the very start. You can understand that we don’t think of PepsiCo as a closed door. We think of it as an open window.

**A culture gone astray**

This brings me to the third point, which has to do with our modern business environment: It’s a lot more difficult to act in an ethically responsible way than it should be — and that’s not right.

I don’t believe our recent financial troubles are the result of a lack of regulation. Nor do I believe we can place the entire blame for the crisis on a small minority of high-risk profit chasers. Many companies that contributed to the financial crisis a decade ago had clearly established values statements that said all the right things.

However, where we suffer is from a business culture that places too much value on the short term. It’s a nearly all-encompassing short-term, quick-fire environment that makes it too hard to focus on long-term sustainability. Gandhi once said, “There is more to life than increasing its pace.” Well, I don’t think he ever watched real-time global news, minute-by-minute financial updates, and tweets reporting the content of meetings before they are finished.

As a CEO, I see that some analysts demand visible change four times a year. Short-term holders of stock “judge” company leadership based on very short-term actions and results. Then you have 24/7 media amplifying the smallest missteps. That forces many corporate leaders to be constantly on guard. It’s worth noting that 40% of CEOs last no more than two years in the job. Faced with these pressures, there is precious little time to pause and think. Attention spans are short, time is money, and there is a premium on speed.

Many organizations, like the Conference Board and the Business Roundtable Institute for Corporate Ethics to name two, have pointed out this bias toward short-term thinking. Most of us would agree that it has become a normalized and accepted behavior among corporate executives. It’s a deeply entrenched global business culture. Thinking long-term, setting future-focused goals, being responsible and considered in risk taking… well, it’s like swimming against the tide. And because it is so entrenched, I am not convinced that regulation alone will change this. It might act as a life raft, but it won’t turn the tide. To do that, all the swimmers have to decide to stand up and change direction. That requires radical thinking. It requires questioning the entire premise of what a company is “for.”

**The trinity of good business**

Larry Thompson, our general counsel, recently wrote a paper on *The Responsible Corporation*. His paper gives such a rich account of the purpose of a company. Quoting from Larry’s paper, acting ethically “is not a call for corporations to compromise, let alone to abandon, their commercial mission to pursue opportunities aggressively and to maximize return on capital. Whatever one may think of Adam Smith’s famous ‘invisible hand,’ he clearly got this part right: the greatest contribution any company can make to society will always be increasing the pie on the table at which we all dine.… All that is required is recognition that shareholder value is a result, not a strategy, and that a corporate manager’s main constituencies are [her] employees, [her] customers and [her] products.”

Lots of companies would do well to consider these words carefully — *employees, customers, products*. This is the trinity of good business. Let me tell you how we put this into practice.

We set out to consciously marry our ethical and our finan-
from predecessor to successor, ACE insures progress

To address the complexities of D&O insurance, it takes the right people, a strong balance sheet, worldwide capabilities and a flexible approach. These are the strengths of ACE. We take on the responsibility of your risks so that you can take on the responsibility of making things happen. We call this insuring progress. Visit us at aceusa.com
cial activities in what we call “Performance with Purpose.” We put our targets in four areas: financial performance, human sustainability, environmental sustainability, and talent sustainability. Underpinning this is a set of plans based on transparent targets, which cover both the short and the long term.

Setting out our targets in this way means shareholders know exactly what we are doing. From directors down to front-line associates, all the PepsiCo family knows exactly what we stand for and what we are working towards. Finally, the public can hold us accountable for our progress. We want to ensure that our company performs well today and sustains this performance well into the future. That’s how it looks on paper. Let me bring it to life with an example.

**Winners at every stage**

In Mexico, we saw a clear need that reached across our business, the economy, the health and wellness of the local community, and the environment. Farmers needed steady jobs. The community needed more activity to sustain itself. Our business needed a reliable and cost-effective source of oil for our snacks. Our customers were demanding healthier options.

We worked for two years with experts at the Inter-American Development Bank to create funding for farmers to plant sunflowers. When they were harvested, we were able to use the sunflower oil in our products. Farmers are now working, and we will buy the products to use in our offerings to consumers for healthier options. There are winners at every stage. We get a local, steady supply, and the farming community gets steady business. We flourish together.

Five years on, in places like Mexico we are seeing the ethical and financial work together, and the short and long term in harmony. And so Performance with Purpose has proved a great success. It has embedded our business ethics at the center of our financial algorithm. And by making everything so transparent, by making Performance with Purpose a source of pride and part of our business identity, it means that some business practices in PepsiCo are simply not acceptable. Our external business practice complements the internal culture and together form a strong moral compass. We don’t rely on regulation like Dodd-Frank to keep us on the right path.

Striking a proper balance between short- and long-term thinking should be at the heart of every modern, successful business strategy. If there is a single lesson I want to get across, that is it. Yes, corporations must first perform for their shareholders, but they must also be good stewards of society and natural resources. Of course, balancing short-term competitive pressures with longer-term growth and sustainable societal objectives is a fine art. In practice, it means thinking about all your stakeholders, including shareholders, customers, employees, suppliers, communities, and the environment. Every business is different. Every business will need to plot its own path between short- and long-term considerations. But those paths need to be tended.

**An unprecedented opportunity**

We now have a stronger consensus among policy makers for the need for mature, responsible businesses to deal with global challenges. Consumers are demanding it too. People don’t just want businesses they can trust because they have been “made safe” with regulation. They want businesses they can trust because they are trustworthy.

Striking the right balance between short- and long-term thinking is the greatest challenge of the modern CEO. It is a challenge that can only be met with the support and guidance of the best academic, legal, and financial minds around.

I encourage organizations like the Weinberg Center to remain active in the debate and engage businesses to look within themselves to critically evaluate their own cultures. To ask, honestly, whether the unwritten rule in their boardroom is to move too quickly and operate with too much risk. To show how both business models and internal cultures can be changed to uphold and encourage a balance between long- and short-term thinking, more responsible business practices, and a constructive working environment where reckless risk taking, an obsession with quick returns, and exploitation of loopholes will simply not be tolerated. Helping businesses think about the internal mechanisms at their disposal, and challenging authorities to think laterally too, will be the most effective way to eventually end the scandal-regulation cycle we have all been laboring under for so many years.

Regulation solves past problems. It is reactive. Changing cultures is proactive, something which preempts problems we have yet to encounter. It is easy to look to others to solve the problem. It is easy to say it must be done through regulation. It is easy to say that the environment does not encourage us to think about the long term, and therefore we can’t do anything right now. If we all look to someone else to act then we will proceed tomorrow exactly as we did yesterday.

But the solution lies with all of us and we can start straight away. In the aftermath of the most recent financial crisis, we have an unprecedented opportunity to wipe the slate clean, adopt a new approach, and work together to make this a reality. Indeed, we must.