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Bill George on rethinking capitalism

The Harvard Business School professor and former Medtronic CEO explains why the market's obsession with short-term performance ultimately hurts investors, companies, executives, and consumers.

It often seems that many companies craft strategy in three-month increments, working toward their next earnings release. In this video interview, Harvard Business School professor and former Medtronic chairman and chief executive Bill George argues that this obsession with short-term performance comes at the detriment of long-term value creation. He urges executives and boards to take a longer-term view, criticizes the impact of activist investors, and believes companies ultimately succeed when they create customer value, which drives shareholder returns. This interview was conducted by Rik Kirkland, senior managing editor of McKinsey Publishing. An edited transcript of Bill George's remarks follows.

I don't subscribe to the notion that companies exist to create value strictly for their shareholders. I think they are there to create value for the customers. I think we need to reorient how we think about capitalism. Anyone who's willing to postpone the long-term strategies to make the short-term numbers is in route to going out of business.

Insisting on the long term

Capitalism's going through a major transformation right now. As capital becomes global, resources have to be moved flexibly, globally. We need global leadership. But the problem is that the stock market, particularly the New York Stock Exchange, is shorter term than ever. And we have this new class of investor activists who are very, very aggressively involved, looking for short-term gains: Dollar or two a share. Come in, make a quick hit, move on. They *say* they're long term. They outline a strategy as if they know how to run the company better than the company knows how to run itself with professional executives. But really, the goal is a short-term hit and move on.

And honestly, you cannot put a strategy in place today—in the pharmaceutical industry, in the automobile industry, in the food industry—with less than a seven- to ten-year time frame. That's how long it takes. And particularly for companies going through a cultural transformation, it takes closer to ten years to get it done. You can make a lot of progress in the first three to five, and you can start making the numbers get better. But to really put it in place, it takes that long.

Now will shareholders give people that long? That's what's worrying me a lot right now. So my argument is, do not let your shareholders manage you. You have to manage them. You have to say what we're going to be, here's our strategy, here's the team we're putting in place, here are the tactics. And then you have to buy time to get it done.

Managing expectations

If you're an American company in the New York Stock Exchange, you have to report. So you don't have a lot of choice. I think the quarterly earnings can get in the way. But I think that's a manageable thing. I think what may not be manageable is playing the expectations game that the stock market will set out. And no matter what your expectations are, they want to push you higher, and I think that's a big mistake.

I think you need to hold your ground, and occasionally you're going to miss the numbers. That's OK. But the important thing is that you're making decisions for the long term. At Medtronic, frankly, I would terminate any executive who made their numbers for the year if they sacrificed the ventures, the R&D, the market-development things we need to do to build the company. They couldn't work for the company.

The problem with activism

It's extremely important for management of a company and the board of directors to get alignment over the long-term goals and objectives and strategy to get there, and then to shape its investor base to match that goal.

If you've got a long-term growth goal, then you want a growth-oriented investor. If you're just cutting cost, you're probably going to get a value-oriented investor. If you want somebody that wants dividends, that may not be consistent with heavy cash investments in building your business. So I think it's up to you—the board and the management—to shape those expectations, not let the investors shape you.

But then what happens if an activist steps in? And how does a Warren Buffett contrast to a Carl Icahn? Warren Buffett buys into companies like Coca-Cola and Wells Fargo and now IBM and he holds them forever. And he trusts the management. And Carl Icahn says, “I know more than the management. I’ll tell *you* what to do.” But then as soon as he gets what he wants in the short term, he’ll get out. And you’re left holding the bag and running the company for the long term.

And that’s why so many American companies have gone down. And I think it’s a very, very difficult situation. Now contrast that with the many global companies that are family owned, that are owned by large, family conglomerates in Brazil and China, in India, throughout the world. And those companies have much more of a long-term view, and that’s who you’re going to be competing with.

Where boards go wrong

I think we need to reorient how we think about capitalism and how we think about the investor’s role in capitalism. It’s management’s job to think about the kind of investor it wants and then actively shape that in the way it sets its goals and then actually going out—as we did at Medtronic, talking to investors that fit our profile who weren’t currently investors in Medtronic.

I think boards today are way too concerned with the short term. As a board member, you can’t influence the quarterly numbers. What you can influence is, obviously, a selection of leaders, but also the long-term strategy of the company and staying the course. And I’ve seen some boards who react to the kind of activist investor who comes in or the short-term shareholder or they see the stock go down and they panic.

You really have to stay the course through those things if you know you’re on the right track. If you’re on the wrong track, then shift gears. But the board’s job is to stabilize. The board’s number-one goal is to ensure that the company has the right mission and values and that it follows that, and that it has the right leadership that will reinforce that and the succession coming along behind it, and that it has the strategic goals for the company that provide them winning strategies globally. Any company that doesn’t create better value for its customers than its competitors do will be out of business. So if you start with just meeting the shareholders’ needs, you may find yourself out of business in ten years.

Creating lasting value

I don’t subscribe to the notion that companies exist to create value strictly for their shareholders. I think they are there to create value for their customers, and that gets to the mission of the company. And ultimately, doing that, they create value for society.

If they forget about that, they have no legitimacy, they have no right to exist, no matter how much short-term shareholder value they create. And the shareholder value is misunderstood. It comes as a result of great value for your customers that leads to growth, and that comes from engaged employees that are innovative and provide superior customer service.

Today's group of CEOs is the best I've ever seen in my lifetime, far better than my generation. Even though the publicity has gone from CEOs as heroes to CEOs as bums, this is a terrific group of people. They're committed to long-term value. They're committed to values. They're committed to their customers. And the good ones have the courage to look past the pressures from the outside world to capitulate for the short-term gain and go for the long term.

William George, a professor of management practice at the Harvard Business School, is a board member of ExxonMobil, Goldman Sachs, and the Mayo Clinic and previously served on the boards of Novartis AG and Target, among others. From 1991 to 2001, he was the CEO of Medtronic, whose board he chaired from 1996 to 2002. **Rik Kirkland** is senior managing editor of McKinsey Publishing and based in McKinsey's New York office.