Principles and Profits Working Together

THE CLEAN YIELD

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Saying Nay to Exec Pay

Let's see… As shareholders we own the company, right? And the board we elect represents us by setting policy and overseeing management, correct? Actually, not so much. These days, top management rules, and nowhere has its power been more patent than in the explosive growth of executive compensation at the expense of shareholders. But a whiff of change is in the air.

According to the *Wall Street Journal*, CEO pay at the 200 largest companies dropped a bit over 3% last year. It was the first drop in many years, but it probably won't garner much sympathy, because the median CEO still pocketed $8 million on the year.

Top management has held the upper hand for decades, accruing power most dramatically in the years since Reagan took office. His pseudo-academic trickle-down economics theory provided a veneer for exorbitant salaries. Those salaries obligingly channeled cash to political campaigns, which, in turn, netted a flood of access and influence for corner office occupants.

While corporate and political hands energetically washed each other, President Reagan busted the air controllers' strike and appointed foot-draggers to the National Labor Relations Board. Unions lost members and power and were no longer effective in dampening executive pay. The net result: further insulation of corporate executives from any constraints on pay.

Technically, corporate boards set executive compensation, of course. However, CEOs almost always have a key role in picking directors for the board. And in recent years, board positions have grown so financially cushy that directors routinely return the favor by rubber-stamping management pay. Moreover, board posts have become increasingly entrenched, as mutual funds, hedge funds, and other institutional investors, representing a larger and larger share of outstanding stock, can now almost always be counted on to vote the management line.

According to the Institute for Policy Studies, in 1980 the CEOs of large corporations earned 42 times the average worker's pay. Today that ratio is 344 to 1, by far the highest in the developed world. Where's the limit?

Two years ago, the union of government employees, AFSCME, frustrated at its diminishing influence, turned to SRI and began using its tried-and-true method of influencing corporate policy, the shareholder initiative. Working with Tim Smith, a pioneer in proxy proposals, the union developed a resolution requesting that companies offer shareholders an advisory vote on executive compensation packages: the "say-on-pay" resolution.

It struck a chord. Dozens of new shareholders joined the fray and became "proxy activists." In a coordinated campaign, individual shareholders, unions, pension plans, NGOs, religious institutions, foundations, and many SRI organizations have introduced the say-on-pay resolution at nearly 100 companies in each of the first two years. The result has been that a half-dozen companies have already adopted the measure. A much larger group has indicated it is likely to do so after further study. Though these proxy votes are only advisory, roughly 15 companies have seen say-on-pay votes exceeding 50%, and boards will ignore them at their peril.

These proxy initiatives were already well underway before the economic meltdown and well before AIG's taxpayer-funded, multimillion-dollar bonuses hit

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Youthful community organizer, Barack Obama, joins in honoring a founder of ShoreBank Corp., the first community development bank.

Ties that bind: Obama and SRI

Is President Obama a social investor? Could be. He certainly knows the territory.

Screened mutual funds? Barack is a close buddy with John Rogers, an SRI original. Rogers is the highly respected manager of one of the largest and oldest social mutual funds, Ariel. Rogers first befriended Michelle Obama, whom he met while they were both at Princeton. Later, he worked with Barack on voter-registration drives in the African-American wards of Chicago in the early 1990s.

Community investing? Obama was a community organizer in south Chicago, the heart of ShoreBank country. He is pictured above in 1988, honoring one of the founders of ShoreBank, one of the largest community development financial institutions (CDFIs) in the U.S. In Obama's stump speech, he often made reference to the effectiveness of CDFIs.

Divestment? When the Sudan Divestment Task Force identified mutual funds' connections with companies in Darfur last year, the Obamas found one of their funds on the list. They reportedly withdrew their $180,000 investment forthwith.

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MARKET NOTES

Whither goest thou, market?

As we mentioned in a recent quarterly letter to our clients, the stock and bond markets are back to responding to economic-related news instead of reacting to wholesale panic. This development is comforting to those of us in the investment business, because it tells us that the investment infrastructure is still intact. The investment metrics may change dramatically—we expect they will—but there is still a house with a foundation, kitchen, bathroom, and bedroom—remarkable given the tornado that leveled the markets in October, November, late February, and early March.

Obama is the carpenter who has been keeping the markets intact. For once, the nation's hopes before an election are panning out early in the new administration. It is not that the president has done radical remodeling during his first four months to turn things around; it is rather that he has been relentless in tackling every major problem the nation faces, hammering home his determination to master almost impossible circumstances and overcome them. He is also showing the country a face of seriousness and fierce intelligence. In short, he has established a floor of confidence that things can get fixed.

This constructive attitude is all the financial markets have needed to begin responding to real economic factors. They don't need the details. They don't even need specific accomplishments--there is plenty of time for that. They just need confidence that the infrastructure, however shaky, is still in one piece.

Now that the markets' foundation is deemed fit to build on, the hard work begins. The administration will face plenty of success and failure. The economy and all of its pieces will take a long time to put back together. And the pieces will not fit in the same way. It is going to be a new house, but, hopefully, it will be one that is sturdy and built on slow, manageable growth.

Much of the current economic information, and much that will arrive

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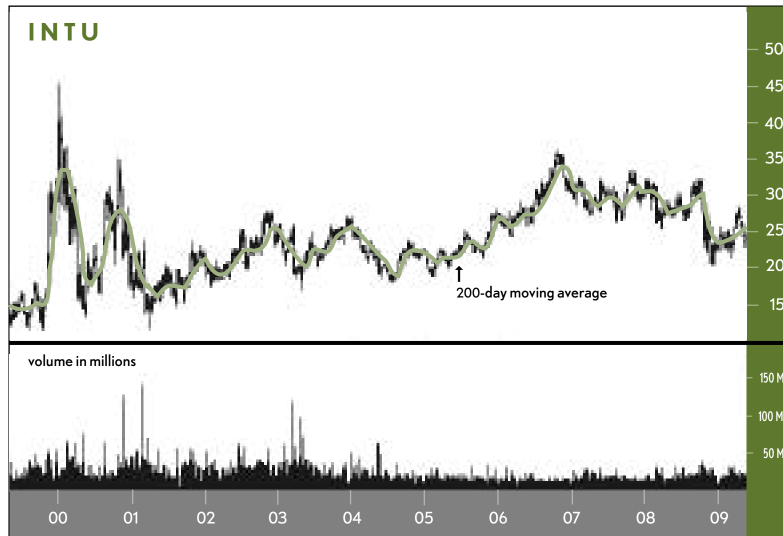


INTUIT (INTU)

Revenues: $3.06 Billion
EPS: 2010E $1.95
2009E $1.78
2008A $1.60
Web site: www.intuit.com

Projected Annual Growth Rate: 8%
Dividend: 0%
52-Week High–Low: $32.00 – $20.18
Risk: Medium

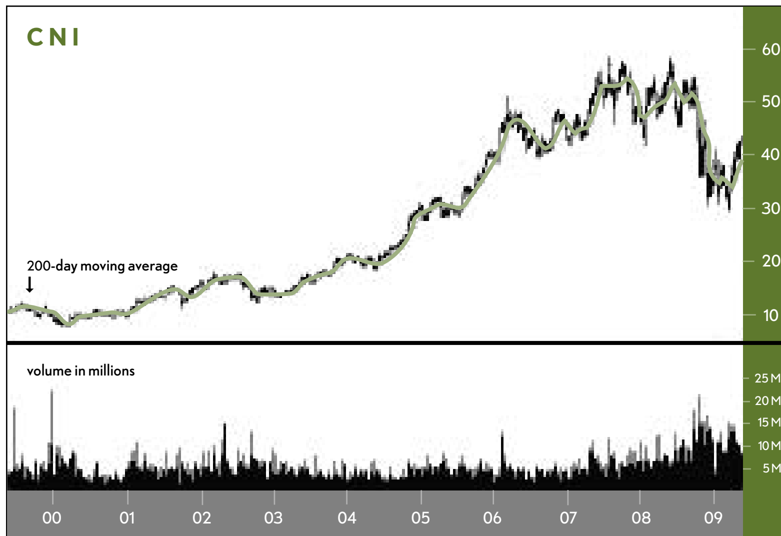
Hook and Rebate

Tax season may be behind us for this year, but it will be around again before you can say Form 1040. That's part of the appeal of Intuit, the maker of TurboTax, QuickBooks, Quicken, and other business and personal financial software and services. As we've written before, during an economic downturn the safer bets are on companies that provide nondiscretionary services, and tax preparation software, in particular, is a classic of the genre. The consumer income-tax business generates about one-third of Intuit's revenues. This is a competitive business, but Intuit captured a large portion of market share early in its history with strong online tools. The software saves customers' information automatically, making next year's returns quicker and simpler—glue to keep customers sticking with TurboTax. QuickBooks is the primary tool on the market for accounting, check writing, and payroll for small- and medium-sized businesses. Although such businesses are struggling, Intuit has rolled out programs to start them on software packages for free—a tactic that should pay off over time as business picks up and the companies require more advanced services.

Intuit had a challenging start to 2009. The company announced expected earnings in February but warned that revenues would probably be on the low side for the rest of the year because of the effect of the economy on small business. Intuit has good cash flow, which is necessary for its robust research and development that keep it ahead of the Web-technology curve. This year, for instance, it included a social networking component in its tax preparation software that allows individuals to discuss tax questions with others for free while working on their taxes. The company has also been keeping an eye on its costs, including decreasing its own work force right before things turned sour last summer. Intuit's stock price is now back near its December low, 30% off of its 2008 high, which gives this cycle-resistant stock space for many happy returns.

Corporate Responsibility

Intuit has been a leader in social responsibility since its beginnings 25 years ago. The company is committed to the environment in all aspects of decision making, as well as conducting business in a transparent manner. On its Web site, you can find a summary analysis of its own carbon footprint, including the number of flights employees took and pounds of waste generated in 2007. Additionally, Intuit is known for providing tax and business services to the poor for free or reduced cost through government programs and software donations. ■



CANADIAN NATIONAL RAILWAY CO. (CNI)

Revenues: $6.90 Billion
EPS: 2010E $3.60
2009E $3.15
2008A $3.46
Web site: www.cn.ca

Projected Annual Growth Rate: 4%
Dividend: 2.0 %
52-Week High–Low: $58.50 – $29.39
Risk: Low

Rails to Sales

Canadian National Railway, the primary rail shipping company in Canada, dates to the early 20th century, when it was a state-owned enterprise. For the better part of the century, until the railroad was privatized in 1995, CNI suffered from political and governmental interference, and the company was not always making the grade. During the last fifteen years, however, Canadian National's management has made many wise moves, including acquiring lines that gave it direct access through the U.S. to the Gulf of Mexico. It has also significantly cleared up areas that were too congested with rail traffic. It now boasts the highest profit margins in the railroad industry and a reputation for on-time deliveries.

The economy's slump has pushed much railroad activity off onto a siding. Railroad revenues are directly tied to the amount of freight that is shipped, and that fell 17% industrywide in January alone. Although railroads have lost some steam, as long as there are still manufacturers and natural resources in North America, rail transportation will be needed. Canadian National is particularly well positioned for an economic upswing, since it recently acquired a line that circumvents a notoriously congested area around Chicago. It is also buying 65 new high-powered, fuel-efficient locomotives. Its steady cash flow should result in continued dividend increases, and although the stock price was cut almost in half during the last nine months, it is back on track to regain those losses.

Corporate Responsibility

Rail is the most fuel-efficient means of traditional land transportation: railroads account for 40% of freight-ton miles moved, but only 8% of the associated fuel. In addition, CNI uses "precision railroading," a method of packing loads that cuts down on the number of cars required. And the company has invested in fuel-efficient engines. The company provides customers with information on the carbon footprint associated with different transport options and participates in the Carbon Disclosure Project. Canadian National also stands out for its governance, safety, and community programs. The board, which includes two women, is focused on transparency and has an ombudsman available to help employees resolve code-of-conduct issues in an impartial and confidential setting. On the community side, the company sponsors 45 scholarships for women studying in nontraditional fields and funds an aboriginal scholarship program. ■

***Market Notes** continued from page 2*

later this summer, is full of mixed messages. Billions are being poured into the financial system, which could stimulate inflation. But at the same time, corporate earnings and falling interest rates counter with a deflationary scenario.

In the short term, between now and the end of the building season in November, we think that the markets will test the March lows and eventually lumber towards 10,000 on the Dow; ranging perhaps as much as 3,000 points. Until the markets get a signal from truer economic indicators, whether we be in store for a sustained period of inflation (stocks do best) or sustained deflation (bonds do best) or somewhere in-between (our hope), stock prices will be volatile as investors worry over whether some unpredictable tremor might bring down the house. ■

SOCIAL NOTES

✷ **Green Mountain Coffee Roasters** recently announced the winners of its Web-based contest among nonprofits for the best proposals in four categories to counter climate change. Each nonprofit receives $200,000. One winner, the International Center for Tropical Agriculture/Catholic Relief Services, will forecast the impact of climate change on coffee growing and help small growers with adaptation strategies. The contest site on JustMeans.com generated over one million hits.

✷ "Employment Gap Scholarships" is the name **DeVry University** is using for its new awards program at each of its 86 undergraduate locations nationwide as well as its "online campus." More than 725 individual scholarships are being offered to students who have lost their jobs in the last 12 months. The need-based grants are focused in areas of expected employment demand, such as computer systems analysts.

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the news. But the AIG revelation opened the door to public outrage previously unseen on this or any other corporate-governance issue.

The Obama Administration has taken notice and laid down a rule: all companies that have received TARP money *must* offer an advisory vote on pay. That's some 400 companies. If there be silver linings to this dark-clouded recession, count as a bright one the newfound recognition by shareholders: Guess what… *We* own the company! ■

Ties That Bind *continued from page 1*

Proxy activism? The first social shareholder proxy initiative was organized by the iconic Chicago-based community organizer Saul Alinsky against Eastman Kodak in the late 1960s. Alinsky died in 1972. Barack arrived in Chicago 13 years later to work with the Developing Communities Project, an offshoot of Alinsky's network, a context which must have made him conversant with proxy voting strategies.

Social venture capital? On the campaign trail, Obama promised to create a Social Investment Fund Network. On May 6, he announced that he was asking Congress to budget $50 million for a Social Innovation Fund to help replicate the success of high-impact nonprofits. Beyond, the White House's new Office of Social Innovation is working with Howard W. Buffett (Warren's grandson) and others to promote for-profit companies that have social missions and public-private partnerships that are seeking ways to close education gaps and solve other social problems. ■

Blinders

Give us a hard-line economic theory and we'll give you a whipping boy for the subprime mortgage debacle and its follow-on, the global economic crisis. You say "free-market capitalism" and we'll blame the government for its policy of pushing homeownership through Freddie Mac and Fannie Mae. You say "populism" and we'll give you back corporate greed and bought-off politicians. "Marxism," you say? It's all about exploitation, overproduction, and the wealth gap. Big on "individual responsibility?" We'll pin the downturn on lower-income people who should have known they couldn't make mortgage payments. Are you a monetarist? Greenspan set too-low interest rates. Spiritually oriented? Exploding materialism and the consumer-debt overhang. As the bear market deepens, there's a bull market in blame out there. Though the blame comes out of one orthodoxy or another, taken together, they provide more than enough grains of truth to clog the gears of any economic machine.

Peering through the ideological fog, we can see at least one specific cause for the meltdown that we can learn from and rectify: the 1999 rollback of the Glass-Steagall Act. This critical, Depression-era law was dismantled when a single unchallenged doctrine—hands-off-the-market—became the *zeitgeist*.

Through the Looking Glass-Steagall

At its core, the 1933 Glass-Steagall Act erected walls between commercial banks that traditionally accepted deposits and made white-bread loans, insurance firms that traditionally earned their keep by assuming well-considered risks, and, most pointedly, investment banks that traditionally underwrote bonds but that had begun creating more-arcane securities, including ones that were highly precarious. From a 1933 perspective, when the country's knees were still shaking from bank failures, prohibiting stodgy commercial banks from hanging depositors' nest eggs out on thin limbs seemed eminently sensible.

Overconfidence, excess risk, market collapse. That sequence should have been an indelible lesson of the Depression, but in the tech-boom environment of the late 1990s, financial risk seemed a remote concept.

Safeguards Come Tumbling Down

Awash with literally billions of lobbying and campaign dollars from Citibank and others in the financial sector, Congress and the Clinton Administration blanked on 1930s lessons and joined in the mantra that U.S. banks would fall behind European competitors unless all barriers to mergers were eliminated. Congress, playing Joshua at Jericho, caused the Glass-Steagall walls to tumble amidst much fanfare and self-congratulatory trumpeting from both parties.

I think we will look back in 10 years' time and say we should not have done this but we did because we forgot the lesson of the past, and that which is true in the 1930s is true in 2010.

—Senator Byron Dorgan of North Dakota, quoted in the *NY Times* on Nov. 5, 1999, as Glass-Steagall protections were being unraveled.

Citibank had already combined with Traveler's Insurance through a temporary waiver. It now became permanent. The huge Swiss bank UBS would shortly swallow the brokerage firm Paine Webber. On these banks' heels came a dizzying cascade of mergers and acquisitions. The result: behemoth institutions that knew perfectly well they would be too big to let fail. These financial giants were flush with fresh capital from engulfing stable commercial banks, and secure in the knowledge that Joe P. Taxpayer was in the wings in case of a stumble. No surprise that they felt free to offer junky subprime loans and Rube-Goldberg derivatives by rolling these dicey loans into collateralized debt obligation (CDO) vehicles. Other entities—such as your pension fund and mine—bought them. A hard lesson, measured in hard cash, is that we must learn from history and not blindly follow anyone's hard-line ideology. ■

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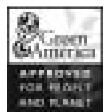

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