

A professional portrait of a middle-aged man with short, light-colored hair. He is wearing a dark suit jacket over a light blue dress shirt and a red patterned tie. He is smiling slightly and looking directly at the camera. The background is a solid, neutral gray.

**MY ROLE AS EXECUTIVE  
CHAIRMAN IS TO  
OVERSEE THIS COMPANY  
FOR THE INTEREST OF  
ALL SHAREHOLDERS  
— NOT ONE CLASS OF  
SHAREHOLDERS, ALL  
SHAREHOLDERS.**

# William P. Lauder on governing the controlled corporation

*The best reason to invest in companies, says The Estée Lauder Companies Executive Chairman, is that they are really good at what they do . . . and not what their voting system is.*

The John L. Weinberg Center for Corporate Governance at the University of Delaware has been dogged in its examination of corporate ownership structures, with particular attention paid to the potentially problematic governance of companies with dual-class share ownership. In 2012 it conducted a major program on dual-class ownership, which was documented in *Directors & Boards* (see “Dual-Class Shares: Governance At the Edge,” Third Quarter 2012). Again in 2013 the Center conducted a deep analysis of “The Role of the Outside Director in a Controlled Corporation.” Charles Elson, the Edgar S. Woolard Jr. Chair in Corporate Governance and director of the Weinberg Center, gathered together on the university campus a dozen senior executives from the worlds of business, law, and institutional investing to debate the tradeoffs when boards are subject to a controlling interest. To help lead this exploratory examination, he turned to William P. Lauder, Executive Chairman of The Estée Lauder Companies Inc. A leader in the prestige skin care, makeup, fragrance and hair care products businesses, The Estée Lauder Companies is one of the most prominent companies traded on the New York Stock Exchange to have a dual-class share structure. William P. Lauder joined the company in 1986, served as CEO from 2004 to 2009, and has been its Executive Chairman since July 2009. The following is an edited excerpt of the discussion the two had in October 2013 on governance in the controlled corporation.

— James Kristie

**Charles Elson:** *The Estée Lauder Companies, when it went public, was a family business, founded by your grandmother and grandfather in 1946. It adopted a dual-class structure, which many family businesses do when they go public. The company has been extraordinarily successful, and the family is highly involved in the business as they have been from the start. How does corporate governance fit into the way you run Estée Lauder?*

**William P. Lauder:** If you think of the classical definition of governance as representing the voice of the shareholders, that holds true here because

the largest shareholders in our company happen to be active in management. By having gone public, we accomplished a number of objectives.

First of all, we cleaned up the internal governance structure. No longer were board meetings also known as Thanksgiving dinner. It got us to bring in some outside directors and ask the question, “What is the role of an outside director?” Clearly the most important thing was to give us insight and advice in areas for which we did not have experience. So for our first wave of outside directors we chose those with public company experience,

either as sitting CEOs or in other aspects of public company operations. Our management team was really expert in our business but we needed to learn how to operate in this new environment.

We wanted to be very careful, though, to not become subservient to the quarter, or even to the year. Nor to allow the analyst community and what some may think is a knee-jerk reaction to dictate how we operate. This was a key driver for us as to why we justified the dual-class structure.

As a company, we have always invested for the long term. For 50 years we have invested in developing brands that sometimes took a longer horizon to achieve returns, but whose returns are very good

over a long term. Secondly, from a competitive standpoint, the vast majority of our competitors were also family-controlled companies, or if they were public their float was very small. So they had the same horizon that we had. Those companies in our competitive set that were broadly held seemed to be less durable. We had, over time as a private company, overtaken them because they were more inclined to succumb to a shorter-term horizon. They had management that had bigger skin in the game in short-term performance than in long-term growth of equity value. We felt it was very important to align ourselves with a set of values for long-term sustainable success — which, especially in the consumer-branded world, is where the real payback is.

And finally, as a private company, there was nothing in the compensation structure that aligned employees with the ownership structure, because their compensation was purely cash. We had no phantom equity or other means of compensating. Now, we have an equity component to offer.

***When you went public, did you ever consider not using the dual-class structure and going with a more traditional governance structure?***

We did consider it. What we decided to do was put a sunset provision into the dual-class structure so that it would not be permanent. We also defined the universe of those who could hold the B shares to be a very small group of family members. If the B shares leave that universe they instantly become A shares. So what was an 80 percent-plus economic interest in 1995 is now a 40 percent-plus economic interest, with different family members now having different interests both from a voting control standpoint as well as an economic interest standpoint.

***Do you think the dual-class structure affected the valuation of your public offering? Did the market price you down a bit?***

I have to say that the P/E that we enjoyed in our first year of being public bore no relationship whatsoever to our underlying earnings — it was something like 90 times when the market at that period was more like 20 times. That had more to do with the scarcity of shares than with any underlying attitude toward the business. I really have not had any substantive conversation with shareholders on the dual-class structure.

My view is this. “One person, one vote” works in a Jeffersonian context, but we don’t run our company as a democracy. So if we don’t run the company as a democracy, what makes one think that the capital structure ought to be operated as a

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\* The National Basketball Association named Dick Parsons the interim CEO of the Los Angeles Clippers on May 9, 2014.

democracy? Is the herd smarter than management and its experience? I'm not certain. I'm not saying it is and I'm not saying it isn't. It is a question to ask. Had we not had a dual-class structure, with our long-term orientation and economic interest as a family, we could be in a very different place. In 30 years time, if we do not have engaged family ownership and are broadly held — and our competition is still narrowly held — likely we will not be as competitive because we will not have a management team with as much skin in the game and long-term interest to make the investments that are required for long-term sustainable success.

***As you say, you limited the dual-class provisions, which I think is quite a smart idea. But you were hamstringing yourself by doing so. What was the reasoning behind that?***

We believe that if we are going to ask you to invest in a company in which you have an equal economic interest — one share to our shares — but a difference in the voting interest, the minimum we could offer is to set a point where you do not have the minority controlling the majority. Secondly, by arranging that the existing shareholders on the day before the IPO would remain a relatively finite number and will not expand, the outside directors can feel a level of confidence that there is not room for abuse of the ownership structure. That being said, what we are really about is a value system we have in managing our company. We believe in ourselves, and if we don't believe in ourselves who else is going to? You are investing in our company because you believe it is a good long-term investment and not because of our voting system.

***Companies that have recently gone public with a dual-class or multiclass structure have explained that a motivating factor was that they wanted to insulate management from market pressures. What decisions could you make when you were a private company that become more difficult as a public company? Had you not been dual-class would you make certain decisions differently?***

I cannot think of a single strategic decision, either in capital structure or operationally, that we would have done differently if we were not a dual-class company. The reality is, the best reason to invest in companies is that they are really good at what they do. Being really good at executing your business plan, delivering results, exceeding expectations, delivering sustainable, meaningful return on invested capital and all of the other metrics that are used by the investment community is a bigger attraction from an investment standpoint than the somewhat arcane byways of what goes on in the

boardroom. We set a value system that says we are going to do this right and do it well. My role then as Executive Chairman is to oversee this company for the interest of all shareholders

— not one class of shareholders, *all* shareholders. If it's right for the largest shareholders, it ought to be right for all shareholders, because we all benefit equally from an economic standpoint. Our independent directors' role is to occasionally remind us what the outside world's view might be, but I can't think of any time we have been at odds in that conversation.

***Can independent directors of a dual-class company be truly independent? Do they see their role as representing all the shareholders or representing the controlling shareholder?***

As an independent director, your job is to ensure that the interests of all shareholders are being met by management, and that the board itself is representing the interests of all shareholders. From my view, the danger to me would be to get into a conflict with my independent directors over differing perceptions of where the company ought to go. If they were to say, "Either follow our direction or we will resign," that would be an extraordinary threat. And if they did get up from the table one day and leave, that would send a powerful signal to the marketplace. My economic interest in the company would likely be halved overnight. "All in favor, say aye; all opposed, say I resign," is just not a responsible position for a controlling director to have. You haven't invited an independent director to be there just so they can enjoy the coffee and doughnuts. You have them because they have some value to add, some insight to offer, and some experience to bring in an area where you feel your business needs to expand and grow.

***Do you see the independent board members more as advisors, or as monitors? There is a difference.***

A director on the audit committee would have an advisory and oversight role that is somewhat different than a director on the nominating and board affairs committee. A director on the compensation committee would have a role to challenge us to make certain that management's compensation in-

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terest is aligned with the long-term interest of the shareholders. Every director doesn't come with the same role because of their positions on different board committees, but all have an oversight role.

***How do you like to run your board meetings?***

We have a very collaborative approach. We spend most of our time on a business update and review of performance to date. We will look ahead at what we see as operational challenges and opportunities. This is all done in a robust, open dialogue so that the directors are fully informed of what is going on.

Depending on the desires of the directors or the needs of the CEO or my needs as Executive Chairman we will do an executive session where we can have a more quiet, more intimate conversation on an issue requiring board understanding, which is usually on a personnel issue of one sort or another that perhaps ought not to be shared in a wider context. We make a strong effort to involve our directors with our senior management. For example, we recently had a global leadership meeting with the top 300 executives of our company and all but one of our directors were able to join us in Shanghai for this meeting and spent five days with this senior executive team. When our directors are traveling around the world we invite them to tell us where they are going so we can introduce them to our local management team and show them our business. That way, when we talk in a board meet-

ing about our business in Korea, for example, they have met the general manager in Korea, have seen our stores there and understand the market that we're referring to.

Collaborative works better than antagonistic. If you are dismissive, or not inclusive, of your directors and their inputs, or

you behave in a manner that appears, from the responsible director standpoint, to be counter to the interest of our shareholders, you are inviting an antagonistic relationship.

***How do you deal with the split chair and CEO positions? You have a CEO who came from outside the family. How do you divide up responsibilities between the two of you?***

I am very lucky in having a phenomenal partner in Fabrizio Freda. We have a well understood divi-

sion of roles and responsibilities. There are things we're each good at and we give each other a lot of room in that space, and where there is overlap we spend time talking through the issues. Before he ever arrived we spent a great deal of time defining the roles and responsibilities that each of us would have, so we got into alignment quickly. There are very few times when we are at any kind of an impasse. It may take some convincing on his part to get me to a place on a certain decision and it may take some convincing on my part to get him to a certain place, and when that happens we go into one of the other's office and say, "Hey, what do you think about this?"

What has also helped is that the management team that is in place now is a management team that I have built over a 20-year period. He has found a way to work with them and make them even better. The result is that they are confident in our leadership. They see us as a real partnership, and see that we are not getting in each other's way in making decisions.

***Put your investor hat on. If you had a choice between two companies that were very much alike but one had a dual-class structure and one did not, would that be a factor in your decision?***

If that was the one difference? No. It would not even be near the top of my investor checklist. No. 1 on my list is quality of management. No. 2 is quality of the underlying business. And No. 3 would be the economic conditions in that industry that give the company room for growth in its existing markets and in future markets and what the obstacles are to sustained profitability. That to me is a far more compelling story than whether it is dual-class or not.

***I agree that a dual-class structure, or a controlling family interest, should not be an automatic disqualifier. You have to evaluate management for their own talents. But it does muddy the water a bit — at least that's the perception. Hence the controversy, and why we're talking about it.***

The argument from an academic standpoint that a controlling shareholder will, by definition, not make the right decision is not entirely fair. There are broadly held companies with one person, one vote, that are badly mismanaged, and there are narrowly held companies with one person, all votes, that are very well managed. You cannot say one is perfect in all circumstances and the other is bad in all circumstances. You have a great company when you have great people, great management, and great underlying business principles. Those are the bigger driving influences.

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