Ed Garden on an "Ownership Mentality" for Boards

As an engaged shareholder, Garden aligns ESG with profits.

As chief investment officer and a founding partner of Trian Fund Management, L.P., Ed Garden has influenced some of the largest corporations in the U.S. He currently serves on the boards of General Electric and Invesco and is a former director of Wendy's, Family Dollar Stores, Bank of New York Mellon and Legg Mason.

In an interview with Charles Elson, executive editor-at-large of *Directors & Boards*, Garden discussed the benefits of "having skin in the game" as an investor and a director whose active engagement often leads to a company's turnaround and sustainable success.

This text has been edited for clarity and length.

Charles Elson: **Let's talk a little bit about Trian and your approach to investments. What's your opinion of ESG and whether stakeholders, in addition to shareholders, should be part of the equation in a company?**

Ed Garden: At Trian, we invest in what we think are fundamentally great companies where management and, by extension, the board, is struggling to make the company best-in-class: best-in-class organic revenue growth, best-in-class margins, best-in-class return on invested capital and best-in-class from an ESG perspective.

We believe there's a strong correlation between being best-in-class from an ESG perspective and best-in-class operationally. Our job is to work with the board and the management team to really get the company on its front foot. At Trian, we think a fundamental part of what we do is bring a strong ownership mentality into the boardroom. I would argue that there's been a transfer of wealth from public shareowners to private equity over the last 40 years, with private equity buying public companies or divisions of public companies. We were told as shareholders those companies had become commoditized with low growth and were not great businesses, but somehow private equity firms were able to make a lot of money from those investments.

When you look at a private equity portfolio company, there's a very clear distinction compared to a public company. In a private equity context, the board is made up of the owners of the company — partners of the firm; management reports to them and those board members know the company as well as management does. The firm has a lot of skin in the game and the board is highly incentivized. That's very different from a public company boardroom where directors in a lot of cases own very little stock and don't really know the industry that well. Directors don't necessarily feel comfortable holding management accountable and there is a low level of ownership mentality. We call our model "hybrid private equity" where we seek to bring that ownership mentality into public company boardrooms.

ESG gets to the heart of shareholder primacy. It's interesting that the Business Roundtable made a statement arguing for more of a stakeholder-centered model. I would argue that what's missing in this whole dialog is that if you're actually going to execute on the goal of delivering for all stakeholders, you need a real ownership mentality in the boardroom. The main objective of every owner is value creation and we believe that is inextricably linked to the well-being of all stakeholders.

If you're an owner of a company and you have a lot of skin in the game, then satisfied customers, employees, suppliers, communities are just table

stakes. If you're truly an owner of the company, you want to be best-in-class from an environmental or diversity and inclusion standpoint because it's good for the business. It's not simply words, it's not simply trying to impress others, it's good for the business. You want diversity in your workforce because you want to hire the best people. You want to have strong sustainability efforts because that's the way you're going to attract employees — especially millennials — and customers. You're thoughtful about things like governance, how you're paying management because it's your money and you ask tough questions in the boardroom.

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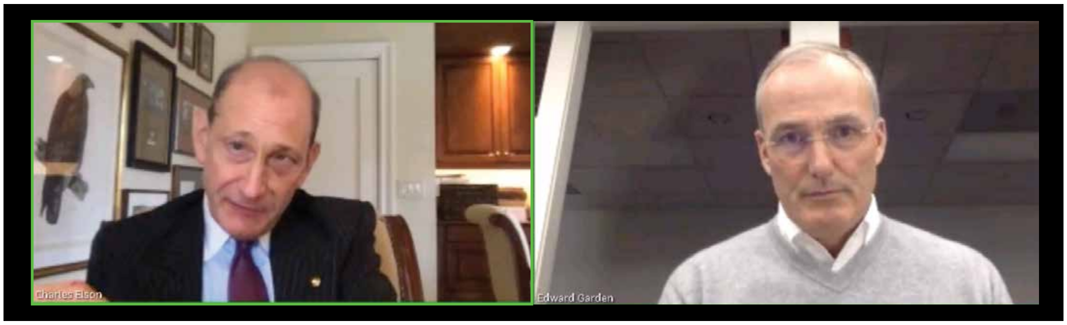
The vast majority of companies that we invest in got off track because management was trying to make short term numbers that hurt the business. When you're truly acting like an owner, you don't buckle under pressure from people who are looking for short-term fixes to prop up the share price. If you're truly acting like an owner, you're thinking long term. The management teams I've seen get into trouble are trying to meet unrealistic goals and they get on a treadmill of spinning rhetoric to try to explain what's happening and doing things that hurt the business long term.

I'll give you an example. Trian has been invested in Wendy's since 2005. We're the largest shareholder and it's been an amazing turnaround story. When we became the largest shareholder of Wendy's, it had been in a state of decline since Dave Thomas, the founder, died. Store sales and margins were down, and the business was going in the wrong direction. What had happened, in our opinion, was that management was trying to make quarterly numbers and had cut the quality of the food — cut the quality of the bun, cut the quality of the beef, cut the quality of the condiments — and hadn't invested in the physical plant. You had stores that had the linoleum floors and looked circa 1974. Consumers are not dumb. When you're serving bad food in an unattractive building, what do you think is going to happen? We went to shareholders and said this is going to take a number of years to fix but we're going to invest in the food — better quality bun, better condiments, better cheese, better burger, better fries, better salad. And we're going to spend significant money on the physical plant. Fast forward, the reason we've been successful at Wendy's is we're serving great food at a great price in a really nice building.

***CE:* Let's talk about diversity and inclusion. You took a very interesting approach at Bank of New York Mellon. Can you describe this?**

EG: Just as a backdrop, the Bank of New York merged with Mellon in 2007 and had made commitments to shareowners about what that merger would mean. Over the next seven years, things did not go as planned and earnings were flat to down — the share price didn't do well. We invested in 2014 and one of the things that I wanted to make sure we got right was compensation. When we go on the board of a company, we typically go on the compensation committee because compensation is an important lever that we have to pull to make sure that management is incentivized appropriately. That does not mean we don't want to pay management. We want to pay management a lot of money if they build the business. What we don't want is management getting paid a lot of money just for showing up.



In this case, obviously a human capital business, your people are your assets and getting your compensation design right was very important.

I went on the compensation committee, which also included responsibility for company-wide human resources, and I ultimately became chairman of that committee. When we were doing our diligence, we would hear from people who knew the company well over a long period of time that the culture was staid, that there was a need to revitalize the work force. We had heard those comments, but I didn't know exactly what that meant. After being on the board for maybe 18 months, I had an epiphany. I said to my fellow board members, "Is it just me or does it feel like everyone at this company played lacrosse against each other in high school and college?" I was being a bit facetious, but the point I was trying to make was this is a very homogenous workforce. I started asking questions and what I wanted to see was what our diversity looked like.

What came back very quickly was: "We're diverse. Forty-six percent of our workforce is women. We're diverse." But I really wanted to understand what our workforce looked like. When you're on the compensation committee of a public company, you're controlling the compensation of the top 10 to 15 people. But in an organization like Bank of New York, you're talking about 50,000 employees all around the world. To me, it was all about how we ensured that we were hiring the best people, that we were promoting the best people, that we were able to attract the best people; conversely, weeding out the underperformers all around the organization.

I asked to see diversity by ethnicity broken down, and I wanted to see it by gender in every business, at every level, in every geography. I doubt most companies truly have a handle on that because it took us maybe a year to really get the numbers and then to really drill down on why we looked the way we looked. The bottom line was we didn't have a whole lot of ethnic diversity or gender diversity.

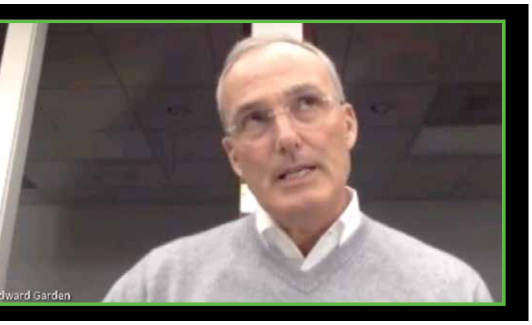
In the boardroom, I argued that as Trian was one of the biggest owners of this company, I'm focused on this because we're a human capital business. If we don't have diversity, by definition we're not hiring the best people. As an owner, I need the best people in this company. I want to understand how we are attracting people and if there are people that we're trying to hire and we can't, I want to understand why. I'm not trying to embarrass people in the H.R. department, I'm trying to understand how it all works.

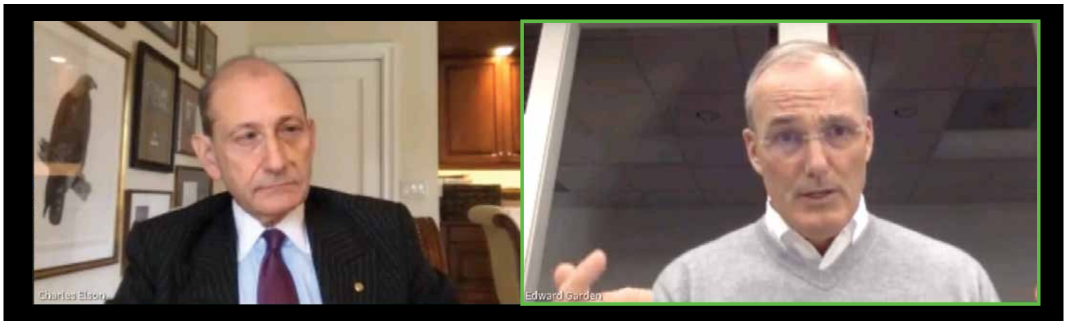
One concept that was very loud and clear was that we weren't doing as well as we could in hiring diverse talent. As the chairman of the human resources and compensation committee working with senior management and the rest of the board, I felt strongly we had to do two things. Number one, we needed to make creating diversity and inclusion throughout the organization an important component of how people got paid. In other words, you're not going to get paid unless you, as a manager, make your group diverse. And we mandated a diverse slate of candidates when hiring. Secondly, and I know there are pros and cons to this, we did an annual forced ranking. We really worked to identify the top performers and made sure they were compensated really well and, conversely, we identified the underperformers and moved them out to make room for new people to come in with new blood, new energy and new perspectives. I think all of that has made Bank of New York Mellon better for the long term.

I want to underscore that there are a lot of words that are well-intended, like "best in class from ESG perspective" or "work for all stakeholders," but I think the tricky part is actually making those words a reality. I'm proud of what we do at Trian in terms of actually making it happen.

***CE:* Trian makes a number of significant investments. How does "E" factor into those? How do environmental factors affect how you view your role both as an investor and director? How do you interact with management and institutional investors on that particular point?**

EG: We believe there's a strong correlation between operating performance





and ESG. If you show me a company that's best-in-class with regard to organic revenue, best-in-class from a margin perspective, best-in-class return on invested capital, my guess is they're best-in-class from an industry perspective. The reverse is also true.

A fascinating situation we came across was with Procter & Gamble, where they have a new technology called EC 30. It's a technology and a concept that we think is brilliant, which is to basically take the water out of a product — shampoos and soaps and things like that. We all have water in our homes, so why are we packaging this product with water in the plant and requiring plastic packaging? This technology allows products to ship in basically a wafer form that becomes liquid when the product mixes with water in your home. It allows you to eliminate all the plastic packaging. It's breakthrough technology that they had been working on for a long time. Nelson Peltz, my partner on the board of Procter & Gamble, focused on that technology at the board level and viewed it as a game changer, given it is so in tune with sustainability. It's transformative from a packaging perspective and could satisfy the need to attract not only employees, but customers and vendors as well. Even though EC 30 was not fully developed when he joined the board in early 2018 and was going to require a huge investment to actually make it reality, Nelson saw EC 30 as hugely important to the future of the business. It's the ownership mentality that is willing to make those investments. I'm not saying that they wouldn't have done so otherwise, but the point I'm trying to make is that it was clear from Nelson's standpoint, as a big owner in the boardroom, that this was a game changer over the long term. P&G had to spend money to realize this. So, yes, ESG typically plays an important part of our investment decision and our goal is to add value from an ESG perspective on every investment.

***CE:* What does the ideal board look like from your fund's standpoint and from your personal standpoint as a director?**

EG: It would depend on the company and industry, but there are a couple of important pillars. I think, generally speaking, the more industry expertise you have in the boardroom that really understands the nuances and subtleties of the business, that's helpful. One of the reasons public companies get into trouble is that management has an information advantage over the board, and the board doesn't really understand the company. They only know what management's telling them. At Trian, when we go on a board, we literally send a due diligence request. We have a data room set up and parachute our team in. I think industry expertise and eliminating management's information advantage is vital.

There are other types of expertise needed. We like to say that every company is a technology company, even though they may not know it. For example, we tell Wendy's management that it's a technology company because the world's gone to mobile pay, mobile ordering and advertising over social media. We have a lot of CEOs who are not technologists trying to navigate all these changes in technology opportunities and threats, and it's important to have people in the boardroom who can help. There are also companies we're involved with like General Electric where people with a governmental or public affairs background are really important.

The most important thing, I would say, is transparency. Also, being open to having that environment of "respectful confrontation" — the word "collegial" is overdone. Obviously, you don't want dysfunction in the boardroom and it's great if everyone likes each other, but it's not a country club. You're trying to serve shareholders and other stakeholders. You're trying to make the company best-in-class. You're trying to make a real difference.

Just imagine a world where every director was required to invest a material amount of their net worth in the company and to keep it invested for the duration of their time on the board. I think that would be a fascinating paradigm shift. That's what's happening at Trian and when I go on the board, I have a big part of my net worth tied up in that company, so I am highly motivated to make the company successful for the long term. ■