THE EVOLUTION OF NESTLÉ'S INSTITUTIONAL CONFIGURATION[1]

Peter Brabeck-Letmathe, Chairman at Nestlé since 2005, was preparing his appearance at the General Meeting of April 2016. He would then face his last year as Chairman of the company as he would turn 72 in November 2016 and that was the age limit set in the company's Articles of Association (AoA) to hold the position of Chairman. He was, therefore, due to retire in the 2017 General Meeting.

Peter Brabeck, who had begun to work at Nestlé in 1968, had met with success many times throughout his career, often facing difficult challenges. While reflecting upon the messages he wanted to convey in his speech, he recalled the situation he had experienced during the first months of 2005.

In January of that year, the Nestlé Board of Directors announced that it intended to propose the continuity of Peter Brabeck as Chief Executive Officer (CEO) in the General Meeting of Shareholders that would take place in April. The Board would also request his appointment as Chairman of the Board of Directors to replace Rainer Gut, who had reached the statutory age limit.

As a result of this announcement, and with the support of other funds, ETHOS[2], a Swiss foundation for sustainable growth, presented a proposal to introduce four changes in Nestlé's AoA, pursuing the following goals:

- Prevent the same person from being Chairman of the Board and Chief Executive Officer simultaneously.
- Reduce the Directors' term of office from five to three years.
- Choose each Director in a separate vote
- Reduce the number of shares required to submit proposals at the Meeting from one million to one hundred thousand.

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[1] Case published by the Research Division of Instituto Internacional San Telmo, Spain. Prepared by Professor Antonio García de Castro and research assistant Ms. Rocío Reina Paniagua. This case is intended only as a basis for class discussion and not to illustrate any judgment on the effective or ineffective management in a specific situation.

[2] ETHOS was founded in 1997 by two pension funds headquartered in Geneva and in April 2011 it comprised 130 institutional investors. It also carried out consulting and investment activities. In the last two years it represented around 8 per cent of the shareholders in Nestlé's Annual General Meeting.

Between January and April 2005, there was an intense public debate on these proposals, particularly in Switzerland, to the point that Peter Brabeck was willing to resign as CEO if the Board's proposal was not accepted at the Meeting. Near the date of the meeting, an influential American consultant, the Institutional Shareholder Services (ISS[3]), publicly expressed its support to the first two proposals.

After several hours of discussion, the assembly finally rejected all four ETHOS' proposals. However, the one referred to the barring of the possibility of holding the positions of Chairman and Chief Executive Officer simultaneously received 35.9 percent of votes in favor and 13.5 percent of abstentions. For additional information, see Exhibit 1.

Once the outcome of the vote was known, Peter Brabeck announced at the Meeting that he intended to leave the position of CEO in three to five years, after the process of strategic change that the company was carrying out was complete.

Despite the majority support of the shareholders, Peter Brabeck and the Board of Directors were convinced of the need to revisit the Corporate Governance regulations. The goal should be to align them with the practices observed in other companies comparable to Nestlé, while at the same time keeping the pragmatism that characterized the company and steering away from fads. Among others, they should review the articles on shareholders' rights, structure and functioning of the Board and its Committees, terms of office and compensation of the Directors, responsibilities of the Chairman of the Board and of the Chief Executive Officer, etc.

According to Peter Brabeck, the guiding principles of that revision should be the following:

- Respect the responsibility of the Board of Directors as the body that managed the company and supported the CEO and the Executive Board in creating long-term shared value for stakeholders, staff, consumers, customers, suppliers, and society at large.
- Strengthen Corporate Management and Compliance based on the company's core values as reflected in its Corporate Principles, Management and Leadership Principles, and Code of Conduct.
- Guarantee Nestlé's values and long-term continuity, avoiding the risks and crises that a significant number of large global companies had already entered.

Since then, the situation had improved considerably. Nestlé had even been awarded for its good management. Among other things, he now faced his own succession as Chairman after having been re-elected in every vote with the support of almost 100 percent of the votes.

[3] ISS was an influential Corporate Governance advisor for the global financial community. Over 1,700 clients trusted ISS's experience to help them make the best investment decisions regarding companies' Corporate Governance.

NESTLÉ'S INSTITUTIONAL CONFIGURATION[4] IN THE COMPANY'S EARLY YEARS

Henry Nestlé, of German descent, was Nestlé's Sole Administrator from the company's inception in 1866 until 1878, when, having no children and seeking to give continuity to his business, he sold Nestlé to three Swiss entrepreneurs who had a complementary set of skills. In 1905, these entrepreneurs decided to merge Nestlé with Anglo-Swiss in order to avoid the price war that had been going on since 1878. In the negotiations, Nestlé was represented by two bankers: the General Director of Credit Suisse and Administrator of Anglo-Swiss and the Managing Director of the Banque Suisse et Française. This arbitration led to the creation of Nestlé Anglo-Swiss.

Although in 1905 Anglo-Swiss contributed the highest value, the number of factories was balanced, with each company having nine. However, the merger took the form of a takeover of Nestlé at full parity. The merger brought to light how different the approaches of the two companies were. Anglo-Swiss had no debt other than those arising from everyday operations. Nestlé, on the other hand, had several encumbered facilities. Having a much more Germanic mindset, it would take Anglo-Swiss several years to fit comfortably into Nestlé's more open views.

The speed at which Nestlé expanded in the following years soon had an impact on the company's financial configuration. When in November 1921, the Board realized this, it feared they would face considerable losses for that fiscal year. The stock exchange furthered the existing discomfort. It reacted sharply to the rumors of a dividend suppression, which had reached 65 francs the previous year. Nestlé plunged into a crisis, its first and most severe one.

On November 20th that year, Nestlé shares fell to par level, contributing to the stock market panic. This fall was all the more surprising as it was unforeseen. Shares, which had a nominal value of 400 francs, plummeted from 1,020 francs in January 1920 to 550 francs in July 1921 and to 225 francs in December, hitting bottom at 145 francs in early 1922.

The company was healthier than its results in the stock market suggested. From that moment, Nestlé understood the volatility of the stock market and the fact that, if the business was to run according to its real results and with the long-term in mind, it could not be managed focusing on the stock market. That decision explains why, since then, Nestlé would only be listed on certain exchange markets, those where it would not need to present quarterly results.

After that episode in the stock market, financial reserves were insufficient. It was critical to obtain funds to solve the company's liquidity problems. However, that was difficult since they had made extensive use of their credit. The company even carried out a

[4] Institutional Configuration: Area of management that focuses on company ownership and the relationships between different types of shareholders. It also analyzes the relationships between shareholders, their representatives, and the top management, and delves into the topics of institutional initiative, financial configuration, and the power games that ensure the continuity of a company.