NESTLÉ CORPORATE GOVERNANCE AND COMPLIANCE[1]

In April 2011, Peter Brabeck-Letmathe, the Chairman of Nestlé, was on his way back from London where he had been awarded the World Finance Magazine Award for the Best Company in terms of Corporate Governance. The award was in recognition of the work carried out by Nestlé in this field during recent years and was added to others that had been received in 2011, such as the IR Magazine[2] and the University of St. Gallen (Switzerland) awards as the leading company in Corporate Governance.

Throughout his career, Peter Brabeck, who started working for Nestlé in 1968, had known moments of great success and others full of difficulties and challenges, but on this happy day, having collected a major prize, the most difficult situation that came to his mind was the one that he had lived through in the early months of 2005.

In January of that year, Nestlé's Board of Directors announced its intention to propose Peter Brabeck's succession as CEO (a position that he had occupied for eight years) during the Annual General Meeting due to be held in April. At the same time, they planned to propose his appointment as Chairman, in replacement of Rainer Gut, who had reached the statutory age limit.

Subsequently to this announcement, ETHOS[3], a Swiss foundation for sustainable development, together with the support of several pension funds, elaborated a proposal to call for shareholders to vote on the introduction of four changes in the Articles of Association, with the following objectives:

- To prohibit that the same person could be both chairman and CEO
- To reduce the term of office of the board from 5 to 3 years
- To elect each Board member individually

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[1] A Research Department Case Study from *Instituto Internacional San Telmo*, Spain. Prepared by Professor Antonio García de Castro and Research Assistant Rocío Reina Paniagua, with the financial support of the IDECA advisory council to serve as a basis for discussion and not as an illustration of adequate or inadequate management of any specific situation.

[2] Publication of Cross Border Ltd, a business media company renowned for its magazines, webs, events...

[3] ETHOS was founded in February 1997 by two Geneva-based pension funds and is currently composed of 130 institutional investors. It also conducts investment and consulting activities. In the last couple of years it has influenced about 8 per cent of the votes at Nestlé's Annual General Meeting.

- To reduce the number of shares required to submit proposals to the General Meeting from one million to 100,000 shares

Between January and April 2005 the public debate on these proposals was intense, particularly in Switzerland. Peter Brabeck made it clear that he was willing to resign as CEO if all these proposals went through. As the date of the meeting drew near, an influential American proxy advisor, the Institutional Shareholder Services (ISS[4]), publicly revealed its support for the first two proposals.

Finally, during the General Meeting and after several hours of discussion, shareholders rejected all the proposals presented by ETHOS. Nevertheless, the idea of not allowing the functions of Chairman and CEO to be held simultaneously by the same person received significant support (35.9 percent of the votes in favour and 13.5 percent abstention). You will find additional information in Exhibit 1.

At the same meeting and once the outcome of the votes was known, Peter Brabeck announced that he intended to step down from his position as CEO in a period of three to five years, once he had completed the strategic change that the Company was undergoing.

Peter Brabeck, together with the Board of Directors and the Executive Board, was convinced that it was time to carry out a thorough overhaul of Corporate Governance in order to align Nestlé's practices with those that were being established in the financial markets. This overhaul would address issues such as terms of shareholder rights, structure and functioning of the Board and its committees, terms of office of directors, executive remuneration as well as the responsibilities of chairman and CEO.

According to Brabeck this review should be based on the following principles:

- Respect for the responsibility of the Board of Directors as the body in charge of executive management and control of the company, which leads and supports the CEO and the Executive Board in creating long-term shared value for shareholders, staff, customers, clients, suppliers and the society in general.

- Strengthening of Corporate Governance and Compliance based on the company's core values, as reflected in the Corporate Business Principles and Management and Leadership Principles. A new Code of Business Conduct was to be developed.

- To ensure the continuity of Nestlé's values as well as long-term sustainability, avoiding the risks and crises which other large companies had already suffered.

[4] ISS is the leading provider of corporate governance solutions to the global financial community. More than 1,700 clients rely on ISS' expertise to help them make more informed investment decisions on behalf of the owners of companies.

To help Peter Brabeck implement all these changes, David Frick, formerly General Counsel and Head of Legal and Compliance at Credit Suisse Group, was appointed Director of Corporate Governance and Compliance, reporting directly to Peter Brabeck.

Nestlé Business Development and Management Structure

In 2011 Nestlé was the world leader in the Food & Beverage sector and was the global leader in Nutrition, Health and Wellness, with more than $ 90 billion in revenue. Exhibits 2 and 3 show tables with the accounts from recent years. The Company, which was founded in 1866, was present in 150 countries and had a workforce of over 280,000 people.

The major competitors in 2011 were Pepsico which had a turnover of $ 65 billion, Kraft Foods, with sales of $ 55 billion, following them; it was Coca Cola with a turnover of almost $ 50 billion, Unilever with approximately $ 30 billion, like Mars, and beyond that, Danone with just over $ 25 billion of revenue.

Paul Bulcke, who started working for Nestlé in 1979, was appointed CEO in April 2008. Under his stewardship the so-called Nestlé Model of financial performance was further refined for guiding the future outlook of the company. It includes organic growth of between 5 and 6 %, an improvement in both trading operating profit margin and underlying earnings per share in constant currency and continued improvement in capital efficiencies. In addition the company values and Nestlé Leadership Principles were refined and can be found in Exhibit 4.

In 2008, when Bulcke became CEO, he envisioned a clear path for the Company in the coming years:

”Our future growth will be based on internal growth as we already have an incredibly powerful foundation. Our main strong point is our range of products and brands. Furthermore, research and development is a fantastic platform we have to take advantage of. Our third strong point is our international presence. Finally we have our Nestlé people and culture. My challenge is to drive growth from this active basis and to do this we will base our ideas on four strategic pillars: updating and innovation of products, operational efficiency, product availability and communication with the consumer.”

Bulcke and his management team developed a vision which could be summarized in one page, the Nestlé roadmap. It included four competitive advantages (Unmatched product and brand portfolio – Unmatched research and development capability – Unmatched geographic presence – People, culture, values and attitude), the four growth drivers (Nutrition, Health and Wellness – Emerging Markets and Popularly Positioned Products – Out-of-home Consumption - Premiumization) and also four operational pillars (Innovation & renovation – Operational efficiency – Whenever, wherever, however – Consumer communication). All these areas were built on the