

# DIRECTORS MONTHLY

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## Building a Values-Driven Organization

By Peter M. Nicholas

**The chairman of Boston Scientific reviews his company's history and an amazing and unrepeatable year.**

Boston Scientific began in 1979 as an acquisition of MediTech, Inc., a small technology division of Cooper Scientific, which had been founded by John Abele. John and I retained 100 percent of the stock in the early days, mortgaging everything to retain 100-percent control. But in order to grow the company, it became apparent we needed capital. As a result, we had to spend an inordinate amount of time researching organizations that might have interest in investing in us.

Eventually we found a company, Abbott Laboratories, that made surgical equipment and was interested in extending its product line to include products such as ours that might eventually make surgery unnecessary. Abbott invested \$100 million in Boston Scientific, which amounted to a 20-percent stake in our company. Later, when we went public in 1992 with a \$1.7 billion capitalization, their \$100 million had grown to \$340 million. Boston Scientific was the single largest initial public offering (IPO) in history at the time.

Today, when companies go public, it is customary for the founders and the senior managers to piggyback on the IPO and unload some of their shares. But when we

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went public, we faced a very different situation. The documents to support our public offering noted that one of the special risks of the offering was that the company's management owned an inordinately high percentage of the stock and that they operated the business on the basis of long-term strategies. Can you imagine, they put a disclaimer in the prospectus, because they thought we owned too much stock and were long-term oriented? Today, we still have a higher concentration of employee stock ownership than most other companies listed on the New York Stock Exchange and, in my view, our employees' interests are very clearly aligned with those of shareholders. In 2004, we were the only company to receive all "A" ratings in the *Wall Street Journal's* "Shareholder Scorecard" edition with regard to the performance metrics measured for one-, three-, five-, and 10-year periods. It's kind of amazing. We didn't have a plan to be that. But it is nice to know that along conventional financial metrics we are regarded pretty highly. We were in the top 10 most prodigious producers of intellectual property in America.

### **Developing Strategic Mass**

In 1992, President Clinton and Hillary Clinton tried to change the healthcare system by establishing national health insurance. Hospitals were aggregating aggressively in order to improve efficiency.

Hospitals teamed up to form purchasing groups so they could buy in large quantities, forcing prices down. We were afraid we'd be at a disadvantage because we were too small and I concluded that we needed to get big in a hurry. I coined a concept that I called "strategic mass," as opposed to "critical mass." The idea was to consolidate groups of companies that would each focus on an individual system, such as urology, cardiology, etc. We acquired a number of companies to that end and overnight became a \$1.3 billion company. The result was, not only did we improve our capability to negotiate with these people, we also significantly broadened our company, in geography, in technology, in our organizational girth, and in our capacity to fund research and take higher risks—we believed that larger size provided strategic advantages.

### **Governance in the Early Public Years**

In 1996, governance was a topic much on my mind. At the time, I was CEO of Boston Scientific and we were an independent company; I wanted us to remain that way. As a co-founder of the company, I was afraid that, after I was no longer CEO, another CEO might undo a lot of things that represent the culture and values of Boston Scientific. It became very important for us, therefore, to create a set of governance policies in the company. But we didn't know how. We talked to groups like NACD. We

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talked to institutional shareholders like CalPERS. We spent a lot of time working on governance matters, and in the end we developed what I considered to be a very forward-looking set of governance policies. We wrote down the policies, and invited third-party reviews. We wanted to know what others thought of them. When the Sarbanes-Oxley Act of 2002 was passed, we discovered something interesting: We had relatively few changes to make to our governance procedures to comply with the new rules.

### **A Medical and Business Breakthrough**

Last year, our company received FDA approval to market TAXUS, a coronary stent system that delivers a drug dosage which helps keep coronary arteries open. That product was both revolutionary for the industry and the most incredible boon imaginable for Boston Scientific. In 70 days, we had captured 70 percent of the U.S. stent market. It was the most successful product launch ever of a device or drug in the U.S. healthcare business. It was amazing, and that's not boasting. We sold \$1.5 billion the first year for that product alone.

The irony is, we've been condemned by our success because there is no way to top it. Yet people are asking exactly that: What are you going to do next year, and the five years after that? It is clearly not possible to achieve

**Director Summary:** The chairman and co-founder of Boston Scientific describes the birth and growth of his company and says that the entrepreneurial management retained its stock during its public offering. Rather than start a company to sell it and gain wealth, he advocates for growing the company and nurturing it to maturity.

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growth over the next five years that would mimic the last five. That would be death-defying. You can't go from \$3 billion to \$6 billion every year.

### A Change in Leadership

Back in 1996 and 1997, when I was still CEO, I felt the company was getting too big for me to run. At the end of 1997, I told the board that I was going to institute a succession process and find my replacement. The board was a bit shocked and surprised and asked me: "What do you know that we don't?" But there wasn't, in fact, any big secret. The board got over the shock of it and satisfied itself nothing was wrong. They then agreed with the founder that this was sensible. After running Boston Scientific since 1979, I wanted to see the company move beyond having its founder as CEO. I wanted to see Boston Scientific move to a stage where, rather than relying on the goodwill of the person in the CEO role, we had an organization and leadership and a governance system in place that could move the company forward independent of me.

So I set out to search for a successor. It took us two and a half years to find that person. In the spring of 1999, Jim Tobin, the former CEO of Biogen, arrived at BSC and took on the job of CEO. At that time I moved up to non-executive chair. Very few people who are really good at what they do are willing to work alongside a founder. But it worked for us. After Jim came on, he and I spent two or three years finding our own space: What do you want to tell me and what do I want to tell you? How does this all work? At the end of three years he was on his own. I believe Jim and I have developed a partnership that has strengthened the company. Generally, I think the chairman and the CEO of a company should not be the same person.

When our company celebrated its 25th anniversary in 2004, one of the significant metrics for me was that we had grown from 38 employees and \$2 million in sales

in 1979 to, in 2004, more than 16,000 employees and sales of \$5.6 billion—and that we had accomplished that growth with many of the same members of the management team. People running the company today have a very keen understanding of where we came from and what the company was like in earlier years. Perspective is an enormously important thing, and it helps inform decision making. I have always understood that in order to chart the future, it helps to understand the past.

Our board members are chosen to be very hard-charging. They are not shrinking violets; many have run organizations. Our board has regular executive sessions, and the CEO always steps out during closed executive sessions. We have 12 directors, and all but four are independent. As a company, we have a process in place to ensure that there is some change in board membership over time; periodically "re-greening" the board is important.

Today, the issue I'm most concerned about is short-term versus long-term perspectives—in particular, in the way Wall Street measures companies. This is not so much a concern for a company like ours, where employees and managers own a lot of stock. As a founder, what I care about is how Boston Scientific is doing as a company, not what its stock price is today. But it's not clear that my counterparts, executives at other public companies, have that luxury. Executive compensation is increasingly tied to stock performance, which, given the vagaries of the stock market, is not a very good proxy for company annual performance.

At Boston Scientific, we deal with many young medical device companies that are like we were when we were small. However, there's one important difference. When I co-founded Boston Scientific, I had the long-term goal of building an enterprise; I never had the goal of having the company acquired. Today, most of the founders of these young companies start with the expectation of selling the company and leaving. I think the "instant wealth" mentality that characterized the Internet bubble is still very prevalent in our society. And that kind of mindset and culture is anathema to company-building.

I would encourage entrepreneurs and their boards, as they develop their strategies, to look beyond the immediate wealth that can be made by selling their companies while still in their infancy. While that kind of gratification is alluring, it cannot compare to the thrill of seeing a company from birth to maturity, working together with one's employees to create a lasting legacy. ■

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