CORPORATE GOVERNANCE

Analysis

The Long Term, the Short Term, and the Strategic Term

In their Corporate Governance column, David A. Katz and Laura A. McIntosh write: The short-term/long-term, shareholder/stakeholder debate is likely to become more intense, and more political, in the near future. As the landscape of corporate governance shifts around them, companies should seek firm ground on a foundation of business success by creating and implementing a strategic plan over a time horizon that will maximize both growth and profitability.

By **David A. Katz and Laura A. McIntosh** | September 25, 2019 at 12:40 PM

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After many years, this past summer the Business Roundtable updated its principles of corporate governance with a new Statement on the Purpose of a Corporation. In the accompanying press release, the Business Roundtable emphasized the larger societal role of corporations in America: "If companies fail to recognize that the success of our system is dependent on inclusive long-term growth, many will raise legitimate questions about the role of large employers in our society." Superseding the decades-long period during which the Business Roundtable supported the view that "corporations exist principally to serve their shareholders," the revised statement of purpose is oriented toward "the long-term interests" of "all of our stakeholders."

The Business Roundtable thus joins other prominent voices in corporate America that are now disavowing long-held views of shareholder primacy. The Business Roundtable press release identifies the two sources of this trend. The first is a perceived disconnect between the short-term interests of "shareholders" and the long-term interests of "stakeholders," a group that, writ large, could encompass all of American society. The second is a desire to stave off government intervention that could impose an overly burdensome stakeholder-centric model of corporate

governance through legislation: “If companies fail to recognize that the success of our system is dependent on inclusive long-term growth, many will raise legitimate questions about the role of large employers in our society.”

The short-term/long-term, shareholder/stakeholder debate is likely to become more intense, and more political, in the near future. As the landscape of corporate governance shifts around them, companies should seek firm ground on a foundation of business success by creating and implementing a strategic plan over a time horizon that will maximize both growth and profitability. With a well-developed, well-articulated, and well-executed strategy, a chief executive can generate productivity and value, and a successful enterprise will have correspondingly wide latitude from investors and regulators alike to engage in responsible corporate stewardship in the manner, and over the timeframe, that is best suited to the corporation.

Combating Short-Termism

Pressure toward short-termism—the maximization of immediate shareholder profits at the cost of longer-term investments and employee compensation—has several sources. Hedge funds and other activist investors, equity incentive compensation plans, quarterly earnings releases, and the related but separate issuance of quarterly guidance, are all important factors in promoting short-term-oriented decision-making. This past summer, the Securities and Exchange Commission held a roundtable on short-termism and its interplay with the periodic reporting disclosure system. SEC Chair Jay Clayton announced the SEC’s intention to investigate “whether our disclosure framework and other regulations have encouraged a focus by companies—and not just securities traders—on the short-term over the long-term.”

There are increasingly calls for—in the words of corporate lawyer Martin Lipton—“a meaningful and successful private-sector solution to attacks by short-term financial activists and the short-termism that significantly impedes long-term economic prosperity.” The implication is that the problem of short-termism must be solved, whether by companies themselves or through the intervention of regulators and lawmakers. In other words, though for the last half-century companies generally have been rewarded and praised for creating economic value for their shareholders, there is now a view, held by influential participants in corporate America, that maximizing financial returns might be antithetical to the overall health and well-being of the nation.

Forestalling Legislative Intervention

Recent statements by prominent politicians that the federal government should assert greater control over corporate governance indicate that market-based capitalism is in the political cross-hairs. In 2018, for example, Sen. Elizabeth Warren introduced the Accountable Capitalism Act, a bill that would federalize corporations with $1 billion or more in revenue. Earlier this year, Sens. Chuck Schumer and Bernie Sanders published an op-ed describing legislation that would require corporations to meet specified employee wage and benefit levels and blaming stock repurchases for restraining public companies’ “capacity to reinvest profits more meaningfully in the company in terms of R&D, equipment, higher wages, paid medical leave, retirement benefits and worker retraining.” The Business Roundtable’s new Statement of Purpose can be understood as an effort to forestall legislative intervention through private sector initiatives. As Mr. Lipton observed earlier this month, “Calls for the exercise of corporate social responsibility have become increasingly urgent.” There is a growing sense that in order to preempt legislative action, corporate America must take visible, substantive steps toward “responsible corporate stewardship.”

Those attempting to implement the broad ideals expressed in the Statement of Purpose can look to Mr. Lipton’s project, The New Paradigm, “a reconception of corporate governance as a collaboration among shareholders, managers, employees, customers, supplies, and the communities in which corporations operate.” Mr. Lipton initially presented the New Paradigm at the 2016 World Economic Forum as, in his view, the best path for corporations collectively to maintain market-based capitalism and avoid the strictures of state corporatism. The New Paradigm offers a roadmap for corporate stewardship, emphasizing the need for shareholders, particularly asset managers and institutional investors, to uphold stewardship principles that would ensure support for boards that are pursuing long-term strategies and ESG (environmental, social, and governance) principles. Many institutional investors have announced support for socially responsible corporate governance, but the contours of this commitment remain vague for the most part. The New Paradigm presents specific, yet flexible, principles for investors to follow.

The Strategic Time Horizon

While regulators and lawmakers consider their options, and while companies maneuver to forestall federal intervention (of the type seen in the United Kingdom), it is worth considering whether the choice between short-term and long-term decision-making is in important ways a false dichotomy. As one panelist at the SEC Roundtable observed, "public company boards need to be more agile and manage for both the long term and the short term." In fact, a business strategy should be sensibly developed and implemented with respect to the timeframe suited to the business and to the strategy, not by reference to inchoate time horizons. The phrase "long-term" may not be financially meaningful to individual investors, while "short-term" decision-making may be counterproductive to the company's continued success. Shareholders invest or remain invested in a company if they believe that the company's strategy will be successful over its applicable timeframe. As a practical matter, the only time horizon that is relevant to investors is the strategic term; they literally either buy into it or they do not. If the strategy is successful, the company will create value, and a prosperous company will have the wherewithal and the latitude to be a responsible corporate citizen. The long-term interests of society are bolstered by the execution of one successful corporate strategy—each with its own relevant decision-making term—at a time. Each company has its own strategic timeframe; as with so many elements of corporate governance, here too, one size does not fit all.

In 2016, a group of prominent chief executives issued an open letter presenting "Commonsense Principles of Corporate Governance." The principles emphasized the importance of strategic planning, good communication, and long-term thinking by leadership: "A company should take a long-term strategic view, as though the company were private, [including making investments that may not pay off in the short run] and explain clearly to shareholders how material decisions and actions are consistent with that view." While articulating the view that long-term thinking is crucial, nonetheless the principles include the following: "Companies should frame their required quarterly reporting in the broader context of their articulated strategy and provide an outlook, as appropriate, for trends and metrics that reflect progress (or not) on long-term goals." The appropriate outlook reflects the time horizon in which a business can be a productive enterprise. Corporations should not be compelled to prioritize long-term ideals any more than they should be compelled to maximize short-term profits. Business requires freedom to flourish. The corporate America in which large companies are engines of social good is only possible if these corporations are ultimately successful; only with that foundation can any meaningful and lasting stakeholder prosperity be built.

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