July 30, 2012

Short-Termism

On July 23, John Kay, an economics professor at the London School of Economics, issued his final report, *The Kay Review of UK Equity Markets and Long-Term Decision Making* which was commissioned last year by the UK Department for Business, Innovation and Skills. Kay reaches a number of conclusions about governance and fiduciary duties in business corporations, finance and investment management in the UK that have corollaries in the US.

Kay's principal conclusion is that finance and investment management have become obsessed by short-term profits and that they are imposing this obsession on business corporations to the detriment of Britain's economy:

> "But competition between asset managers on the basis of relative performance is inherently a zero sum game. The asset management industry can benefit its customers – savers – taken as a whole, only to the extent that its activities improve the performance of investee companies. This conflict between the imperatives of the business model of asset managers, and the interests of UK business and those who invest in it, is at the heart of our analysis of the problem of short-termism."

So too in the US traditional institutional investors have become obsessed by short-term profits and will abandon their support of corporate strategies designed to achieve long-term growth and support activist hedge funds in seeking to force companies to take actions to produce short-term profits.

Kay joins the growing number of economists who have recognized that *the efficient market theory* and *the capital asset pricing model* have proved to be erroneous bases for the theoretical justification for shareholder-centric governance that promotes short-termism. It is to be hoped that academic economists and law professors in the US will study the Kay Review and recognize that short-termism is a major threat to our economy. I commend the Kay Review to your reading and consideration.

Martin Lipton

If your address changes or if you do not wish to continue receiving these memos, please send an e-mail to Publications@wlrk.com or call 212-403-1443.

W/1979228