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Corporate Governance—The New Paradigm—A Better Way Than Federalization

While "The Accountable Capitalism Act" introduced last week by Senator Elizabeth Warren contains several very worthwhile provisions, it is premised on the federalization of all public corporations with revenues in excess of $1 billion. Mandatory federal incorporation and the creation of a federal office to make regulations and supervise compliance would be a major incursion into state corporation law. It is reminiscent of proposals by Ralph Nader some half-century ago to achieve control of major corporations by mandatory federal incorporation. Warren's proposal should not receive any more support than Nader's. However, like Nader's proposal led to significant changes in environment regulation, Warren's will likely lead to major changes to the relationship between corporations and the institutional investors and asset managers who control them.

The change that is essential is the replacement of shareholder primacy by stakeholder primacy. The concept that corporations should maximize profits for the benefit of shareholders must be replaced by the concept that corporations should be managed in the public interest, by considering employees, customers, suppliers, communities, the environment, the economy and the public interest generally, as well as the shareholders.

The rejection of shareholder-centric governance has recently been receiving important support in academic circles and from major institutional investors and asset managers. So too, from state legislation like the "benefit corporation" statutes and a refocusing on state constituency (stakeholder) statutes in some 30 states and the stakeholder principles approved by the Supreme Court of Delaware in the 1985 Unocal case.

Having been a vocal advocate of stakeholder-centric governance since 1979, and a frequent critic of short-termism and the so-called "empirical studies" used to support attacks by activist hedge funds, I was asked by the World Economic Forum to prepare a paper describing and advocating a new paradigm for corporate governance that I had been writing and speaking about. Together with several of my partners, I prepared, and the World Economic Forum in September 2016 published and sponsored, *The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth*. (Available here.)

The New Paradigm is a corporate governance framework that derives from the recognition by corporations and by investors and asset managers that short-termism and attacks by activists seeking short-term gains significantly impede long-term economic prosperity. *The New Paradigm*, as well as a rapidly growing number of academics and major investors, rejects the proposition that short-term activists and reactive corporate behavior spur sustainable improvements in corporate performance, and thereby systemically increase rather than undermine long-term economic prosperity. *The New Paradigm* is premised on the idea that corporations and investors and asset managers can forge a meaningful and successful private-sector solution, which may preempt a new wave of legislation and regulation such as Senator Warren's Accountable Capitalism Act.

In essence, *The New Paradigm* recalibrates the relationship between corporations and major institutional investors and asset managers, and conceives of corporate governance as a collaboration among corporations, shareholders and other stakeholders working together to achieve long-term value and resist short-termism. In this framework, if a corporation is diligently pursuing well-conceived strategies that were developed with the participation of independent, competent and engaged directors, and its operations are in the hands of competent executives, investors will support the corporation and refuse to support short-term activists seeking to force short-term value enhancements without regard to long-term value implications. As part of their stewardship role, investors and asset managers will work to understand a corporation's strategies and operations and engage with it to provide it with opportunities to understand the investors' opinions and to adjust strategies and operations in order to receive the investors' support.

The New Paradigm concluded with this statement:

> The World Economic Forum has long been concerned with facilitating an environment that is conducive to long-term investment and sustainable growth.

> The enabling factors of corporate social responsibility, quality employment, and human capital are important levers against the dangers of rising inequality and political tensions. The resurgence and momentum of the recent focus on deploying capital to generate long-term wealth creation and economic prosperity is encouraging. This project organized by the International Business Council of the World Economic Forum is a testament to the global desire and efforts to restore a focus on the long-term sustainability of corporations. We are optimistic that the endorsement and implementation by corporations and investors of the New Paradigm outlined in this report will effect meaningful and lasting change.

If *The New Paradigm* is fully adopted and adhered to by corporations and institutional investors and asset managers, there will be a private solution that obviates the need for legislation like Senator Warren's Accountable Capitalism Act. That this is a realistic expectation is evidenced by the action of the Investors Stewardship Group (an organization of leading investors and asset managers formed in 2017) stating in its principles that, "[I]t is the fiduciary responsibility of all asset managers to conduct themselves in accordance with the preconditions for responsible engagement in a manner that accrues to the best interests of stakeholders and society in general, and that in so doing they'll help to build a framework for promoting long-term value creation on behalf of U.S. companies and the broader U.S. economy."

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