



## Aspen Corporate Values Strategy Group (CVSG) Summit

July 11-12, 2011

GREENTREE | MANHASSET, NEW YORK

### Combating Market Short-Termism: Reflections from our summer dialogue

On July 11-12, 2011, a group of 22 senior executives, asset managers, and other interested participants came together for a dialogue about the role of business in society and how to best combat market short-termism. The summit, facilitated and hosted by the Corporate Values Strategy Group (CVSG) of the Aspen Institute Business and Society Program (Aspen BSP), builds on an ongoing dialogue and body of work about the role of business and society. In 2007, a similar summit launched the practice-focused [Aspen Principles for Long-term Value Creation](#); and in 2009, led to a public policy-oriented statement titled [Overcoming Short-termism](#). This summit continues the work that the CVSG has facilitated since 2003.

Throughout the summit, participants focused on several key questions:

- How well are beneficial owners ultimately served by capital markets?
- Can a company truly turn away from the “expectations market,” even if it is committed to doing so?
- How far can we get in addressing market short-termism with stewardship?
- Wither business leadership: is there a vacuum of courageous business leaders?
- And underlying it all; what really is the purpose of the firm?

### Consequences of disintermediation of the investment chain

Perhaps most prominent was a question of the degree to which the current capital market structure provides benefits to asset owners. Concern was raised about the market’s ability to accurately inform investors of their investee’s worth – a serious issue especially for long-term investors. Some participants suggested that the cause of this communication breakdown stemmed from the increasing dominance of the “expectations market”<sup>1</sup> – driven by stock traders and hedge funds – and the market volatility which has come with it. One participant provocatively noted “I no longer believe in the tooth fairy, and I don’t believe stock markets effectively show the real value of a corporation.” Another participant reflected on a past experience bringing a company public, and during planning meetings with investment bankers wondering “are they really working in my best interest?” Yet another speaker described capital markets as being backward – where asset managers and investment banks seem to have “gained control” over corporations and asset owners.

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<sup>1</sup> Roger Martin’s *Fixing the Game* was a suggested pre-reading for the summit. The 2011 book defines the expectations market as “the world in which shares in companies are traded between investors – i.e. the stock market. In this market, investors assess the real market activities of a company today and, on the basis of that assessment, form expectations as to how the company is likely to perform in the future.”

## **Is turning away from the “expectations” market a real choice for public companies?**

Issues relating to classical principal-agent dilemmas, like the ones above, dominated the dialogue at times. Some asked if a company could avoid these problems by simply ignoring the expectations market (or at least minimizing one’s involvement in it). One corporate manager thought such action to be possible, but noted it would take a certain set of circumstances to do so. CEOs would need to be strong enough leaders to transition a company away from the expectations market; they would need to disengage by moving away from quarterly guidance; they would need to build in checks and balances by demanding strong, independent boards; they would need to restructure compensation in a way that incentivized long-term value creation; and they would need to seek out shareholders who are most interested in investing for the long-term. Some investors agreed with this approach, noting that the qualities required of corporations fighting against pressures causing short-termism are the same qualities that signal a company is a good investment.

Although some attendees voiced support for a corporate exodus from the worst effects of the expectations market, not all agreed this was a real solution. The question was raised: “Couldn’t corporations act responsibly without turning away from the expectations market?” One investor questioned whether asset owners and their asset managers had placed any real pressure on corporations to act unsustainably by asking a corporate executive “What did these shareholders make you *do*?” Yet another participant questioned whether asset managers were really the root of the problem, noting that if owners demanded their agents to invest in a certain way, those asset managers would meet such demand. Following this point, several noted that beneficial asset owners (e.g. the “Mom & Pop” pensioners) do indeed want to invest their capital to promote sustainable prosperity. It seemed that individually each player in the capital market system was ready to work toward long-term value creation, but as a system there seemed to be a breakdown. Suggested causes for this breakdown included interference by trade associations and the inability of managers and investors to quantify the value of taking the longer-term view.

## **Stewardship and a changing role for the investors**

Rather than push corporations away from the expectations market, some instead suggested that asset owners and asset managers should be more active stewards in their investments – an idea supported by Roger Martin’s newly published *Fixing the Game*. However, one attendee noted an immediate free-rider problem: an individual investor wishing to practice good stewardship would need to contribute a significant amount of resources to do so, yet would only reap a percentage of the benefits (depending on their ownership share). Meanwhile, that investor’s competitors would realize the same benefits despite never having expended any resources toward stewardship. Another participant noted that stewardship for some asset managers would be near impossible considering some portfolios held shares in thousands of companies. One solution offered in regards to these issues was to restructure shareholding voting rights to correlate with liquidity – that is, to provide stewards with greater control. Another participant, citing recent research that the benefits of diversification diminish once a portfolio contains 30 to 50 stocks, suggested that asset managers might hold fewer companies in order to be able to devote more

attention to each business. However, some managers pushed back at stewardship altogether, arguing that investors needed to “let managers manage their company.”

### **Wither business leadership?**

Several argued that the stagnation of long-term value creation in capital markets wasn't due to a lack of good ideas, but to a lack of the will to act with a long-term perspective in mind. Participants considered several levers for change. Conventional strategies—enacting new regulations, changing the legal code, and pushing for policy changes—were discussed and generally ruled out. Legal experts noted that current laws already allow corporations and their owners to embark on a long-term value creation path; others suggested that pushing for regulatory or policy changes in the current political climate would get little traction. Some participants called for a solution through strong business leadership. Yet others were pessimistic, with one noting the “era of the outspoken CEO is just gone,” another admitting “taking a stand [as a manager] results in taking a lot of hits,” and others describing the current business landscape as a “keep-your-head-down” type of culture. One participant agreed that CEOs seemed to be missing from the policy arena as well, declaring “Nowhere, it seems, is corporate voice being heard [on important policy issues]”. Still others thought the focus ought to be on investors and their asset managers, arguing that “[positive action] we see on the corporate side is outpacing the capital market side.”

### **Moving forward: ideas for further action**

Ultimately, paths to shift the behavior of corporations and capital markets and “move the beast” began to take some form. Many endorsed the Aspen BSP style of gathering “strange bedfellows” to discuss ideas, and others advocated for even greater heterogeneity by suggesting that more international representatives be included in future summits to incorporate knowledge and experience of other capitalist models.

Investors, academics, and operating company executives were happy to have the chance to work collectively toward a common goal; and collective action, in general, garnered support. Participants suggested engaging actors in the capital markets who were seen as a current barrier to long-term value creation practices – from corporations, to institutional investors, to trade groups. Others suggested that Aspen Institute convene smaller groups representative of those in the investment chain to tackle specific problems, rather than host a single, diverse summit for CVSG.

Proponents of the “courageous business leader” solution advocated that CVSG work to identify new leaders and potential “founding fathers” to spearhead solution implementation. Specifically, it was noted that Aspen BSP may want to articulate the “transmission belt” that will help move forward ideas generated during dialogue to supportive action partners who have the ability to influence policy, influence other market actors, and deliver lasting change.

We thank all who joined us during the 2011 summit and look forward to making further progress through the Aspen Institute model of dialogue and emphasis on values-based leadership.

**Appendix to follow:** Participant list and Dinner provocations

## APPENDIX 1: 2011 Corporate Values Strategy Group Summit Participants



1. **Roberta Bowman**, Executive Vice President & Chief Sustainability Officer, Duke Energy
2. **Theodore Carter**, Executive Vice President, CB Richard Ellis Inc.
3. **Donna Dabney**, Vice President, Secretary and Corporate Governance Counsel, Alcoa Inc.
4. **Rebecca Darr**, Senior Fellow of Corporate Programs, Aspen Institute Business & Society Program
5. **Abe Friedman**, Partner, CHJ Capital Management
6. **Michael Garland**, Executive Director, Office of the Comptroller of NYC
7. **Ben Heineman, Jr.**, Senior Fellow, Harvard Law School
8. **Tom Kiely**, Director of Sustainability, McKinsey & Company
9. **Peter Knight**, Co-founder and President, Generation Investment Management
10. **Dean Krehmeyer**, Executive Director, Business Roundtable Institute for Corporate Ethics
11. **Robert Kueppers**, Deputy CEO, Deloitte
12. **David Langstaff**, President and CEO, TASC Inc. #
13. **Matthew Lepore**, Vice President and Corporate Secretary, Pfizer Inc.
14. **Andrew Letts**, Managing Director, Head of Corporate Governance and Proxy Voting, State Street Global Advisors
15. **John Manzoni**, President and CEO, Talisman Energy #
16. **Nancy McGaw**, Deputy Director, Aspen Institute Business & Society Program
17. **Colin Melvin**, CEO, Hermes Equity Ownership Services, Ltd.
18. **Bridget Neill**, Director of Regulatory Policy, Ernst & Young LLP
19. **John Olson**, Senior Partner, Gibson, Dunn & Crutcher, LLP #
20. **Judith Samuelson**, Executive Director, Aspen Institute Business & Society Program
21. **Ruby Sharma**, Partner, Ernst & Young LLP
22. **Damon Silvers**, Policy Director and Special Counsel, AFL-CIO
23. **Lynn Stout**, Paul Hastings Professor of Corporate & Securities Law, UCLA School of Law #
24. **Simon Wong**, Partner, Governance for Owners and Adjunct Professor, Northwestern University
25. **Robert Zivnuska**, Director, Americas Corporate Governance and Responsible Investment, BlackRock Inc.

Hash marks (#) denote Aspen BSP Board Members who will join us for the dialogue.

## **Appendix 2: Monday Dinner Provocations, from Roger Martin's *Fixing the Game***

Published May 3, 2011 by Harvard Business Press. Shared with author's permission.

### **Orientation**

In the current environment, to simply ignore the expectations market is to court disaster. (119)

*On the other hand...*

But when three of the fifteen most valuable companies in the world [J&J, P&G, Apple] – companies that have clearly outpaced their peers on the creation of value for shareholders – are explicit about not seeking to maximize shareholder value, something interesting is happening. (50)

Investors, analysts, and hedge funds are all creatures of the expectations market and they continue to reward firms that meet expectations and punish those that do not. (118)

### **Role of the customer & customer primacy**

The firm attempts to maximize shareholder value and the executive attempts to maximize personal incentive compensation. In such a context, there is no incentive to maximize customer delight. Rather customers simply impose a minimum constraint; as long as the company and its employees don't treat the customer too badly, they will stick around. (126)

*On the other hand...*

Which is the most powerful...placing shareholders first or placing customers first? (70)

When the real market is dominant, customers are the focus, and the central task of companies is to find ever better ways of serving them. Entrepreneurs that create customer value through innovations...earn the highest rewards. When the expectations market is dominant, traders are the focus and gaming markets is the task. (31-32)

## **Executive compensation**

When a board gives its CEO stock-based incentive compensation, whether stock options, stock or phantom stock, it is issuing an incentive to do one thing and one thing only: raise expectations from the current level to a higher level. (119-120)

*On the other hand...*

With respect to monetary incentives, one rule is crystal clear: they should be grounded entirely in the real market. They should provide motivations to produce real outcomes, not expectations-market outcomes. (127 – 128)

## **Public company board governance**

Within this [current company Board] structure, the role of shareholder white knight falls to the independent directors because inside directors are considered ill-equipped to perform it, especially to the extent that the inside directors have meaningful stock-based compensation. As actors in both the real and expectations markets, inside directors have a powerful incentive to focus on raising expectations... (138)

*On the other hand...*

In this best-case scenario, independent directors are motivated by a desire to provide an important service to the public at large; for directors, that service is the safeguarding of an essential foundation of democratic capitalism – the belief that individuals can provide their capital to a company and have it treated with fairness and respect. (150)