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THE LONG VIEW

MARTY LIPTON

The legendary foe of short-termism speaks with Brunswick's **LUCY PARKER** about his career-long push for business to serve all stakeholders.

IN AUGUST OF 2019, THE BUSINESS ROUNDTABLE'S annual statement for the first time since the 1970s described the purpose of a corporation as serving all stakeholders, not just shareholders. That watershed moment was brought about in part by the lifelong work of one man: Marty Lipton.

A founding partner of the New York law firm of Wachtell Lipton Rosen & Katz, Mr. Lipton has been fighting short-termism and defending corporations against shareholder activism since the 1970s. He pioneered the so-called "poison pill" and other corporate defenses against raiders and helped write groundbreaking legislation in the 1980s. Appearing in 2016, his 19-page treatise, "The New Paradigm," spelled out exactly how businesses can and must be of benefit to all stakeholders, laying the groundwork for the Business Roundtable move a few years later.

For this issue of the Brunswick Social Value Review the legendary lawyer joined the head of Brunswick's Business and Society practice, Lucy Parker, herself a longtime proponent of social value in the corporate arena, to discuss the current outlook.

The last few years have seen dramatic change in the mindset of corporate leadership. Amid the growing calls for businesses to address climate change, the pandemic has pushed issues of inequality into the foreground for business leaders. In response, the conversation in boardrooms has decidedly turned, not to the detriment of shareholders, but to the inclusion of broader societal value.

Mr. Lipton has argued for decades that corporations must look beyond the C-suite, to focus on employees, and the resilience of the economy, capitalism and democracy, pushing back on the notion, popularized by Nobel Prize-winning economist Milton Friedman, that a public company should by rights be focused primarily on making a profit for shareholders.

"I was never a lone voice in the desert," he says. "The New Paradigm" was written simply "to overcome any continuing, lingering thought that the shareholders own the company and can run it any way they want. It has never been true the that shareholders own the company. It was a misconception that caught hold."

Lucy Parker is co-author of the book *Everybody's*

Business: The Unlikely Story of How Big Business Can Fix the World and brings to the table more than 20 years' experience in helping global companies engage with the role they play in society. She and Mr. Lipton exchanged observations on the future of business, how the pandemic is shaping society's attitudes toward reforms, and the important role regulation, or the threat of regulation, can play.

Their conversation took place over Zoom, Ms. Parker from her home in London and Mr. Lipton from his in New York.

You've been a pioneer in this field forever, in trying to make companies understand long-term and multi-stakeholder responsibility as part of the essence of being a company. There have been lots of steps along the way since you started in the '70s, but now the issue seems to have become a focus in a way that even those of us who have been plugging away at it for years might never have counted on. Do you see that? What do you think has made it happen?

Well, there's no one answer to that, as you know. There are a multitude of things. In my experience, companies have always recognized that the path to success was through long-term investment in physical property, in human capital—a well-trained work force—and in intellectual capital.

The problem arose starting in the 1960s with the increasing power of institutional investors to seek short-term value from the companies they invested in, putting pressure on the companies' ability to make the long-term investments in CapEx—both physical CapEx and intellectual and human CapEx. As that activity increased in the 1960s, the pressure on companies increased.

By 1966, the Williams Act had been introduced in Congress—it passed in 1968—regulating tender offers and so on. We've been on a path since the '60s of increasing the power of institutional investors to impose their demands for instant gratification on companies that can only operate if they have the scope to make the appropriate investments.

As you know, there's no way to increase profitability over the long run other than by increasing productivity. If shareholders pressure companies to not make the necessary investments for long-term success, you don't increase productivity and therefore you don't increase profitability. To increase profits for the benefit of shareholders, you have to take it from R&D, from CapEx investment, from human capital, and so on.

It really wasn't until the financial crisis in 2007-2008 that there was the kind of recognition of the adverse impact of short-termism that was necessary to get a shift in attitude. There were those of us who had been trying from the '70s to get that recognition accepted. Unfortunately, Milton Friedman had come along in the early '60s and, by 1970, he was a god in the business schools.

> "We've been on a path since the '60s of increasing the power of institutional investors to impose their demands for instant gratification."

It was really the financial crash that you feel was the inflection point?

That was a key inflection point. We had earlier ones, but they just sort of rolled over and we didn't get the kind of response that we finally got 2008-2009.

And since then, we've been seeing these ideas move center stage in the corporate world in a way it may not have done before. Do you agree with that?

Oh, yes, very much so. There have been a number of reasons. I think the World Economic Forum has played a major part, for many years, even pre-dating 2008. In 2013, the International Business Council of the World Economic Forum came to me because of my writing in this field and so on, and basically asked me to create what we call "The New Paradigm."

It was published in 2016. It was the precursor to the Business Roundtable in 2019. Then, after the Business Roundtable, the World Economic Forum in January of 2020 came out with the Davos Manifesto, which is just another version of Business Roundtable recognition of stakeholder governance.

Now I should not leave out ESG. I view ESG as one of the stakeholders in stakeholder governance. In other words, the environment and the societal issues are all among the stakeholders of a corporation. So stakeholders, for me, is a shorthand that includes ESG and so on.

So, there you were with "The New Paradigm" for the World Economic Forum, then we see the Business Roundtable letter and then Davos follows up again with the manifesto. What was the shift, after the crash, that made it bite—that drew in a much broader base of people?

There were regulatory efforts, particularly in the EU and in the UK. Section 172 of the Companies Act of 2006 basically says the objective of a corporation is to consider the interests of all the stakeholders.

There was also a growing recognition by the business schools, particularly the Harvard Business School but in many of the business schools, that Milton Friedman and Michael Jensen and Eugene Fama—the Chicago school economists who were being relied on to support maximizing shareholder value—were wrong. Robert Shiller came along, another Nobel Laureate, with behavioral analysis of economic situations. That got a lot of play. The major institutional investors, both the index funds and the active managers, began to feel pressure from the public, from their constituents.

Larry Fink at BlackRock initiated a series of January letters to CEOs basically focused on long-term investment. Slowly, over the last eight or nine years, those letters have shifted so that the most recent have been with respect to the purpose of the corporation, corporations recognizing all of the different stakeholders of the corporation and recognizing the environmental factors, particularly climate, which is such a key issue today.

You have an amalgamation of climate and other environmental issues, and inequality that grew up from the fact that there was a greater allocation of business profits to shareholders than employees. That led over a period of 35-40 years, to a considerable increase in inequality between providers of capital and the working people.

All of that has to be considered in the context of everything that was happening in this area in the western world. Various organizations grew up to promote the interests of one or another of the constituents. Activity grew, you have the momentum for the major changes that began to take place.

Do you think 2020 will prove to have been an inflection point as well?

Yes, indeed. There's just no question that with respect to racial equality and basic inequality issues and the recognition of the impact of the lockdowns on different groups of society, 2020 is a greater inflection point than any we've had in the past.

In the work that I do, I see that these big societal pressures, environmental issues and the societal issues, are now on the boardroom agendas of big companies around the world. Is that what you mean when you say ESG is a stakeholder?

Yes. In "The New Paradigm," we talk about governance, the relationship of corporations with their shareholders, the relationship of shareholders with directors and directors with management.

The way to rationalize the interests of the stakeholders on one hand and the investors as stakeholders on the other hand is through engagement so that they work together to come to an understanding as to the strategies that companies should follow.

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Companies' leadership will sometimes say to me, "Oh, this stuff coming from index funds, whether it's Larry Fink or others, it has no teeth. They're just grandstanding." What's your take on that?

I don't think that's true. There are proponents of stakeholder governance that are really only supporting activists attacking companies for short-term profits. But there are those that truly mean it and follow through on it and I think that's the only way we're going to achieve it short of legislation.

As you know, two years ago Elizabeth Warren, here in the US, introduced the Accountable Capitalism Act, the key part of which was federal regulation of corporations and the rules of incorporation, with 40 percent of the board of directors being designated by employees. At the same time, Prime Minister May spoke out sharply in the UK for stakeholder governance and recognition of the interests of employees. The Financial Reporting Council started to amend the guidelines for both corporations and investors to the current focus on stakeholders. Both sets of guidelines now focus on stakeholder governance and ESG and long-term investment.

You've also had statutory changes in France and the Netherlands. There has been a great interest in this among economists in the business schools. And you have organizations that like focusing capital on the long term, under names like inclusive capitalism.

Yes, inclusive capitalism, responsible capitalism, stakeholder capitalism, ethical capitalism ... They're all there with different angles on this same theme. So if some of the business leaders I sit down with now literally say to me that the institutional investors raising these topics are just grandstanding, you're saying that's not true?

I don't think it's true. Over the course of a year, we meet with anywhere from 40 to 70 boards of directors. We are in a board meeting once or twice a week—all looking for advice in this area. I think my exposure is a reasonable reflection of what's going on in the business world today. I haven't run into a CEO or a board of directors that has not been concerned about this question. The reason I'm there is because they're concerned about it and have invited me to come and talk about it.

Do you think ESG goes far enough? Could you argue that ESG is about mitigating a problem, not actually changing the paradigm, to use your very good word?

It depends on what your definition of ESG is. The climate people will say, "Well, we're not happy with the GRI metrics, but we are happy with the SASB metrics," and so on. So you've got organizations focusing on E and on S from many different standpoints. Nordic companies think that 40 percent female directors is an appropriate societal goal. I'd say that most American companies and proponents think two or three would be just fine because we're still fighting to get one.

There's a lot of work on ESG metrics at the moment, isn't there?
Many different approaches. I know you're familiar with the metrics posed by the World Economic Forum and [Chairman of the International Business Council] Brian Moynihan. But it hasn't been universally accepted at all. And there are some 20 other sets of metrics still kicking around. Quite frankly, I don't think we're ever going to have a satisfactory set of metrics that are the equivalent of financial metrics. I think we're going to have to view ESG metrics not just from a financial standpoint, but from a goals standpoint that transcends impact on finance.

People want it to be tidied up in one package.
Exactly. And I'm just not sure that it can be. I think the single most important thing, what we advise our clients is, it's very important that you understand your constituents. Not just the shareholders, but your customers, the political organizations in the areas in which you operate and so on—understand exactly what they're interested in and your ability to deliver. Sometimes it's not even possible to deliver what people may want. But if you can't deliver exactly what's being sought, then explain to them how you can't do everything but you're trying to reach a goal that's mutually acceptable.

In part, it's about the company indicating that it's responsive to the idea that these things should matter, as opposed to only the financial metrics, yes? It's indicating you understand the question.
Exactly. You stated it better than I did.

If I have to put my finger on what is driving the purpose movement, it's actually externalities. People are looking at the big companies and saying, your footprint is now so big that you have to take into account that you can't deliver your financial profit at the expense of everybody else. Do you agree with that in part?
I agree with it in whole, not just in part. But I also think that business organizations are run by people. And they're anxious to be relieved of pressure from greedy shareholders. The problem is not corporate management. The problem is the greedy shareholder. And we have to focus on the greedy shareholder, not on corporate management. That's been true from the beginning.

> "What I frequently say [to investors] is, 'You do realize that unless you accommodate the stakeholder and ESG interest, you're going to be regulated?'"

I often meet, and you must meet them still more than I, the CEO who says, "Of course I want to do this, but my shareholders won't let me." What should they say?
The shareholder communities are not omnipotent. What I frequently say is, "You do realize that unless you accommodate the stakeholder and ESG interest, you're going to be regulated?" It's the fear of regulation that has motivated these major investors.

So the way to go after the investor is to speak up for the regulation?
Absolutely.

What would you like to see by way of regulation?
I don't want to see anything. I want to see the "New Paradigm." I want to see well-advised investors work with well-advised corporations to achieve an agreed-upon strategy for operations that have the objective of long-term growth in the value of the company. You can reach that through profitable operations that take into account the interests of all of the different stakeholders so that your ultimate goal is long-term increase in the value of the company—not long-term increase in the stock price as such, but long-term increase in the value of the company. Hopefully stock price will come along with that, but the focus on the company, not on the price of the stock.

So, what can be done about the "greedy investor"?
I wouldn't mind having a statute that eliminated shareholder activism, but that's not going to happen. But just as pressure is put on corporations to achieve these goals, pressure has to be put on investors. And it is being put on them. Investors have to recognize they have the same obligation to service the public in these areas that corporate management has.

If the corporate community and the investor community do not adopt a real "New Paradigm," we're going to get very significant legislation. You see it in the EU right now. Much of this going forward is going to be more political than commercial.

I'm a strong believer in minimum regulation in this area because I think that business operates best in a market economy, where the market does the allocating and it's not done by a governmental agency and so on. It's the difference between what we call western capitalism and state corporatism—which can range from the quasi-capitalist approach to communism in China, for example, or traditional socialism, and variations in between.

Business works best in a minimally regulated market economy. Some regulation is always required, but let the broad outlines be filled in by the participants, the companies and the investors. That is the best structure that will create the most productive companies and that creates the greatest wealth that can be shared among all the stakeholders.

I know you're concerned about these issues with regard to the treatment of employees. Can you talk about that?
When you look at ESG, and the employee as a stakeholder, one of the most serious issues is the loss of the defined benefit pension plan. This goes a bit beyond ESG. But it goes to this whole question of employment in light of globalization, technological disruption and shareholder privacy.

No one of those is responsible for the current situation. But when you put them all together, that's why we're where we are today, with the rise of political populism.

No one likes to live with the threat of starvation in retirement. No one likes to be unemployed and so on. One of the most important things that we have to solve is really good jobs for everybody and an absolutely certain retirement.

In my view, this insecurity of the workforce is the most important socioeconomic problem we face today. It involves everything—education, healthcare, retirement. There's no reason why a country like the United States can't be run on a basis that everyone has housing, healthcare, a good job, education—really, there's no reason why the world can't.

The problem is that we seem never to be able to stay on the right path long enough. I mean something comes along to disrupt things. In the post-World War II period, the country was doing fabulously well. We had created an unbelievable balance in the economy.

And then we took the wrong turn in the '80s with financialization of the economy. And this is where we've ended up, with half the population of the country living at or below the poverty line. Which is a condition that bodes ill. If you went back in history, inequality has been the cause of one type of revolution or another throughout history.

> "The problem is the greedy shareholder."

LUCY PARKER, a Partner, leads Brunswick's global Business & Society offer.

What should companies do about that?
Well, they can focus on improving the lot of the employees. I mean it's a question of wages, it's a question of training, it's a question of the working facilities that they are provided. And more than anything, it's a question of retirement. Shifting from defined pension plans to contribution plans, 401(k)s here in the US has really created doubt in the minds of the average employee as to the stability of her or his retirement.

For me, that's another area of the externalities. People have been squeezing and squeezing and squeezing the front-line workforces. And that's totally non-sustainable, whether it's skills or wages or pensions.
I often say that the worst part of maximizing shareholder value is forcing companies to reduce employment in order to meet a quarterly guideline on profitability, that time and again corporations have announced restructurings—another word for reducing employment significantly—so that they can announce that the running rate of margin improvement from the reduction in employment will meet the future guidelines on quarterly employment. I think making employees the pawns in adjusting to meet profit objectives is one of the worst things that has happened and is the most significant thing that has to be reversed.

And I think it is being reversed. I think companies are more and more recognizing, or have recognized, that having a strong and happy content workforce is probably the best asset a company can have.

And COVID has put it right in the front of people's minds, hasn't it?
It has certainly has. COVID and the racial issues here in the United States. Those racial issues have become pervasive around the world, but here they have been of great significance.

Thank you. It's been wonderful to talk to you. What will ring in my ears from this conversation is that you've said, in the end, it's the greedy investor. I want to go into my next meeting thinking: what do we do about the greedy investor?
I recommend Alex Edmans' books and articles. He's of the London Business School. The most interesting is his book *Grow the Pie*. His view is that intelligent stakeholder governance does not in any way take away from the shareholders. What it does is it grows the pie so that everybody has a nice slice of it. That is the "New Paradigm" and I endorse it. ◆