COLLECTIVE INTELLIGENCE

The Bankside Triangle

Politicians, regulators and investors can all encourage corporate short-termism – but there are ways that CEOs can overcome the pressure.

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Six months ago, I handed in my UK government ID and left the Canary Wharf offices of the Competition and Markets Authority for the last time.

I had spent the past three years leading strategy for the British antitrust watchdog in a period when it took on a much bigger and more ambitious role globally. Now I'm back in the private sector at the advisory firm Brunswick, and though it's not the first time I've worked in the business world, something feels different this time.

Last month, The Economist published a leader column on the 'overstretched CEO' who faces dealing with governments that are becoming ever more dirigiste while businesses themselves get drawn ever more inexorably into political controversies.

If anything, I think The Economist understated the degree of the challenge.

I've taken to calling it the Bankside triangle, after the district of London that sits midway between Westminster (where the politicians are based), Canary Wharf (where most of the key regulators are now headquartered) and the City (where many leading investors remain).

Over the past few months, I've been struck by the impact these three different groups can have on CEOs who are trying to focus on the long term.

The Economist emphasised the role that politicians play in this challenge. It argued that in the past governments set taxes and wrote rules but then broadly left businesses alone. Today, the paper went on, this old 'unspoken agreement' has broken down, as governments intervene more in business while businesses get drawn into areas of political controversy.

Recent evidence of politicians' greater expectations of business – and their greater willingness to make those expectations known – came at the start of this summer's UK corporate reporting season.

Chancellor Jeremy Hunt sounded a warning to companies in an article in the Times, headlined 'use your bumper profits to help people'. Mr. Hunt wrote that 'for many [companies] profits will go up significantly' and that, while he welcomed this, the other side of the coin is a company's 'social contract' with customers. He said that he 'hope[s] we hear about what they have done and are doing for their customers directly' to help with the cost of living.

And it's not just elected politicians who are applying reputational pressure on companies. When the independent sectoral regulators were set up in the 1980s and 1990s, it was precisely because investors feared that after they put their cash into UK utilities and other businesses, the government might try and siphon off the returns to help meet other policy objectives. By setting up regulators operating independently from politicians, the idea was to give investors confidence that this kind of intervention would be avoided.

But regulators themselves are intervening more. In July, the Financial Conduct Authority (FCA) publicly summoned bank chief executives to a meeting because 'we are not happy with some of the lower savings rates we see'. Meanwhile the chief executive of Ofgem wrote to energy suppliers warning them that 'I expect no return to paying out dividends before a supplier has met … essential capital requirements.'

On the face of it, this looks eminently sensible. Many of us would probably agree with much of what the Chancellor and the chief executives of the FCA and Ofgem said. But what is striking from a business perspective is that the regulators here were not enforcing pre-existing rules on the companies involved. Nor were they using their well-established processes to create new rules for the companies to follow. Instead, they were using their 'soft power', including through the media, to stop companies from doing things that may well have been within the rules.

This means that, for a company, regulatory affairs is no longer just about following the rulebook or managing the right relationships. It is also about being forward-thinking enough to anticipate the issues that will emerge, sophisticated enough to balance the commercial and stakeholder imperatives and agile enough to implement solutions quickly.

And if all this did not give CEOs enough to worry about, at the same time they face an aggressive group that is pulling them in the opposite direction, pressing them to do more to increase their profits and to do it now.

It used to be that the shareholder base of major UK companies would be dominated by 'long only' pension funds and insurers who provided patient capital and had trusted relationships with the managers of the companies in which they held a stake.

But recent years have seen a new class of investor – the activist shareholder – who acquires shares in a company before launching a public, and often highly critical, campaign to press management to change strategy in the hope of returning more cash to shareholders and more quickly.

According to Barclays, the first half of 2023 saw a record-breaking number of such campaigns launched by activist investors. In Europe the growth was particularly stark – up 40 per cent year on year – and the largest portion of campaigns involved pushing boards to agree to sell or break up their companies and hand the proceeds to shareholders, including of course the activist.

All three of these groups – politicians, regulators and activists – would argue that their various demands are in the best long-term interests of companies. Politicians and regulators are correct when they say that companies ultimately prosper only when they do the right thing by their customers. And activists will often claim that well-managed companies have nothing to worry about from their campaigns.

But in practice it is not so straightforward. For politicians and regulators, there are often more plaudits to be gained by showing 'tough' action against an unpopular business or practice than for a mealy-mouthed explanation of why they can't do so or why the market should be allowed to work.

And as for the shareholder activists, they can be more interested in extracting value as quickly as they can – for example through a divestment and immediate special dividend – than in supporting investments which could actually generate much more value by building a business for the long term.

In contrast, it is often the CEO of a company who is best placed to take a long term view. Unlike the activist investor who can exit the stock in an instant, the CEO is not only contractually bound to the company but tends to be deeply committed to it mentally and emotionally. Unlike the politician, the CEO has no interest in opinion polls or 'dividing lines' but instead in unifying and motivating his employees and expanding his customer base. And it is often the CEO who would like to invest in long-term growth but is held back by short-term pressure to meet this quarter's numbers, raise the dividend or launch a buyback.

So how can CEOs overcome the short-termist pressures they face? For many, it will require a rethink in how they deal with each group in the Bankside triangle, both privately and publicly.

Here are two suggestions for how they can start.

First, politicians and regulators will not expend their own valuable political capital in defending a company's profits if the company itself is not prepared to show what wider purpose those profits serve.

Even if the company is a responsible player in its sector, it still risks suffering reputational and regulatory collateral damage from the worst of its peers if the outside world does not have confidence that it is a force for good.

The CEO must therefore be prepared to explain their story publicly: showing how they are delivering both financial value and social value and how they are managing the difficult trade-offs between them that can emerge. By doing this, the CEO can protect their own company's licence to operate, which is important for all three sides of the Bankside triangle. Beyond that, they will also help maintain the legitimacy of business and the market economy overall, on which we all depend so heavily for our prosperity and well-being.

However, this wider public role does not often come easily to CEOs. Many went into business precisely because they had no desire to enter political debates or be in the media spotlight, but instead because they had ideas about how to run a complex business in ways that delivered great value to customers and, in doing so, provided a return to investors.

That is where my second suggestion comes in. If CEOs are going to be drawn inexorably into areas of controversy with politicians, regulators and investors, they need to ensure their company has the structure and skills to enable them to make sophisticated judgments about how to anticipate and manage these controversies.

Traditionally, a company might manage relationships with politicians through a small public affairs team; regulators would be dealt with by a team reporting to the General Counsel; and an investor relations team might report into either the Finance Director or the Communications Director.

But there are a couple of flaws in this approach. The separate reporting lines mean that no one person is responsible for 'joining the dots' between the various groups and considering the trade-offs between them. Too often, that only happens properly when it gets to the desk of the CEO. This puts an unnecessary extra burden on the person at the top of the business.

It also means that the required skill sets are not combined properly. For example, lawyers will be well placed to oversee formal regulatory processes but might not predict when political considerations might interfere with them. And when faced with an aggressive activist shareholder, a company needs to combine deep knowledge of its investor base with the strategy of a political campaign. The right specialisms need to be joined up internally but, for this to happen, they may need to be integrated within the company's structure and with the right leadership so that the CEO is not the only person looking at all the trade-offs.

The Bankside triangle is a treacherous place for companies. But with an outward-facing approach and an astute, joined-up team, CEOs can successfully navigate their ship, avoid the obstacles and reach the destination for which they originally set out.

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To continue the conversation

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