How populism is undermining accountability in corporate governance

Keynote address held by SCGI Director Mats Isaksson at the International Corporate Governance Network*
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Dear friends,

Let me first of all thank Eva and Kerrie, the AP2 and the ICGN for the privilege to address this distinguished meeting. I would also like to thank the ICGN for honouring me with their Lifetime Award in 2021, for which I never had the opportunity to thank you in person.

I have been asked to reflect on how corporate governance has developed during my professional career and what I observe today. Since we only have a few minutes, my exposé must be partial. But with the vast experience present in this room, you will yourselves be able to fill in the blanks. And at the end of the day, I believe we will all agree that the essence of my reflections is more relevant than ever.

Considering my long career at OECD, my approach is one of public policy. That is, an approach that sees beyond the immediate vested interests of individual companies, investors, professional service providers, industry associations and other market participants. Instead, it is focused on creating a regulatory framework that serves the long-term interest of society at large. In his memoirs, the great central banker Paul Volker warned us that the quality of public policy making and analysis has deteriorated, with negative effects on democracy and public welfare. So let's make an effort to get it right, at least in corporate governance.

The bottom line public policy objective with respect to corporate governance is to design a legal and regulatory framework that provides incentives for an efficient and

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market driven allocation and use of productive resources. But this is easier said than done. Particularly, since such policies often run contrary to the interests of individual companies and investors. The reason for this contradiction is what Adam Smith thought us about the fundamental instinct of market participants to avoid scrutiny, competition and the annoyance of accountability. This goes for hired corporate managers as well as fund managers.

This was understood in the academic works of Berle and Means already in the 1930's. And it became a tangible reality in the early 1970s when over capacity and the need for restructuring of the US industry became apparent. Many large American corporations fought for survival, workers in the rust belt fought for their jobs and hired corporate managers fought to keep their private jets and exclusive country club memberships.

Then, showing up at the factory gates were individuals and companies who thought they could make better use of the corporate assets. In short - if management can't get it right and improve performance, an outside acquirer would offer shareholders an alternative option to create value. Not by working through the internal governance system of the company, but by buying it.

So there it was. Corporate governance in its purest form: the battle for how to allocate and use the company's resources in the most efficient way.

However, and following the instinct to escape scrutiny, entrenched hired executives and captured boards didn't give up that easily and a range of corporate defence tactics were invented to fend off and to deter takeover bids. Some of them had colourful names, such as Pac-Man defense, Golden parachutes, Green mail buy-outs, Crown jewel lock-ups. And then we had the classical poison pill in the form of the Shareholder Rights Plan. In the battle for public opinion, critics of the market for corporate control even managed to establish the term "hostile bids", which obviously is a contradiction in terms.

Needless to say there were excesses on both sides of the fence. But in essence, the market for corporate control was a market driven reaction to deal with the failure of the company's own internal governance mechanisms, with entrenched managers, captured boards, dispersed shareholders and ineffective shareholder's meetings. And as a consequence it moved the dial by showing the legitimacy and necessity of shareholders having a say in the strategic direction of the company. Contrary to received wisdom it also became increasingly clear that in the search for better governance, controlling shareholders could be the solution rather than a problem.

So, when the dust settled, an important lesson coming out of the controversial takeover era of the 1970s and 80s was that the internal governance mechanisms of companies had to improve. And many would refer to the time of the Cadbury report in 1992 as a defining moment. Obviously followed by the creation of ICGN in 1995 who has dedicated itself to this effort ever since.

In parallel to the surge in takeover activity, the shareholdings of institutional investors that manage other people's money had increased quite dramatically. And as a next major step in corporate governance history, CalPERS, which is a large public pension fund, felt obliged to adopt their own corporate governance plan.

Our good friend Ira Millstein who helped CalPERS write the document said that: "*Big institutional investors offer lots of advice to corporations and their boards. Many say it is time that these institutions look at how they are running their own business…*"

Since then, the governance of CalPERS may not have been exemplary at times. But that is just a reminder that the accountability of institutional investors that Ira called for is more important than ever as a growing number of ordinary households depend on the performance of those who manage their hard earned savings. Because the managers of these institutional investors, just like corporate managers, are not immune to the instinct of avoiding scrutiny and accountability.

And the best way to escape scrutiny is probably the old and time-tested trick among magicians. Namely, to confuse and distract.

This can be done in many different ways. Complicated fee structures and benchmarks are classics.

Another way to distract from the bottom line duty is by introducing multiple performance criteria, such as environmental impact, sustainability goals, gender objectives and social performance. Criteria that for all practical purposes are almost impossible to measure when it comes to impact. Moreover, the claims that these additional performance criteria would increase the financial returns for beneficiaries are typically unsubstantiated. The one fund that actually spend time looking at the effects on returns from their product and ethical exclusion policy is the Norwegian Bank Investment Management who holds stock in almost all listed companies in the world. In their 2022 report they conclude that their combined product and ethical exclusions has reduced cumulative returns since 2006 by about 2.5 percentage points. Considering the size of the fund that is a lot of money. But at least they are open about it. And I warmly welcome all work to make the impact and financial

performance of all these multiple non-financial performance criteria measurable, comparable and auditable in a single money-denominated bottom line.

While the examples of additional criteria that I just mentioned can indeed be effective in distracting from financial performance, the ultimate home run for any manager of other peoples´ money who wants to avoid accountability is obviously to shift the focus of corporate activity by redefining the very purpose of the corporation. An agenda that I understand has recently come into swing.

But be aware. Unlike ESG and sustainability criteria, that in principle can be limited to the way in which individual companies should operate, the reformulation of the corporate purpose is a bid to alter the way that our entire economies and societies shall function.

Consequently, you would assume that the introduction of ESG, social responsibility and the reformulation of the corporate purpose away from profit would be unthinkable for business leaders who declare their enthusiasm for the market economy. Not necessarily. Because, if shifting the focus to a set of ill defined and hard to measure performance criteria can help you escape scrutiny and accountability: why not? Hence, many of them happily signed off on declarations such as the Davos manifesto. Often arguing that there is no need for political intervention with respect to environmental and social issues. Corporations will take care of it by exercising so called stakeholder capitalism.

So here we are today, with a perfect unholy alliance between corporations and funds. Both with an interest to make the scrutiny and accountability of how they manage other people's money more difficult. Often supported by ignorant, naive and populist politicians, academics and representatives of the so-called civil society.

This is why I am so happy that the ICGN has as its first, objective to promote the public benefit.

If we want to secure public support for our democratic institutions and open markets - that are currently undermined – a view to the public good is more important than ever. And for that purpose we need to establish a fair and functional division of powers and responsibilities between policy making and business.

Business cannot be given the franchise to solve what are real societal problems, such as increased inequality or environmental standards. And politicians should not be given an excuse to avoid tackling those same problems by referring to some vague business intentions of stakeholder capitalism.

If democratic market economies can uphold such a time-tested division of responsibilities, business can continue to focus on their social responsibility to maximize profits within a legal framework of transparency and accountability.

This approach is also at the heart of the Swedish model of corporate governance. A model that I believe has helped us build a comparatively fair and equitable society.

Thanks you very much for your kind attention.