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Comment

Time is up for short-term thinking in global capitalism

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Why do investors and business leaders continue to focus on the short-term and ignore the fact that businesses that think long-term end up more competitive and profitable? Behavioural economists believe they have the answer: our brains are hard-wired to think short-term because evolution has rewarded serial short-term successes such as avoiding predators and other dangers that faced our ancestors. Their survival ensured our existence – but predisposed us to the same kind of short-term thinking. As a result, even though our world is very different from theirs, long-term decision-making remains the exception, not the rule.

The global financial crisis had its origins in short-term, unsustainable strategies and actions. Before the crisis and since, we (and others) have called for a more long-term and responsible form of capitalism – what we call "sustainable capitalism". Yet despite our collective best efforts, one year on, the capital markets seem to be reverting to business as usual.

Winston Churchill said: "It's not enough that we do our best; sometimes we have to do what's required." So what is now required? How do we change? In order to start developing sustainable capitalism, we need to reconsider the basic building blocks of commerce and markets: accounting, disclosure, incentives, regulation and responsibility.

Surely a broader accounting of economic activity will enhance economic policy and decision-making. We commend the work of Professor Joseph Stiglitz and the Commission on the Measurement of Economic Performance and Social Progress for recognising that while facts and figures are important – indeed critical to thoughtful decision-making – we have placed too great an emphasis on outdated modes of distilling economic value. The longer we defer the proper accounting for externalities such as global warming pollution, the greater the strain we place on our already fragile economies. For example, by ignoring the real risk-profile of highcarbon businesses, we are both allocating capital poorly and creating trillions of dollars of "subprime carbon assets". If the most powerful force in the world is indeed "an idea whose time has come", the most destructive force in capital markets may well be "an assumption whose time has suddenly elapsed". Just as widespread assumptions about the value of bundled and securitised subprime mortgages collapsed when tested by reality (thereby detonating the first stage of the financial crisis), the current widespread assumption in markets that it is perfectly fine to dump 90m tons of global warming pollution into the thin shell of atmosphere surrounding our planet every 24 hours – as if it is an open sewer – is also now colliding with reality. Though we cannot predict when this assumption will collapse, it is obvious that it will – and most likely within the time-span relevant to genuine long-term investors.

We need to reconsider the basic building blocks: accounting, disclosure, incentives, regulation and responsibility

Disclosure and transparency are critical to the optimal allocation of capital. We strongly endorse both the Aspen Institute's call for a more responsible approach to investment and business management, and the disclosure recommendations promulgated by the Committee for Economic Development in the Washington-based think-tank's 2009 publication *Rebuilding Corporate Leadership*. We also strongly support initiatives such as the UK-based Carbon Disclosure Project and the UN Global Compact, which are providing a forum for companies to communicate the risks and opportunities they see related to long-term sustainability challenges. These initiatives, coupled with investor initiatives such as the Principles for Responsible Investment and International Corporate Governance Network, support a better long-term allocation of capital. Collectively they will allow management teams the latitude to enact long-term strategies and provide investors with the tools to make better investment decisions. This, in turn, will create stronger and more sustainable economies.

Executive and Wall Street compensation needs to be better aligned with stakeholders and long-term objectives, but so does compensation of investors and asset owners. Specifically, if asset owners continue to review and reward their asset managers reflexively on a quarterly or annual basis, they should not be surprised to find their investors optimising returns within this time-frame – often at the expense of long-term value. People often do what they are paid to do. And if asset managers are compensated for maximising short-term value while saying they are focused on long-term value, they are fully capable of doing exactly that.

In truth, this approach to investing is not investing at all. It is trading, or – at its worst – gambling. These asset managers are betting that they can anticipate the behaviour of other short-term investors and move assets more quickly than the herd. Some managers are skilled at this. But this approach has not typically maximised value for investors or economies. This should change. Asset managers (and owners) should be evaluated and incentivised (compensated) using long-term metrics that measure – and reward – long-term performance.

In addition to regulation, which is quite rightly receiving scrutiny, investors and asset owners must take the initiative to be much more responsible owners. We must exercise our voting rights, work with global regulators to improve shareholder rights and responsibilities, and more aggressively hold company boards to the highest standards of governance and ethics. Trustees must also receive proper resources and training.

Albert Einstein famously remarked: "We can't solve problems by using the same kind of thinking we used when we created them." To solve the still prevalent problems in capital markets, we need new thinking. We must re-examine old perceptions and re-evaluate obsolete assumptions. Many, including the present chief of staff in the White House, have said that a crisis is a terrible thing to waste. Yet we are in danger of doing just that. We need to change urgently and should start by revisiting the fundamentals necessary for strong and functioning capital markets. We must act now to do what is required to build sustainable capitalism.

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