Markets need to think long-term to benefit society

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This country has been writing rules maximising the social good of markets since at least the Malmesbury Charter of Edward the Elder in 924. We should be pretty good at it by now. Yet almost 10 years on from the collapse of Lehman Brothers, the onset of the global financial crisis proper, and with more than 150m recent votes for populist parties and candidates protesting primarily about economic inequality, one might say that in getting the best out of markets, rather like the Bourbons, we have learned nothing and forgotten nothing.

As these recent elections show, economic anger, fuelled by perceptions that our institutions and companies are run for the short-term gain of their senior employees and shareholders, is far from abstract. The financial services sector comes in for particular vitriol.

This focus on short-term gain, caused in part by pressure from the capital markets, is much more than a philosophical argument about overpaid executives: a lack of long-term investment in listed companies may be the primary cause of falling productivity over the past decade, and hence falling real wages and economic inequality.

There is much evidence pointing to falling productivity leading to falling real wages. Bank Underground, the blog of the Bank of England, states that: "The MPC, and others, have ... argued that low productivity growth has been a major cause – if not the major cause – of weak wage growth."

The Centre for Social Justice, in a recent report on productivity, stated that "a decline in capital investment has reduced productivity growth ... Why is productivity growth important? Without increasing our output capacity, we are unlikely to see great improvements in wages or our quality of life".

Yet few have taken a step back and seen the connection between short-termism in the markets and social inequality. Nor has there been much reflection on refocusing the finance industry on its essential functions and how they should be provided. Had there been, it would lead to less pressure on listed companies to offer short-term rewards. That short-termism has skewed corporate strategy to focus on activist ownership, optimising corporate structures and M&A to boost balance sheet performance.

This is a far cry from the simple mission that the famously long-term Warren Buffett sets the chief executives of the companies he has invested in: "Run your business as if, 1) you owned 100pc of it, 2) it is the only asset in the world that you and your family have or will ever have, and 3) you can't sell or merge it for at least a century."

But perhaps most importantly from his perspective: "Berkshire has a shareholder base ... that has the longest investment horizon to be found in the public company universe. Indeed, a majority of our shares are held by investors who expect to die still holding them."

Contrast this with comments by Andy Haldane, chief economist at the Bank of England, based on OECD research: "Average holding periods of shares have been in secular decline in a large number of countries for a number of decades. In the UK and US, they have fallen from around six years in 1950 to less than six months today."

What we need to understand, before we can start to remedy the problem, is why asset owners in general have become so short term.

To be clear, asset owners include pension funds, insurance companies, endowments and others with the best of intentions and good reasons to have a long-term perspective. Yet the asset management industry argues, quite rightly, that the mandates from these types of asset owners usually include very specific, short-term benchmarks.

Ever-increasing amounts of regulation that fails to address system-wide issues may be part of the problem. Abuse of asymmetric information may be another. Underpinning it all may be society's loss of trust in the finance industry. What it ultimately means is that management teams at listed companies are actively incentivised to busy themselves with dividends at the expense of growth, and share buybacks that just so happen to maximise the value of management options.

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Taking a step back, therefore, and refocusing on the purpose of finance should give businesses the space to concentrate on long-term investment, spreading the rewards of capitalism more widely within society, helping alleviate poverty and giving people an increasing stake in the system.

Today, our marketplace, and financial services more generally, are not working as they should. It is time we looked afresh at how the financial system works – there is a shared space between finance and society, and this symbiotic relationship works best when it is based on long-term thinking. This is at the heart of the debate we are encouraging with a group of interested parliamentarians of all political persuasions, via the all party parliamentary group on inclusive growth.

If we truly address the purpose of finance, we should be proud to say that while we forget nothing, then at least we have learned something.

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