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Corporate Governance after GameStop

Feb 1, 2021 **FAITH STEVELMAN**, **SARAH C. HAAN**

NEW YORK – Last week, a social-media-fueled populist rebellion gripped capital markets. Retail investors purchased huge amounts of stock in struggling companies like GameStop, AMC, and BlackBerry (among others). They wanted to make a buck. But, even more than that, they wanted to punish the financial elites, like hedge funds, that had been betting on the companies' decline.
The punishment worked: on January 27, investors that had taken short positions on GameStop lost $14.3 billion. But the real story is not who lost (or made) money in a series of stock trades. It is that the prevailing model of modern corporate governance is on the brink of a seismic change.

In the current model, a firm's board of directors exercises ultimate authority over the corporation. The board is responsible for hiring, evaluating, compensating, and, if necessary, firing the CEO and other top management, and its members must approve all other fundamental decisions.

To assess managers' performance, boards have long relied primarily on the stock price. Now, that measure is failing. Evidence is mounting that stock prices aren't reliable metrics of firms' performance or the quality of their leadership. Assumptions at the heart of hands-off board leadership may have been right in theory, but wrong in the real world. By purchasing huge amounts of stock in ailing companies, ordinary people, trading online from their sofas, drove up these firms' share prices, regardless of financial fundamentals, like revenue and profitability.

While the GameStop affair may be the strangest recent evidence of "post-truth" capital markets, it is hardly the first. In the early 2000s, it was revealed that firms had adopted a "fake it till you make it" approach – massaging their financial statements to boost stock prices.

And then there was the 2008 global financial crisis, which erupted after the collapse of a subprime mortgage bubble in the United States. Afterward, in the "flash crash" of 2010, the Dow Jones Industrial Average plummeted nearly 1,000 points in a matter of minutes, partly because of the actions of one high-frequency trader.
Add to that the GameStop turmoil, and it seems clearer than ever that America's decades-long experiment with stock-based corporate governance has failed. That is a good thing: with the benefit of hindsight, it is clear that this approach amounted to an abnegation of private-sector leadership.

With their eyes trained on rising stock prices, corporate boards have overwhelmingly failed to prepare for – or perhaps even to recognize – emerging threats to their firms' success and to overall prosperity. These threats include climate change, the scourge of racial and gender discrimination, and skyrocketing income and wealth inequality (a likely driver of the GameStop rebellion).

The COVID-19 crisis exemplifies the problem. For decades, companies had eagerly embraced far-flung, insecure supply chains. They made no preparations for a pandemic, despite experts' warnings that one was inevitable. Their stock prices didn't reflect the risks; on the contrary, they benefited from the higher profit margins. So, when the pandemic erupted, companies mostly didn't know what to do.

Likewise, before then-US President Donald Trump's supporters stormed the US Capitol on January 6 – an insurrection in which five people died – corporate political action committees poured money into the coffers of the Republican Party and its propagandists, such as Fox News. It didn't matter that Republican politicians and media were amplifying the baseless claims of electoral fraud that Trump was using to rile up his base. With

stock prices strong, the rising risk of radical US political polarization – even domestic right-wing terrorism, with its potential for economic disruption – was not on boards' radars.

It is time for corporate directors to abandon their stock-market myopia and renounce passive leadership. This means acknowledging the disruptive changes underway, engaging more fully with executives and workers, developing more holistic, forward-looking strategies, and marshaling their firms' human and capital resources to advance them. Simply put, boards must own their legal power to learn, strategize, and lead.

New corporate strategies must be, above all, information-based and technologically enhanced. Fortunately, thanks to radically improved software analytics, boards can now reach into the depths of corporate data to grasp valuable insights and identify new questions. Boards are failing if they allow CEOs to capture corporate information and bias its presentation to directors. In just this way, some boards are already moving beyond the limited monitoring-board model and establishing enhanced information and communication processes to evaluate risks and opportunities more three-dimensionally.

The emphasis on human, board-level judgment is also a rejection of futuristic takes on passive, techno-driven corporate governance based on algorithms. Data isn't a panacea, as evident from the social and political disruptions wrought by Facebook and Google. The key is melding better data from within the firm with candid, searching-board deliberation about how a changing world affects the firm's future. This doesn't happen if boards use stock prices as shortcuts.

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With luck, the fall of the monitoring board will lead to a new national conversation about what it really takes to lead big companies, especially amid grave political failures. As board membership becomes increasingly demanding, individual directors will have to serve on fewer boards. This will open up the field of board-level leadership to new – ideally, younger and more diverse – voices.

Recent shocks may also strengthen alternative power centers. Bold institutional investors like BlackRock, for example, have shown a willingness to wield market power to help prevent climate catastrophe (though BlackRock's large stake in Fox News suggests that it is less conscientious about threats to America's democracy).

Last week, ordinary citizens responded to systemic inequalities with a populist, market-based campaign to disrupt the mechanisms of elite accumulation – and sent a powerful message about the need for a new model of corporate governance that depends on human, board-level judgment, not just stock prices. After decades of passivity, the time has come for directors to *lead*.

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