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ON BUSINESS

A Reminder for CEOs Considering a Shift in Focus: Shareholders Are Still King

While 181 CEOs say they are committed to serving 'all stakeholders,' when it comes to assessing their own performance, there is really only one master

From left to right, American Airlines CEO Doug Parker, J&J's Alex Gorsky, BlackRock's Larry Fink, Warren Buffett and Best Buy's Corie Barry. PHOTO: FROM LEFT TO RIGHT: COOPER NEILL FOR THE WALL STREET JOURNAL; GETTY IMAGES; ASSOCIATED PRESS(2); SARAH STACKE FOR THE WALL STREET JOURNAL

By John D. Stoll

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There are plenty of disputes that will be with us for years to come. Should global warming be pinned on humans? Is health care a universal right? Are my Detroit Lions the worst professional sports franchise in history, or would that be the Cleveland Browns?

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What factors should companies use to measure CEO performance and compensation? Join the conversation below.

A perennial debate in Corporate America asks whether a public company exists solely for the enrichment of shareholders or in service of a broader constituency. The question is re-emerging as investors like Warren Buffett and BlackRock Chief Executive Larry Fink bash short-term thinking and promote sustainable business practices. Messrs. Buffett and Fink simply echo millennials who tend to think corporate social responsibility trumps total shareholder return.

Last month, 181 CEOs signed a 300-word Business Roundtable letter that said they agree. Johnson & Johnson CEO Alex Gorsky, chairing the Roundtable's governance committee, said the new statement "affirms the essential role corporations can play in improving our society when CEOs are truly committed to meeting the needs of all stakeholders."

My editor dislikes the ambiguity of the word "stakeholder," so let me unravel Mr. Gorsky's quote using clearer terms. In the pecking order of things executives should care about, the shareholder needs to share the ball with employees, vendors, customers and society writ large. This mirrors a stance the Business Roundtable took in the 1980s, back when a den of corporate raiders and a wave of leveraged-buyouts were reshaping our view of what an investor was and the type of power they could wield.

Now, even as investor interests are increasingly cast as the root of many social problems, I offer this word of encouragement to shareholders: You may be unpopular, but you are still king.

How do I know this? The regulatory disclosures of most of the companies at the Business Roundtable represents tell me that senior leaders get paid for performance, and by "performance" we mean stock price. Almost all of their CEOs issue financial guidance, buy back sums of stock that dwarf capital spending and equate a healthy share price with a healthy payday.

This won't change until the compensation model gets turned upside down. Because there are few concrete and generally accepted ways to judge executive performance beyond share price, it's unclear if the compensation model will ever actually get turned upside down.

Ira Kay, a managing partner at New York compensation consultancy Pay Governance, said boards have long given managers wide discretion to improve diversity, address climate change or improve customer satisfaction. And annual bonuses are often partially tied to those goals, but that is just a fraction of total compensation. "If you don't get your stock price up, you're not going to make $25 million; you'll make more like $2 million," Mr. Kay said.

CEOs, like professional athletes, have a limited time to maximize earnings. Average tenures are shortening to about five years, and many only get one shot in the captain's chair. Executives ignoring the methods by which shareholder returns are maximized—whether it be via share buybacks, pay raises, capital expenditures or layoffs—are ignoring their self-interest.

Boards readily acknowledge this. “We design our annual and long-term incentives to include metrics that focus on profitability, operating efficiency and investor returns,” American Airlines Group, for instance, said in its most-recent proxy statement. If you want information on broader social goals, the board encourages readers to pick up the sustainability report.

Wondering if CEO Doug Parker understands this? Look no further than the section of the proxy outlining how 100% of his pay comes in the form of stock. This was good when American Airlines was riding high, but it’s been a turbulent summer for the Texas-based carrier amid labor tensions and other hiccups. Shareholders have suffered. No one has more incentive than Mr. Parker to fix that.

In fact, most of the Business Roundtable signatories are playing by similar rules.

Best Buy Co. , for instance, said its “philosophy is to align executive compensation with shareholders’ interests.” The retailer’s proxy outlines how to measure that in a slick chart that highlights investor returns, revenue growth, earnings performance and cost reduction. It’s probably safe to bet Best Buy’s new CEO Corie Barry is as familiar with that equation as with recycling policies, employee-engagement stats or recycling efforts.

Experts like Mr. Kay say executive compensation is linked to the stock price because it is widely believed that companies that pursue good practices generally grow in value.

“If you want to be in business next year, then you’ve got to be good to your customers, employees and suppliers,” Nell Minow, vice chair of ValueEdge Advisors, which consults institutional investors, told me this week.

J&J’s Mr. Gorsky is learning first hand that sins of the past will eventually bite you in the pocketbook.

One week after the Business Roundtable letter was published, the world’s largest health-care company was hit with a judgment forcing it to pay $572 million for Oklahoma’s opioid crisis. While lower than expected, the verdict is just the tip of the iceberg when it comes to potential liabilities that J&J and other pharmaceutical companies face.

Ms. Minow said she understands the need for corporations to tell a better story about sustainability, social responsibility or employee satisfaction, particularly as younger buyers, workers and investors gain influence. There ultimately needs to be a way to universally measure success.

“The CEOs who signed this statement know that accountability to everyone is accountability to no one, “ Ms. Minow wrote in a blog post critical of the Business Roundtable’s position. “It’s like a shell game where the pea of any kind of obligation is always under the shell you didn’t pick.”

Of course, what's good for the shareholder isn't always good for the future of the company. General Electric spent years touting its focus on investor returns only to see its stock price collapse after serious flaws in business strategy and other issues emerged. The Securities and Exchange Commission is investigating certain accounting practices, and the company has lost its blue-chip status.

Mr. Kay said his firm's research suggests the GE's saga is the exception instead of the norm, but its decline is a lesson for other industries. Executives spanning oil companies to car makers, packaged-food giants to traditional retailers need to shift their thinking on several issues or prepare for a long demise.

Stock prices aren't perfect. Still, they offer the most concise measure of whether a company is on the fast track or a death march.

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