OPINION

When it comes to corporate governance, one size does not fit all

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According to Greek mythology, Procrustes, a villain living and roaming close to Athens, had an iron bed on which he forced his captives to lie. If his victims were shorter than the bed, he stretched them by pulling the body to fit. If his victims, however, were longer than the bed, he would cut off the legs so that the body fit the bed's length. Irrespective of the case, the victims died.

This story applies to all cases when someone or something is forced to arbitrarily fit into an unnatural pattern and cannot be more fitting than what is happening to Corporate Governance. In recent years, advocates of so-called good governance urge companies to take specific actions because they "lag behind their peers" on some favored practice. A generation ago, the norm in corporate governance was to recognize differences among companies — the need to tailor governance to fit needs, to shun cookie-cutter approaches. In the ESG craze of recent years, however, the norm has veered to a universal expectation that all boards should follow identical guidelines, usually anointed as "best practices" or "gold standards."

The gold standards and best practices are everywhere in governance these days even if they are not good for particular companies. A catalog of good governance reigns, including refreshment imperatives, such as director age limits and term limits, and control-related rules, like majority voting in director elections and negative views of dual-class capital structures.

Yet, while good governance may exist in theory or on paper, formulaic approaches can be perilous in practice. There, what's critical is nuance that formulas can't capture, such as director wisdom, board chemistry, capital allocation sophistication and mastery of a company's culture. Against powerful forces pushing standardization have been the old-fashioned securities research analysts and stock pickers, like value investors. But their valuable voices are often drowned out, and individual investors among them have no way to exert collective power.

And yet, new academic evidence by professors at the University of Pennsylvania, consistent with common sense, makes clear that generalities in corporate governance are suspect.

The issue should always be what is best for a particular company and its shareholders, not what index funds, proxy advisors or policy entrepreneurs declare is best. Take splitting the chair/chief executive roles: Leading indexers and proxy advisors oppose combining the roles because boards appoint and oversee the CEO. Having one person wear both hats creates a conflict, they say. Yet, many corporations thrive when led by an outstanding person serving as both chair and chief, while others have failed amid split roles — think Enron. After all, board chairs get only one vote, so it comes down to the capability of the other directors. Effective ones neutralize such a conflict.

Same applies to the debate over staggered boards. At some companies, every director stands for election every year, while at others only one-third do, each for three-year terms. Critics oppose such three-year terms as impairing board accountability. Yet, a staggered board may enable a company to embrace a longer time horizon than one that can turn over completely in any year. There is substantial value in commitments to long-term strategies.

There are some gold standard governance practices that are highly probative of a board's stewardship, such as disclosure of individual director biographies and each director's qualifications to represent shareholders. But far less obvious are general rules addressing factors such as whether directors serve together on other boards or serve on multiple boards and individual directors' ages, genders and skin colors.

The best directors focus on what's best for their companies, not on what generalist consensus ordains as best practices. They try to lead in their own way, not fear that they lag behind their peers. After all, as any value investor will tell you, following the crowd is

among the worst arguments you can make for doing something and a human weakness that stands in the way of outperformance.

A longer and slightly different version of this article appeared in the 3Q issue of Directors and Boards

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