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Capitalism Wins at DuPont

A vibrant market for corporate control benefits shareholders.

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DuPont Co. shareholders on Wednesday elected all 12 of the company's director candidates, rejecting a campaign by Trian Fund Management to install four new board members, including Trian CEO Nelson Peltz. Some of our media brethren have cast the vote as a defeat for "activist" investors like Mr. Peltz. But it's a victory for all investors when there's a vibrant market for control of public companies, which forces managers to act in the interest of shareholders.

DuPont shareholders were fortunate to be able to consider credible alternatives. Mr. Peltz has proven at H.J. Heinz and elsewhere that he can add value as a board member with formidable analytical skills and a laser-focus on shareholder return. And DuPont CEO Ellen Kullman has earned investor confidence with her market-beating returns since assuming the top job in 2009.

Given Ms. Kullman's success, and DuPont's large size—the company has a market capitalization of more than $67 billion—it was certainly a challenging target for Mr. Peltz. He began pressing for change two years ago and his fund now owns about 2.5% of DuPont.

After a vigorous public and private debate, shareholders voted with Ms. Kullman, and those shareholders then had to accept the consequences of their decision, including a nearly 7% decline in DuPont stock on Wednesday while the broader market was essentially flat. Ms. Kullman will still be under pressure to perform. "We will continue to closely monitor DuPont's performance," said Trian in a statement after the vote.

Another silver lining is the support for Ms. Kullman from DuPont's largest shareholders—Vanguard, BlackRock and State Street, managers of large index funds. All three ignored the advice of proxy advisers Institutional Shareholder Services and Glass Lewis to put Mr. Peltz on the board.

Reasonable people can disagree on Mr. Peltz's candidacy. But it's healthy for markets that large institutions are comfortable exercising their own judgment and rejecting guidance from ISS and Glass Lewis. The two advisers were long given too much implicit authority by the Securities and Exchange Commission.

Thanks to Commissioner Daniel Gallagher, the SEC realized its mistake and last year issued new guidance clarifying that there's no need to hire these two self-appointed and highly political

judges of corporate governance. It’s better for investors now that the proxy advisers have to try to win business through sound analysis rather than a perceived government endorsement.

The DuPont debate is also a moment to say a good word in general for the fund managers who target underperforming companies. “Activists” isn’t the right word because it connotes a special interest pursuing a pet cause. The cause in this case is maximizing shareholder value, so the better word is investors.

Maximizing shareholder value is in bad odor with the political class these days, with no less than President Obama referring on Tuesday in a panel on poverty to “a whole literature that justifies” that you “need to get the best CEO and they’re bringing the most value, and then you do tip into a little bit of Ayn Rand.” You know, as in heartless.

But maximizing shareholder value is another way of saying that a company needs to stay competitive and efficiently exploit its capital. Activists are owners whose focus on value protects investors from managers who can become too self-interested. Activists also press for companies to use their cash or return it to shareholders, who can then invest it in some other useful purpose.

It’s true that activist investor pressure sometimes leads bad managers to ruthless cost-cutting or asset sales, but it’s also true that millions of jobs are lost when management gets complacent and a company loses its edge. Losing a job is no better because it comes from corporate failure as opposed to spin-offs or mergers. Sony and its workers would arguably have been better off if Japan had a more active market for corporate control that would have put more pressure on management years ago.

What’s the alternative to maximizing shareholder value? Political allocation of capital? An active market for corporate control provides a societal benefit by allocating capital to its most efficient use and thus enhancing growth and prosperity for everyone.

INSTRUCTIONS: Explain how the market for corporate control serves as a governance mechanism. Some might argue that it is the governance mechanism of last resort. What does this mean?