ESSAY

SHAREHOLDERISM VERSUS STAKEHOLDERISM—A MISCONCEIVED CONTRADICTION

A COMMENT ON "THE ILLUSORY PROMISE OF STAKEHOLDER GOVERNANCE," BY LUCIAN BEBCHUK AND ROBERTO TALLARITA

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This Essay critiques an assessment by Lucian Bebchuk and Roberto Tallarita of the relative merits of shareholder and stakeholder governance. In "The Illusory Promise of Stakeholder Governance," Bebchuk and Tallarita argue that stakeholder governance is either nothing more than enlightened shareholder value, or it imposes unmanageable trade-offs on directors of companies. But trade-offs are ubiquitous not just in stakeholder but also in shareholder governance, and the resulting judgments that are required of directors should not be viewed as an anathema but a fundamental function of a board, without which untenable outcomes result. The complexity that Bebchuk and Tallarita see in implementing a stakeholder system reflects a failure to recognize the way in which a business routinely makes judgments based on its purposes and values. Purpose and values hold management to account to a degree that enlightened long-term shareholder value cannot. In seeking to demonstrate that directors are not motivated or able to promote anything other than shareholder value in a shareholder-oriented system, Bebchuk and Tallarita merely describe the system that they see rather than

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analyze what it could or should be. "The Illusory Promise of Stakeholder Governance" therefore fails to provide a benchmark against which it is possible to evaluate either the comparative merits of shareholder and stakeholder systems, or alternative proposals for reform.

INTRODUCTION: THE IRRELEVANCE AND IMPOSSIBILITY OF STAKEHOLDER GOVERNANCE?

"The Illusory Promise of Stakeholder Governance" by Lucian Bebchuk and Roberto Tallarita (BT) is a beautifully written article, which, even by the authors' normal standards of lucidity, is a masterpiece of elegance.[1] It is a thoughtful and carefully constructed critique of stakeholder governance. However, as with some of the most beautiful art, its elegance lies more in its form than its substance, which, for reasons I will describe, is less than an initial reading might suggest.

BT's critique is that "stakeholderism"—the idea of promoting the interests of the stakeholders of a firm (its customers, employees, suppliers, societies, and the environment)— is either just enlightened "shareholderism," augmenting the value of shareholders' investments, or it requires directors of companies to make nearly impossible trade-offs.[2] In the latter case, citing Ronald Dworkin, BT describe the tasks that confront the director of a company as "Herculean," involving "superhuman skill, learning, patience and acumen" that make Hercules' Twelve Labors look effortless.[3]

In the first case, stakeholderism as enlightened shareholderism, stakeholder governance is regarded as good business practice that creates greater financial value for shareholders as well as benefits for stakeholders. By supporting their stakeholders, companies establish more loyal customers, engaged employees, reliable suppliers, and sustainable envi-

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1 Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91 (2020).

2 *Id.* at 108–10, 114–19.

3 *Id.* at 115 & n.74 (quoting Ronald Dworkin, *Hard Cases*, 88 HARV. L. REV. 1057, 1083 (1975)).

ronments. These generate greater revenues and lower costs for companies and therefore more profits as well as benefits for stakeholders.[4]

This notion of enlightened shareholder value underpins much public policy and corporate practice. It is, for example, the basis of Section 172 of the United Kingdom's Companies Act 2006, which states that "[a] director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members [shareholders] as a whole, and in doing so have regard (amongst other matters) to . . . the likely consequences of any decision in the long term"; to the interests of employees, suppliers, customers, communities; to the decision's effect on the environment and the company's reputation; and to the need to act fairly as between different shareholder interests.[5]

It is also arguably what the Business Roundtable (BRT) had in mind in discarding their 1997 statement of shareholder supremacy in favor of a corporate purpose which involved delivering value to customers, investing in employees, dealing fairly with suppliers, supporting communities, and creating long-term value for shareholders.[6] In essence, what the BRT intended might well have been what Jim Collins described as the "Genius of the AND"—delivering benefits to stakeholders *and* greater financial value to shareholders.[7]

In the second case, in which directors make trade-offs, companies go beyond promoting the interests of shareholders and benefit their stakeholders at the expense of financial returns to their shareholders, even in the long term.[8] This is the case that concerns BT the most, because the first is no more than shareholder value derived from promoting the wellbeing of stakeholders. It does not, according to BT, involve trade-offs.

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4 *See id.* at 108–10 (discussing enlightened shareholderism).

5 Companies Act 2006, c. 46, § 172 (UK).

6 BUSINESS ROUNDTABLE, STATEMENT ON THE PURPOSE OF A CORPORATION (Aug. 19, 2019), https://system.businessroundtable.org/app/uploads/sites/5/2021/02/BRT-Statement-on-the-Purpose-of-a-Corporation-Feburary-2021-compressed.pdf [https://perma.cc/JC4X-5BZA].

7 *See* JIM COLLINS & JERRY I. PORRAS, BUILT TO LAST: SUCCESSFUL HABITS OF VISIONARY COMPANIES 43–46 (1994).

8 *See* Bebchuk & Tallarita, *supra* note 1, at 114–15 (describing governance if stakeholder welfare is treated as an end).

I
THE NECESSITY OF JUDGMENT AND UBIQUITY OF SHAREHOLDER TRADE-OFFS

The idea of directors making judgments appears to be an anathema to BT. It is not clear whether this is because they believe that decision-making is beneath or beyond the capabilities of the board, but the fact that they describe it as a Herculean task suggests that it is more the latter than the former. Do BT really find it that difficult to make such judgments in their daily lives in ascertaining what is right as against rewarding? And if we feel it to be a normal part of our daily lives, why should it not apply also to our working lives? Or is the objection that, as Friedman would argue, directors do not have the right to exercise judgment because they are not elected to do so by a democratic process, thereby rendering it illegitimate?[9] Where exactly does the case for extinguishing judgment from management lie?

BT argue that "pluralistic stakeholderism relies on directors to make the hard choices necessary to define the groups of stakeholders whose interests should be taken into account and then to weigh and balance these interests, which are often difficult to measure, in the vast number of situations in which trade-offs arise."[10] But this is precisely the reason why it is not only necessary, but essential, that such judgments be made.

The first complication that BT raise is about the class of stakeholders. Who precisely should directors be incorporating in their judgments about contending interests?[11] BT record the various stakeholders that the thirty-one states of the United States that have adopted what are termed "constituency statutes" require directors to take into consideration when making board decisions. All states include employees and customers in the list, nearly all include suppliers, and a majority include creditors and local communities.[12]

In an attempt to illustrate the supposed hopelessness of the Herculean task, BT ask us to consider the case of a corpo-

9 *See* MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133–34 (2002) ("Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible. . . . If businessmen are civil servants rather than the employees of their stockholders then in a democracy they will, sooner or later, be chosen by the public techniques of election and appointment.").

10 Bebchuk & Tallarita, *supra* note 1, at 115.

11 *Id.* at 116.

12 *Id.* at 117–18.

rate plan to relocate to another region. "In addition to the negative effects of the plant relocation on the plant's current employees and the community in which the plant is currently located," they ask, "should the company's leaders also take into account the positive effects on the employees of the new plant and on the community in which the new plant would operate?" And as if to exemplify the absurdity of it all, they ask: "Would the answer to this question change if the new location were overseas?"[13]

Let me rephrase the question slightly differently: Should the company's leaders take no or minimal account of the negative effects of the plant's relocation on current workers, the positive effects on the workers of the new plant, or the effects on the communities in either the existing or new location of the plant? And: Should they take less account of affected parties if they reside overseas? Or to be more direct: Is their responsibility solely to determine what the effect will be on share price or "long-term shareholder value" and ignore the interest of anyone else? My answer to the last of these and therefore to the previous two questions is unequivocally no.

BT go on to give two other examples of the supposedly impossible complexities that stakeholderism creates for directors. Should they be expected to take account of the effect of their firms' activities on competitors' workers or suppliers or their environmental impact on "residents of faraway countries or only on those living in the United States?"[14] The answer that I would give to both parts is yes, of course. Indeed, multinationals should arguably give particular consideration to mitigating adverse impacts of their operations on the natural environment and indigenous industries of low-income countries. Directors may dismiss these effects and conclude that they are irrelevant or unjustified, but they should not ignore them any more than they should ignore casualties and deaths of their employees on their own sites that could only be prevented by expenditures that diminish shareholder value.

Does that give directors carte blanche to do whatever they like? No, not a bit of it. They act according to the reasons for the company's creation and the purposes of its continued existence. These reasons and purposes are the guiding stars of the board, not the rigid rules of shareholder rights or primacy that trump all else. It is against those purposes and their associated values that the board's actions and performance should

13 *Id.* at 118.
14 *Id.* at 118–19.

be judged. As BT themselves acknowledge, directors have the right to act with judgment—business judgment—and they should exercise that judgment in a form that they believe to be appropriate to the circumstances.[15] What shareholder primacy and the type of thesis advocated by BT do is transform directors into automatons programmed according to rules maximizing shareholder value. Directors have discretion to act as they will so long as their will is consistent with the rule. This is free will at a price—the price of a share.

The implications of the opposite position are illustrated by a simple comparison of one corporate policy that delivers enormous benefits to employees, communities, or the environment at home or abroad, and the other that delivers no benefits or only detriments to those parties but a dollar more profit to shareholders. According to shareholder governance, directors must without hesitation adopt the latter policy, notwithstanding that a loss of one dollar in shareholder value in the former would yield substantial benefits for other parties.[16]

If the coronavirus pandemic has done nothing else, it has demonstrated that this is not just a hypothetical situation but one that has confronted boards around the world. Fortunately, many have come to realize the untenability of shareholder governance. Some investors have also come to appreciate the absurdity of it, acknowledging in these exceptional times the need that shareholders be willing to accept lower dividends and subscribe to (non-rights) equity issues.[17] They have done so in the expectation that normal conditions will resume in due course.

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15 *Id.* at 113 n.67 ("The court may hold forth on the primacy of shareholder interests, or may hold forth on the importance of socially responsible conduct, but ultimately it does not matter. Under either approach, directors . . . will be insulated from liability by the business judgment rule." (alteration in original) (quoting STEPHEN M. BAINBRIDGE, CORPORATE LAW 248 (3d ed. 2015))).

16 To use Alex Edmans' terminology, the directors could "grow the pie" enormously by adopting a more judicious approach. *See* ALEX EDMANS, GROW THE PIE: HOW GREAT COMPANIES DELIVER BOTH PURPOSE AND PROFIT 15–37 (2020).

17 *See, e.g.,* Letter from Andrew Ninian, Dir., Stewardship and Corp. Governance, Investment Association, to FTSE 350 Chair (Apr. 7, 2020), https://www.theia.org/sites/default/files/2020-04/Letter%20to%20FTSE%20Chairs%20-%20April%202020_0.pdf [https://perma.cc/KWN2-XFWW] (on file with author) (stating that "[s]hareholders agree that companies should be considering the suitability and sustainability of dividend payments in light of the current uncertainties"); Pre-Emption Group, *Pre-Emption Group Expectations for Issuances in the Current Circumstances*, (Apr. 1, 2020), https://www.frc.org.uk/getattachment/9d158c89-f0d3-4afe-b360-8fafa22d2b6a/200401-PEG-STATEMENT.pdf [https://perma.cc/73K6-3XVK] (suggesting that investors "consider supporting issuances by companies of up to 20% of their issued share capital on a temporary basis, rather than the 5% for general corporate purposes").

There can therefore be no presumption that directors should not take account of stakeholder interests beyond enlightened shareholder value. That part of the case clearly fails. But what about the practicality of stakeholderism? BT first of all note "[t]he [u]biquity of [t]rade-[o]ffs."[18] By positioning stakeholderism as being in contradiction to enlightened shareholder value, BT are indeed making trade-offs ubiquitous by definition. BT then go on to make familiar criticisms of attempts to monetize non-monetary costs and benefits in relation to, for example, human psychological health, societal well-being, and environmental degradation. They conclude that "[r]ather than devoting much attention to developing a methodology for aggregating and balancing the interests of diverse constituencies, stakeholderists commonly deal with this issue by leaving the resolution of trade-offs to the judgment and discretion of corporate leaders."[19]

The answer to the question of how to monetize non-monetary costs and benefits is simple: don't do it. One should measure non-monetary costs and benefits in their own terms. In our daily lives, we do not choose to help our family or friends clean up after dinner because we have attached a monetary value to this help and concluded that helping is most efficient. Instead, we act according to values of care, consideration and concern for others. It is these values, not monetary values, that determine the vast proportion of our actions and intentions. Likewise, companies have purposes that determine what values they attach to their non-monetary as well as monetary costs.

Why should businesses act any differently from how we do in our daily lives? One possible answer is that they are there to make money. But a shareholder perspective that presumes that money is the sole objective is exactly the problem. Money is not the sole objective. Profit is not the corporate purpose. Profit is a product of the corporate purpose, not the corporation's defining motivation. Just as we are steadily coming to realize that the pursuit of happiness is not the source of it, and on the contrary potentially a cause of psychological distress,[20] so we are increasingly appreciating that the pursuit of profit is

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18 *See* Bebchuk & Tallarita, *supra* note 1, at 119–20.

19 *Id.* at 121.

20 *See* Iris B. Mauss, Maya Tamir, Craig L. Anderson & Nicole S. Savino, *Can Seeking Happiness Make People Unhappy? Paradoxical Effects of Valuing Happiness*, 11 EMOTION 807, 809 (2011) (finding that "valuing happiness can lead to less happiness").

not the source of profit but the cause of much dysfunctional conduct.[21]

The weight that is attached to different impacts is determined by the values that are ascribed to them, not simply by their financial value. By seeking to translate everything into monetary terms, a shareholder perspective does not, as is often claimed, simplify management by promoting just one objective instead of many, but rather complicates it by requiring the incommensurable to be made commensurable.

It is as if BT think that corporate boards cannot be legitimately engaged in the exercise of discretion and that promotion of shareholder value is devoid of discretion.[22] Of course, nothing could be further from the truth, because within the class of shareholders there is immense diversity that demands as much discretion and judgment as across the set of stakeholders. At the most basic level, shareholders differ according to their degree of risk aversion and preferences, their time horizons and discounting of future returns, their assessments of future earnings and investment analyses, and their views about relevant risk classes and unquantifiable uncertainties.[23]

In the absence of what is termed "spanning"—that is, a complete set of primary securities corresponding to all possible future states of the world—there will be disagreement amongst shareholders about investment decisions and the optimal allocation of resources.[24] It therefore befalls directors of companies, mutual funds, and asset management firms to make judgments about how to balance the conflicting preferences and interests of different shareholders.

However, the complexity of the task is still greater than that because shareholders are "ordinary people who in their daily lives are concerned about money, but" who also "have

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21 *See, e.g.*, GEORGE A. AKERLOF & ROBERT J. SHILLER, PHISHING FOR PHOOLS: THE ECONOMICS OF MANIPULATION AND DECEPTION 1–11 (2015) (giving examples of where a company's pursuit of profit led its consumers to behave in unhealthy or uneconomical ways).

22 *See* Bebchuk & Tallarita, *supra* note 1, at 121–22 ("Rather than develop methodologies or suggestions as to how corporate leaders should confront such choices, stakeholderists leave them to the discretion of directors without attempting to assist directors in exercising such discretion.").

23 *See* ANDREI SHLEIFER, INEFFICIENT MARKETS: AN INTRODUCTION TO BEHAVIORAL FINANCE 10–13 (2000).

24 *See* Richard C. Green & Robert A. Jarrow, *Spanning and Completeness in Markets with Contingent Claims*, 41 J. ECON. THEORY 202, 202, 208 (1987) (discussing "the extent of market completeness required to ensure the unanimity and irrelevance results of modern corporation finance").

ethical and social concerns."[25] As such, they have an interest in their health, livelihoods, descendants, communities, and future survival, in addition to their financial wealth. In other words, shareholders are concerned about their welfare and wellbeing as well as their wealth. The fiduciary responsibilities of directors of companies and financial institutions should therefore be recognized as being to promote shareholder welfare, not shareholder wealth.

So, beyond the diverse financial beliefs and preferences of shareholders, directors are required to make judgments about how their decisions affect the health and happiness of shareholders and their offspring. How is this insoluble complexity resolved? The answer is very simple. The complexity is resolved through a multiplicity of mutual funds and asset management firms that cater to different preferences and concerns of investors who can then determine for what ends and purposes their investments are managed.[26] And to satisfy the multiplicity of objectives of institutional investment firms, companies establish diverse purposes that reflect the plurality of interests of shareholders and their agents.

Trade-offs and judgments are indeed ubiquitous, particularly in regard to shareholders. They are made on the basis of an organization's stated purposes and values. Together with the values of an organization, they define its reason for being, what it seeks to achieve, and what it refrains from doing. Based on an organization's stated purposes and values, investors then determine which mutual funds to hold, asset managers establish which fund managers to employ, fund managers decide which companies' shares to purchase, and companies choose which stakeholders to engage and support.

II
THE TAUTOLOGICAL CASE FOR SHAREHOLDERISM

The issue is not therefore whether trade-offs and judgments should be made, but rather what purposes and values should underpin them and who should determine and implement them. There are two obvious contenders for the responsibility of setting purposes and values—the first is shareholders and the second is boards of directors.

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25 Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247, 248 (2017).

26 *See id.* at 263–64.

Where certain shareholders hold significant blocks of shares, these shareholders are in a position to determine, or at least influence, a company's purposes and values. Where shareholdings are dispersed amongst a large number of institutional and individual investors, however, no single shareholder is in a position to establish purposes and values. Instead, it falls to executives to determine purposes and values, boards of directors to oversee their implementation, and investors to engage with executives and boards about their formulation and execution.

BT are clear that the incentives under which boards of directors and executives operate encourage them to promote shareholder interests. Their remuneration is predominantly related to shareholder earnings, and threats of takeovers, activist interventions, and proxy contests intensify when their share price performance is poor.[27] Even if boards have the discretion to promote purposes and values beyond those of their shareholders, in practice they won't because incentives and external threats of intervention act to discourage them.

Furthermore, in many cases managers can't promote any interests but those of their shareholders. According to BT, corporate law in the most important corporate jurisdiction in the United States, Delaware, does not give directors the discretion to promote stakeholder interests beyond enlightened shareholder value. BT quote Leo Strine, the former chief justice of the Delaware Supreme Court, who states that, under Delaware law, "directors must make stockholder welfare their sole end" and that corporations can consider stakeholder interests "only as a means of promoting stockholder welfare."[28] Other prominent American lawyers, however, think exactly the opposite and believe that "[d]irectors have a duty to look beyond their shareholders."[29]

In addition, BT contend that even where directors can and should promote stakeholder interests, namely in the states of the United States that have constituency statutes which expect them to do so, they don't.[30] They report that a set of public

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27 *See* Bebchuk & Tallarita, *supra* note 1, at 140–46.

28 *Id.* at 138 (quoting Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 768 (2015)).

29 Martin Lipton, *Directors Have a Duty to Look Beyond Their Shareholders*, FIN. TIMES (Sept. 17, 2019), https://www.ft.com/content/6e806580-d560-11e9-8d46-8def889b4137 [https://perma.cc/9TPX-63G2].

30 *See* Bebchuk & Tallarita, *supra* note 1, at 155–58.

companies incorporated in constituency statute states that were subject to large private equity acquisitions failed to put in place significant protections for their stakeholders (employees, communities, suppliers, or customers) and instead negotiated significant benefits for shareholders, executives, and directors.[31]

However, the failure of constituency statutes to provide protection to stakeholders in private equity acquisitions is only evidence that constituency statutes are inadequate to offer effective protection in an economy in which shareholder primacy reigns supreme. And that is not surprising given the content of the statutes. Consider Minnesota's constituency statute, which provides that:

> [A] director *may*, in considering the best interests of the corporation, consider the interests of the corporation's employees, customers, suppliers, and creditors, the economy of the state and nation, community and societal considerations, and the long-term as well as short-term interests of the corporation and its shareholders including the possibility that these interests may be best served by the continued independence of the corporation.[32]

What sort of a commitment device is that? Apart from its verbose formulation, it sounds pretty similar to the U.K. Companies Act of 2006 and indeed any shareholder or enlightened shareholder interest law.[33] And notice the use of the word "may" at the beginning. "May" is permissive but imposes no obligations on boards to support their stakeholders or protect them against hostile predators.[34]

BT conclude that directors are frequently not in a position to promote purposes and values beyond those of their shareholders, have no incentives to do so, and even where they can

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31 *Id.* at 156.

32 MINN. STAT. § 302A.251(5) (2020) (emphasis added).

33 *See* Companies Act 2006, c. 46, § 172 (UK).

34 Furthermore, even the four statutes that BT elsewhere say "explicitly reject giving shareholders priority over other constituencies" are not always so clear. *See* Lucian A. Bebchuk, Kobi Kastiel & Robert Tallarita, *For Whom Corporate Leaders Bargain*, 94 S. CAL. L. REV. (forthcoming Sept. 2021) (manuscript at 49) (*available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3677155 [https://perma.cc/M5HM-LQ7R]). For example, New York's statute provides that "[i]n taking action, including, without limitation, action which may involve or relate to a change or potential change in the control of the corporation, a director shall be entitled to consider, without limitation, (1) both the long-term and the short-term interests of the corporation and its shareholders and (2) the effects that the corporation's actions may have in the short-term or in the long-term upon any of the following" stakeholder interests. N.Y. BUS. CORP. LAW § 717(b)(i)–(v). "Shall be entitled" is not very different from "may."

and should, they choose not to and instead pursue their own and their shareholders' interests. In other words, BT believe that the idea of pursuing purpose beyond profit and values beyond shareholder value is just wishful thinking.[35]

What is more, BT argue that we should not allow directors to pursue any purpose beyond profit because allowing directors to promote purposes other than shareholder value merely insulates them from external accountability and makes them a law unto themselves.[36] Citing stakeholder interests, directors seek unholy alliances between business and government by which, in return for promises of "doing good," their companies enjoy greater legal protections from outside interference. In effect, BT think purposes other than shareholder value are a sop and an attempt by companies to discourage government from imposing more stringent and intrusive regulation that would force them to implement intended outcomes in less palatable forms.[37]

The decision of the BRT to discard shareholder primacy in favor of stakeholder interests in its 2019 Statement on the Purpose of a Corporation can be interpreted in this context as an attempt by businesses to fend off threats of intensified regulation by promising to mend their ways. The statement is just a smokescreen—a diversionary tactic to avoid what would really help stakeholders: regulation.[38]

But it is a curious world that BT appear to be describing. If regulation could internalize and had internalized externalities, do we really think that we would be fretting about climate change and diversity and inclusion? Do they recognize the problems that the globalization of companies such as Google and Facebook present for designing effective regulation?

The evidence on the failure of the BRT signatories to uphold their promises is, even according to BT's interpretation, not remotely surprising. One interpretation of the BRT state-

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35 Bebchuk & Tallarita, *supra* note 1, at 157–58 ("[I]f stakeholderism is widely accepted, corporate leaders should be expected to choose, as corporate leaders governed by constituency statutes chose, not to use their discretion to provide stakeholders with any such benefits.").

36 *See id.* at 164–68 (defending claim that "[s]takeholderism would increase the insulation of corporate leaders from shareholders and make them less accountable to them").

37 *Id.* at 165 ("[F]or some management advisors, alleged benefits to stakeholders have been, for at least four decades, a standard reason provided for supporting rules that insulate corporate leaders and opposing rules that make them more accountable.").

38 *Id.* at 126 ("We conclude that the BRT statement should be viewed as mostly for show rather than the harbinger of a major change.").

ment was that it was, to borrow a term from BT, an expression of "enlightened shareholder value," demonstrating that businesses were committed to looking after their stakeholders *and* creating long-term value for their shareholders.[39] According to BT, businesses saw no trade-offs in adopting the new statement of purpose and regarded their role as remaining within the confines of shareholder primacy while reinforcing their commitment to their stakeholders in so doing. So, they saw no need to consult their boards, change their governance statements on their websites, or shift their state of incorporation from Delaware.[40]

One should not conclude very much from this. All that it demonstrates is that shareholder primacy reigns supreme in the United States and that an economic system does not change simply because some businesses announce that they are going to change their behavior. But that is not a surprising conclusion, as the discussion about director and manager incentives provided by BT themselves makes very clear.[41]

As BT report, directors and CEOs that support shareholder interests are more likely to keep their jobs and get new ones, and are less likely to be subject to proxy fights, hostile takeover bids, or hedge fund activist interventions, and therefore loss of their jobs and salary.[42] CEOs' salaries are much more closely tied to share prices and returns than any non-financial measure.[43] In a shareholder primacy system, the shareholder who pays the piper calls the tune, which will inevitably benefit shareholders. The system is stacked against directors and CEOs trying to do anything else.

Infeasible, impractical, unrealistic, and undesirable is how BT therefore view any purpose other than shareholder value.[44] However, in presenting their argument, all that BT do is to demonstrate that shareholder interests prevail in a world in which the superiority of shareholder value is presumed and well established. In this world, incentives are aligned to promote shareholder interests; threats of takeovers, and shareholder activism, and proxy votes motivate the enhancement of

39 *See id.* at 129 ("Thus, despite the change in rhetoric, the BRT's revision of its statement of corporate purpose does not seem to be a move away from the shareholder primacy approach of its 1997 statement to pluralistic stakeholderism.").

40 *See id.* at 129–39.

41 *See id.* at 140–54.

42 *Id.* at 144–45, 153.

43 *Id.* at 148.

44 *See id.* at 139 (calling stakeholder pluralism an "illusory promise").

shareholder value; corporate law imposes fiduciary responsibilities on directors to uphold shareholder interests; and regulation is used to align corporate with societal interests where competitive markets fail to do so.

BT therefore simply describe the shareholder primacy system of the United States as it exists now. As BT demonstrate, even in states that enacted constituency legislation to protect companies from threats of takeovers, companies are not immune from outside acquisitions that prompt responses from the targets that mirror those of firms driven by shareholder value.[45] We should not be surprised that pro-stakeholder statements made by the BRT are greeted with skepticism and cynicism in the context of a shareholder primacy system where incentives, markets for corporate control, and the law all promote shareholder interests.

III
EVALUATION OF THE STATUS QUO

The truly illusory promise is not that of the potential for corporate governance reform, but a promise about the potential for a workable retention of the status quo in the absence of any reform. What BT fail to do is provide evidence on the potential for this reform or acknowledge that there are alternative systems around the world that promote different types of corporate conduct and allow companies to strike different balances of interest.[46]

How should one judge whether the promotion of stakeholder interests beyond shareholder interests is beneficial? The conventional way is to look at the impact on a company's share price and returns to shareholders. For example, there is much evidence of a positive association between employee satisfaction, productivity, company performance, and share prices, as reported by Alex Edmans and others.[47] The absence of such a positive relation would be interpreted by critics of

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45 *See id.* at 156–57.

46 *See* Julian Franks & Colin Mayer, *Evolution of Ownership and Control Around the World: The Changing Face of Capitalism* 3 (European Corp. Governance Inst., Working Paper No. 503/2017, 2017), https://ssrn.com/abstract=2954589 [https://perma.cc/5TH8-72P7].

47 *See, e.g.*, EDMANS, *supra* note 16, at 28–29 (explaining that "making products that transform customers' lives for the better, providing colleagues with a healthy and enriching place to work, and renewing the environment for future generations" can "often generate[ ] more long-term profit than pursuing products directly"); Clement S. Bellet, Jan-Emmanuel De Neve & George Ward, *Does Employee Happiness Have an Impact on Productivity?* 33 (Saïd Bus. Sch., Working Paper No. 2019-13, 2020), https://ssrn.com/abstract=3470734 [https://

stakeholder theories as evidence of a failure of stakeholder interests to deliver beneficial outcomes. And a positive relation is interpreted by critics like BT as evidence that it is no more than enlightened shareholder interests. Heads you win, tails I lose.

An alternative interpretation is that investing in stakeholders is beneficial to shareholders in the long run but not observable by them in the short term. This could arise from information problems that occur when shareholders observe or evaluate the effects of companies' decisions, for example, to invest in the education and training of their employees. The positive benefits of these decisions are observed by shareholders in the long term and eventually reflected in share prices, but not in the short term, when they are simply viewed as wasteful expenditures depressing current share prices.

How should one judge whether trading off short-term for long-term shareholder returns, current for future share prices, and shareholder for stakeholder interests is desirable? This raises the question of what should be the objective of business by which we evaluate its success. It is a question that BT's article never addresses let alone answers. So, fascinating as the article is, it is devoid of both conceptual and empirical content.

It is not just that BT's article provides no evidence on the question that needs to be answered. Still more seriously, it suggests no way of evaluating whether such change is desirable. What is "good" for BT? They clearly are genuinely concerned about stakeholder as well as shareholder interests, but they offer no way of judging whether a governance model with shareholder primacy and government regulation actually advances these interests.

Many people think it does not and believe that other systems could do better. Corporations are products of the law and can therefore be created in whatever form the law wishes them to take. The fact that it is perfectly possible to establish corporations serving the public good is evidenced by the fact that that is exactly how they were constituted and operated for several centuries around the world, including in the United States, as BT themselves document in their article.[48]

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perma.cc/568P-N3UX] (finding a "strong positive impact of employee happiness on productivity").

48 Bebchuk & Tallarita, *supra* note 1, at 103 ("In the early history of the U.S. corporation, recognition of the corporate form—and of its most important feature: limited liability—was strictly connected with the notion of public benefit." (citation omitted)).

The question is not whether stakeholder governance is possible but whether it is desirable. And on this the article has nothing to say because it provides no criteria by which to judge this. There is nothing in the article that speaks about the feasibility of another system or provides the criterion by which to establish whether it does better—is it shareholder wealth, total wealth, shareholder welfare, or total welfare?

The article is simply a description of the existing system in the United States and a presumption that it could not be improved on. But we can do better than the system that exists now, and we must do better.

BT look at the world as they see it and conclude that this is the way it must be. They argue that it is impossible to change the system and, in particular, to relate incentives to non-financial measures of performance.[49] That is a curious position for two members of one of the strongest incentive-driven academic institutions in the world, where all the metrics on which incentives are based are non-financial measures. BT talk about climate and the fact that there are many ways of measuring a company's impact.[50] But those are exactly the measures against which financial institutions managing multiple companies are now being evaluated.[51] These financial institutions will put increasing pressure on companies to do the same and to exercise their business judgment when making trade-offs.

In describing the world as they see it, BT fail to consider what it could be, and what one might want it to be. In other words, their analysis lacks a benchmark against which to evaluate the merits or deficiencies of different corporate models and therefore fails to shed light on the relative merits of them. Furthermore, it provides no basis on which to assess the desirability of alternative policies towards the corporate sector.

Suppose, for example, that we want business to promote the wellbeing and prosperity of individuals, societies, and the natural world and to do so in a form that is commercially viable and profitable for investors. Does a system that focuses exclusively on shareholder interests, albeit in an enlightened form, deliver that? Does one that permits companies to promote

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49 Bebchuk & Tallarita, *supra* note 1, at 158–63 (describing "challenges and difficulties" of aligning director interests with stakeholder interests).

50 *Id.* at 121 n.81.

51 *See* Robert G. Eccles & Svetlana Klimenko, *The Investor Revolution: Shareholders Are Getting Serious About Sustainability*, 2019 HARV. BUS. REV. 106, 110, 116 (May–June 2019).

stakeholder interests even at the expense of shareholder value yield better or worse outcomes?

Once we appreciate that trade-offs and judgments are inherent in any system, we should start to think about what trade-offs and judgments we want business to make. Do we really want companies to enhance quality of life in their local communities, protect the environment, respect the safety and security of their employees and workers in their supply chains, and look after the health of their customers only to the extent that these increase their share prices? Put it another way, do we want companies to minimize expenditures on taxes, pollution abatement, employee training, improvement of supply chain working conditions, and reductions in the addictive nature of their products, only as long as these yield increased returns for shareholders? Would we have wanted companies to have responded to the coronavirus pandemic by producing testing and tracing equipment, ventilators, vaccines, and therapies only to the extent they resulted in higher shareholder returns?

Should we look to tougher regulation as the only way of remedying these deficiencies? Why should the regulator and public sector be called upon to prescribe reasonable and acceptable conduct to the corporate sector when we expect such behavior of ourselves as a matter of course? Is it unreasonable to expect companies to have a greater regard and responsibility for the interest of their communities, workers, and customers than merely what accords with their own financial interests?

The financial crisis has made us all too aware of the limitations of regulation designed to define and enforce the rules of the game. The problem derives from the fact that the interests of corporations seeking to maximize their profits are diametrically opposed to the objectives of regulators in upholding the public interest.[52] Corporations therefore lobby to moderate the severity of regulations, seek ways of circumventing them, minimizing their impact and, if possible, turning the regulations to a competitive advantage by using them to keep others out of the market.[53] Attempts to address this through more stringent rules and enforcement not only impose significant costs on business, but are often limited by concerns about exacerbating institutional failures.[54]

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52 COLIN MAYER, PROSPERITY: BETTER BUSINESS MAKES THE GREATER GOOD 1–28, 167–85 (2018).

53 *Id.* at 167–85.

54 *Id.*

If, instead, regulation is used to align the private purposes of corporations with their social purposes—as, for example, might be reflected in their licenses to operate in those parts of the economy where there are market failures, such as utilities and financial institution—then, in place of conflict between the objectives of business and regulators, there is cooperation. More generally, such an alignment of interest can promote more constructive relationships between government and business, in which business does not simply use its power to manipulate government for its own ends but recognizes its responsibilities to promote broader public objectives.

The implications of BT's rejection of trade-offs and judgments yield demonstrably unreasonable and untenable conclusions. None of the evidence that they purport to present provides any support for shareholder primacy and merely serves to reinforce the conclusion that shareholder primacy emanates from a fundamentally deficient system.

But the main criticism of BT's article is not simply that they have failed to demonstrate their point, but rather that they are asking the wrong question. The right question does not force a choice between shareholderism and stakeholderism but asks what form of governance delivers the best outcomes. If the objective is to help solve the problems of the world profitably, then there is a place for both shareholderism and stakeholderism. Different purposes require different corporate structures. If the objective is to deliver the most profitable solution, then shareholder value might well be the most appropriate approach. If, on the other hand, the objective is to produce the best solution, even if it delivers lower profits, then emphasizing other priorities beyond shareholders may be warranted.

By making corporate values explicit and measurable on their own terms, corporate purpose makes management accountable for its delivery in a way in which shareholder value cannot. In a world in which shareholders are interested in their stakeholders' and their own welfare and wealth, companies should be answerable for meeting their targets on carbon emissions as well as financial returns, and for delivering employment to future generations as well as pensions to current ones. In promoting long-term shareholder welfare, enlightened shareholder capitalism makes accountability of management hopelessly imprecise, while corporate purpose and values make it laser sharp.

If companies do not specify a corporate purpose that includes stakeholders and shareholders, then regulation and public ownership will do it for them. If they do not retain sufficient shareholder value in their businesses to ensure fulfilment of commitments to their stakeholders then, as with the banks, regulators will impose capital requirements and dividend restrictions on them. The world had moved on from classical shareholder governance before the coronavirus pandemic; it has progressed much further since.

The contradiction between shareholder and stakeholder interests is not a contradiction at all. These interests are neither always one and the same nor are they always in conflict. They are, in general, complementary ways of delivering the plurality of outcomes that we should be asking of our economic systems, particularly in an era where the dire consequences of promoting one at the expense of the other have become all too clear. Now more than ever we need a multiplicity of purposes and corporate forms to address the multitude of problems that have been of our own creation.

We should encourage a multiplicity of purposes and competition by devising different models to deliver them. We should promote the type of experimentation and innovation that will allow scholars and entrepreneurs to determine in which circumstances a particular model is best suited to delivering the desired results. We should not start with the model—shareholder profit—and simply accept what it delivers. Instead, we should start with the purpose of a business and then determine the model.

CONCLUSION: AN ALTERNATIVE FRAMEWORK

The Future of the Corporation program at the British Academy seeks to do exactly that.[55] It brought together thirty academics from around the world across multiple disciplines in both the humanities and the social sciences to examine how business needs to be reformed to address the environmental, social, and political challenges it faces, and to take advantage of the remarkable technological opportunities that now exist. To promote the practical relevance of their conclusions, the group was advised by business leaders from across multiple sectors of the economy.

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55 *Future of the Corporation: About*, THE BRITISH ACAD., https://www.thebritishacademy.ac.uk/programmes/future-of-the-corporation/about/ [https://perma.cc/ZV9D-5G42] (last visited Mar. 16, 2021).

What emerged was a consensus that the purpose of the corporation is to solve the problems that individuals, societies, and the natural world now face in ways that are profitable and commercially viable but not to profit from producing problems. The program concluded that the purpose of business is "to produce profitable solutions for the problems of people and planet," not profiting from producing problems for either.[56]

In the second phase of its work, the program set out eight principles around which to organize reform of the existing system.[57] These principles concerned law and regulation, ownership and governance, measurement and performance, and finance and investment.[58] It described the basis on which these principles should be formulated and pathways for their adoption.[59]

Now, in its third and final phase, the program moves beyond principles to identify specific policies for reform by both business and government. The program also seeks to describe the role that other parties, such as accounting bodies, civil society, educational institutions—particularly business schools—and regulators should play in the process. The program is designed to provide an evidence-led basis for determining what type of reforms are both desirable and feasible and how in practice they should be implemented and evaluated.

Crucially, the program recognizes reform as a "systems design issue."[60] The existing system is a coherent and consistent formulation of law, regulation, ownership, governance, measurement, performance, finance, and investment. It is the system that BT describe so clearly in the context of the United States and presume to be the only system. But it is not the only system, and it is one that is scholars and experts are increasingly finding to be wanting and damaging.[61]

It is critically important that we recognize the deficiencies of current arrangements and systems and appreciate that par-

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56 THE BRITISH ACAD., REFORMING BUSINESS FOR THE 21ST CENTURY: A FRAMEWORK FOR THE FUTURE OF THE CORPORATION 24 (2018).

57 *See* THE BRITISH ACAD., PRINCIPLES FOR PURPOSEFUL BUSINESS: HOW TO DELIVER THE FRAMEWORK FOR THE FUTURE OF THE CORPORATION 20–29 (2019) (describing the principles).

58 *See id.*

59 *See id.* at 30–35.

60 *See id.* at 37.

61 *See, e.g.*, EDMANS, *supra* note 16, at 19–23 (describing how a pure profit-seeking approach, which Edmans refers to as the "pie splitting mentality," leads to exploitation and regulatory battles, whereas "pie growing"—adding value for more parties than just shareholders—can derivatively increase profits while also benefiting other constituents).

tial remedies are no longer adequate to correct system failures. BT's article is an excellent description of why partial remedies are not sufficient to correct failures in robust and internally consistent systems. BT build in incentive, disincentive, legal, regulatory, ownership, and governance arrangements that ensure that what is observed remains so.

But those systems can come up against boundary conditions—from the environment, society, and the political process—that eventually threaten their continuation and existence. We are at that point and require more than just a description of what is and has been. Instead, we should focus on what needs to be and what can and should be done about it.