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THE ILLUSORY PROMISE OF STAKEHOLDER GOVERNANCE

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ABSTRACT

Corporate purpose is now the focus of a fundamental and heated debate, with rapidly growing support for the proposition that corporations should move from shareholder value maximization to "stakeholder governance" and "stakeholder capitalism." This Article critically examines the increasingly influential "stakeholderism" view, according to which corporate leaders should give weight not only to the interests of shareholders but also to those of all other corporate constituencies (including employees, customers, suppliers, and the environment). We conduct a conceptual, economic, and empirical analysis of stakeholderism and its expected consequences. We conclude that this view should be rejected, including by those who care deeply about the welfare of stakeholders.

Stakeholderism, we demonstrate, would not benefit stakeholders as its supporters claim. To examine the expected consequences of stakeholderism, we analyze the incentives of corporate leaders, empirically investigate whether they have in the past used their discretion to protect stakeholders, and examine whether recent commitments to adopt stakeholderism can be expected to bring about a meaningful change. Our analysis concludes that acceptance of stakeholderism should not be expected to make stakeholders better off.

Furthermore, we show that embracing stakeholderism could well impose substantial costs on shareholders, stakeholders, and society at large. Stakeholderism would increase the insulation of corporate leaders from shareholders, reduce their accountability, and hurt economic performance. In addition, by raising illusory hopes that corporate leaders would on their own provide substantial protection to stakeholders, stakeholderism would impede or delay reforms that could bring meaningful protection to stakeholders. Stakeholderism would therefore be contrary to the interests of the stakeholders it purports to serve and should be opposed by those who take stakeholder interests seriously.

Keywords: Corporate purpose, corporate social responsibility, stakeholders, stakeholder governance, stakeholder capitalism, corporate constituencies, enlightened shareholder value, corporate governance, Business Roundtable, constituency statutes, entrenchment, accountability, managerialism.

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TABLE OF CONTENTS

I. Introduction 1
II. The Rise of Stakeholderism 6
A. Origins, Evolution, and Breadth of Support 6
B. A Critical Juncture 9
III. Alternative Versions and Conceptual Problems 11
A. Instrumental Stakeholderism 11
1. Enlightened Shareholder Value 11
2. Different from Shareholder Value? 12
3. Why Move to Enlightened Shareholder Value? 13
B. Pluralistic Stakeholderism 15
1. Stakeholder Welfare as an End 15
2. Conceptual Problems 17
IV. The BRT Statement: A Meaningful Change or a PR Move? 22
A. Pluralistic or Merely Instrumental? 23
B. Denial of Trade-Offs 25
C. Lack of Board Approval 26
D. Corporate Governance Guidelines 28
E. Disregard of Legal Constraints 30
V. An Illusory Promise 31
A. Director Incentives 32
1. Compensation 32
2. Labor and Control Markets 36
B. CEO Incentives 39
1. Compensation 39
2. Labor and Control Markets 44
C. Have Corporate Leaders Used Discretion to Protect Stakeholders? 46
D. Fixing Incentives? 52
1. Redesigning Executive Pay? 53
2. Changing How Directors are Elected? 55
VI. The Perils of Stakeholderism 57
A. Increased Insulation and Reduced Accountability 58
B. Chilling Stakeholder-Oriented Reforms 60
VII. Conclusion 64

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> [*W*]*e share a fundamental commitment to all of our stakeholders. We commit to* […] *deliver value to all of them, for the future success of our companies, our communities and our country.*
>
> —Business Roundtable Statement on the Purpose of a Corporation, August 19, 2019

I. INTRODUCTION

In the summer of 2019, with much fanfare and massive publicity, the Business Roundtable (BRT)—the influential association of corporate chief executive officers (CEOs)[1]—announced a revision of its conception of corporate purpose.[2] The BRT statement was signed by the CEOs of 187 major public companies that together have a market capitalization exceeding $13 trillion.[3] They committed to "lead their companies for the benefit of all stakeholders,"[4] and to "deliver value" not just to shareholders but also to employees, customers, suppliers, and communities.[5]

The BRT statement was presented by its authors, and characterized by many commentators, as a major milestone in the evolution of the modern corporation.[6] An earlier statement on corporate purpose that the BRT adopted

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[1] Since the BRT was formed in 1972–73, it has evolved into a "singular political powerhouse that would make an indelible imprint on the history of business and politics in the United States." *See* BENJAMIN C. WATERHOUSE, LOBBYING AMERICA 76-78 (2013) (citing an anonymous executive quote found in LEONARD SILK & DAVID VOGEL, ETHICS AND PROFITS: THE CRISIS OF CONFIDENCE IN AMERICAN BUSINESS 71 (1976)).

[2] Business Roundtable, *Statement on the Purpose of a Corporation* (Aug. 19, 2019), https://opportunity.businessroundtable.org/wp-content/uploads/2019/12/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures.pdf.

[3] *See infra* note 33 and accompanying text.

[4] Business Roundtable, *Business Roundtable Redefines the Purpose of a Corporation to Promote "An Economy That Serves All Americans"* (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.

[5] Business Roundtable, *Statement on the Purpose of a Corporation*, *supra* note 2.

[6] *See, e.g.*, Alan Murray, *A New Purpose for the Corporation*, FORTUNE (Sept. 2019), https://fortune.com/longform/business-roundtable-ceos-corporations-purpose/ ("the BRT announced a new purpose for the corporation and tossed the old one into the dustbin"); David Gelles & David Yaffe-Befany, *Feeling Heat, C.E.O.s Pledge New Priorities*, N.Y. TIMES, Aug. 19, 2019 at A1 (stating that the new statement "break[s] with decades of long-held corporate orthodoxy"). David Ignatius, *Corporate Panic About Capitalism Could Be a Turning Point*, WASH. POST, Aug. 20, 2019, https://www.washingtonpost.com/opinions/even-the-business-moguls-know-its-time-to-reform-capitalism/2019/08/20/95e4de74-c388-11e9-9986-1fb3e4397be4_story.html (stating that the statement could reflect a "turning point"). The BRT displays on its website, at https://opportunity.businessroundtable.org/commentary/, commentary by business leaders and major media outlets stressing the significance of the BRT statement.

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in 1997 explicitly embraced the shareholder primacy view that directors should focus on the welfare of shareholders.[7] By contrast, the new statement expressed a commitment to all the other constituencies affected by corporate decisions. To distinguish between shareholders and non-shareholder constituencies, we use "stakeholders" throughout this Article to refer only to the latter.

Following the publication of the BRT statement, in December 2019 the World Economic Forum published a manifesto that urged companies to move from the traditional model of "shareholder capitalism" to the model of "stakeholder capitalism."[8] Shortly thereafter, Larry Fink, head of BlackRock, the world's largest asset manager, issued a letter to all CEOs exhorting them to be "committed to embracing purpose and serving all stakeholders."[9] Also, the Reporter and advisors for the ongoing project for a *Restatement of Corporate Law* are considering the introduction of stakeholderist elements into the restatement.[10] And a memorandum by the law firm Wachtell, Lipton declared 2019 to be a "watershed year" in corporate governance due to "the advent of stakeholder governance."[11]

As we discuss below, these and other recent developments reflect growing support for an approach to which we refer as "stakeholderism"—the view that corporate leaders should give weight to the well-being of stakeholders (not just of shareholders) when making business decisions. This approach, so defined, is the focus of this Article. Our analysis is largely applicable to legal rules that allow or require corporate leaders to act in this way as well as to norms that accept or encourage them to do so.

To assess the merits of stakeholderism, we conduct an economic, empirical, and conceptual analysis of stakeholderism and the claims made by its supporters. Our analysis warns against the rise and growing acceptance of stakeholderism. Stakeholderism, we show, should not be expected to benefit

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[7] Business Roundtable, Statement on Corporate Governance 3 (Sept. 1997).

[8] Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution (Dec. 2, 2019), https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/ ("The purpose of a company is to engage all its stakeholders in shared and sustained value creation. In creating such value, a company serves not only its shareholders, but all its stakeholders."). One observer described stakeholders as the "winner of the 2020 World Economic Forum." Jason Karanian, *And The Winner Of The 2020 World Economic Forum Is… Stakeholders,* QUARTZ (Jan. 25, 2020), https://qz.com/1791153/winner-of-2020-world-economic-forum-in-davos-stakeholders.

[9] Larry Fink, *A Fundamental Reshaping of Finance*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 16, 2020), https://corpgov.law.harvard.edu/2020/01/16/a-fundamental-reshaping-of-finance/.

[10] The Reporter discussed this possibility in an NYU roundtable on December 6, 2019.

[11] Martin Lipton, Steven A. Rosenblum, & Karessa L. Cain, *Thoughts for Boards of Directors in 2020*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 10, 2019).

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stakeholders. To the contrary, it would impose substantial costs on stakeholders and society, as well as on shareholders.

Part II describes the evolution of stakeholderism, and the broad support it has received among academics, practitioners, business leaders, and policymakers. We then discuss how stakeholderism provided the basis for antitakeover legislation adopted in the 1980s and 1990s by a majority of U.S. states. Finally, we discuss how and why support for stakeholderism has been rising substantially in recent years. The long-standing debate on corporate purpose is now at a critical juncture, and the growing embrace of stakeholderism might well in the coming years have considerable influence on companies, their stakeholders, and society.

Part III distinguishes between two different versions of stakeholderism and discusses their conceptual problems. According to the "enlightened shareholder value" version, corporate leaders—a term we use throughout to refer to the directors and top executives who make important corporate decisions—should take into account stakeholder interests as a means to maximize shareholder value. Such an instrumental version of stakeholderism, we show, is not conceptually different from shareholder primacy; it is merely a semantic change, and we show that there are no good reasons for adopting it.

According to the second version, by contrast, corporate leaders can and should regard stakeholder interests as ends in themselves. This view, which we call "pluralistic," posits that the welfare of each stakeholder group has independent value, and consideration for stakeholders might entail providing them with some benefits at the expense of shareholders. This version is the one that in theory—though, as we shall show, not in practice—could lead to decisions that would benefit stakeholders beyond what would be useful for shareholder value maximization.

We also discuss in Part III some conceptual problems and difficulties with pluralistic stakeholderism and its implementation. In particular, stakeholderists have commonly avoided the difficult issue of determining which groups should be considered stakeholders, leaving this decision to the discretion of corporate leaders; have tended to overlook the ubiquity of situations that present trade-offs between the interests of some stakeholders and long-term shareholder value; and have generally not provided a method to aggregate or balance the interests of different constituencies in the face of such trade-offs, leaving this matter again to the discretion of corporate leaders. Thus, the effects of pluralistic stakeholderism would critically depend on how corporate leaders choose to exercise discretion.

Before examining the effects of stakeholderism in general, Part IV considers the expected effects of the widely celebrated BRT statement. Based on a close reading of the statement and of the accompanying materials, as

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well as on evidence that we collected, we show that the statement is largely a rhetorical public relations move rather than the harbinger of meaningful change. In particular, we discuss (1) the statement's ambiguity regarding the critical question of whether it advocates providing stakeholders with any benefits beyond what would be useful for shareholder value, (2) the statement's disregard of the ubiquity of trade-offs between stakeholder and shareholder interests, (3) the decision by many CEOs to join the statement without the approval by the board of directors that is generally obtained for major corporate decisions, (4) the failure to reflect the commitment to stakeholders in corporate governance guidelines, and (5) the lack of attention to legal constraints that preclude many companies from approaching stakeholder interests as an independent end. We conclude that the BRT statement should not be expected, and was largely not intended by its signatories, to bring about major changes in the treatment of stakeholders.

Putting aside the effects of the BRT statement, Part V turns to examine the potential effects of stakeholderism in general. We present an economic and empirical analysis of how corporate leaders should be expected to use discretion to protect stakeholder interests. We show and empirically document that corporate leaders (both directors and CEOs) have strong incentives to enhance shareholder value but little incentive to treat stakeholder interests as an independent end. Therefore, we argue, corporate leaders have significant incentives not to benefit stakeholders at the expense of shareholder value, and they should therefore not be expected to use the discretion awarded to them to do so.[12]

We then examine whether, in fact, the leaders of companies incorporated in states with constituency statutes have used the discretion provided by those statutes to protect the interests of stakeholders when considering a sale of their company. We find that, in negotiating with acquirers, corporate leaders have bargained for benefits to shareholders as well as for themselves but have made little use of their bargaining power to secure protections for stakeholders. This evidence is consistent with and reinforces our conclusion that corporate leaders who have discretion to do so should still not be expected to benefit stakeholders beyond what would be necessary for shareholder value maximization.

The business corporation has proven itself to be a powerful and adaptive

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[12] Our analysis in Part V builds on, but goes substantially beyond, earlier discussions by one of us as well as others that expressed skepticism as to whether corporate leaders can be expected to protect stakeholders. For discussions expressing such skepticism, *see, e.g.*, Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV., 833, 908-913 (2005); Lucian Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 729-732 (2017); 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).

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mechanism for producing economic growth and prosperity. As a result, some of those who wish to protect stakeholders might be attracted to stakeholderism as a way to do so by harnessing corporate power through private action and without resort to costly regulation. However, the past success of corporations has been based on the presence of effective incentives for corporate decision-makers. Therefore, with corporate leaders having incentives not to benefit stakeholders at shareholders' expense, delegating the guardianship of stakeholder interests to corporate leaders would prove futile. The promise of pluralistic stakeholderism, we conclude, is illusory.

Finally, whereas stakeholderists have advocated relying on corporate leaders to protect stakeholders without a major overhaul of existing systems of incentives, including those resulting from shareholders' exclusive voting power, Part V concludes by discussing the possibility of supplementing stakeholderism with reforms aimed at substantially changing the incentives of corporate leaders. We examine changes both to executive pay arrangements and to the rules governing the election of directors. Designing reforms that would provide leaders with adequate incentives to attach independent weight to the interests of all stakeholders, we show, would be quite challenging as well as very costly.

In Part VI we turn to discussing the perils of stakeholderism. It might be argued that stakeholderism, even if it does not provide significant benefits to stakeholders, could not hurt and might even help on the margin. As Part VI shows, however, accepting stakeholderism would be detrimental to shareholders, stakeholders, and society.

We first explain that acceptance of stakeholderism would insulate corporate leaders from shareholder pressures and make them less accountable. Indeed, we argue, the support of corporate leaders and their advisors for stakeholderism is motivated, at least in part, by a desire to obtain insulation from hedge fund activists and institutional investors. In other words, they seek to advance managerialism by putting it in stakeholderism clothing. The increased insulation from shareholders, and the reduced accountability to them, would serve the private interests of corporate leaders. It would also increase managerial slack and agency costs and undermine economic performance. This would have detrimental effects for shareholders and the economy at large.

We then discuss how acceptance of stakeholderism, by raising illusory hopes around the positive effects for stakeholders, would likely weaken pressures for stakeholder-oriented policy reforms and thereby impede or delay meaningful protection for stakeholders. Thus, for those interested in addressing corporate externalities and protecting corporate stakeholders, embracing stakeholderism would be counterproductive.

Before proceeding, we wish to emphasize that our rejection of

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stakeholderism is hardly due to our limited concern for stakeholder interests or a belief that stakeholder protection does not represent an important policy objective. We do not share the view, held by some commentators, that the protection of stakeholders is best left entirely to market forces and private contracts.[13] To the contrary, we take stakeholder interests seriously and believe that some of the adverse effects that companies impose on stakeholders raise serious policy concerns and warrant legal and regulatory intervention. The importance of stakeholder protection, however, does not validate stakeholderism. In fact, as our analysis demonstrates, stakeholderism does not benefit stakeholders, shareholders, or society. If stakeholder interests are to be taken seriously, stakeholderism should be rejected.

II. The Rise of Stakeholderism

A. Origins, Evolution, and Breadth of Support[14]

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.[15] This idea was rooted in English precedent, which drew a distinction between enterprises of direct benefit to public welfare and those aimed at making private profits, and viewed only the former as deserving the privilege of corporate personhood.[16] The argument, as transplanted into American legal thought and practice, was that limited liability was an extraordinary and undemocratic privilege, and only a prevailing public interest could justify it.[17]

This early conception was gradually abandoned with the passing of general incorporation acts, which enabled enterprises to adopt the corporate form without previous authorization by the state. At that point, corporate personhood was no longer a privilege individually received from the state,

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[13] For a well-known early work taking this view, *see* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 37 (1991).

[14] We do not attempt to provide an exhaustive review of this debate. Our goal is only to illustrate the evolution, breadth and recent growth of support for stakeholderism. For a recent detailed survey of stakeholderist theories, *see* Cynthia A. Williams, *Corporate Social Responsibility and Corporate Governance*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 44–52 (Jeffrey N. Gordon & Wolf-Georg Ringe eds. 2018).

[15] Before 1800, more than 75% of corporate charters had been granted to public services enterprises, such as water supply, turnpike, and canal companies; only 4% of the charters belonged to manufacturing, agricultural, or commercial firms. JOSEPH S. DAVIS, 2 ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS 26 (1917).

[16] Frederick G. Kempin, Jr., *Limited Liability in Historical Perspective*, 4 AM. BUS. L. ASS. BULL. 11, 13-14 (1960)

[17] Shaw Livermore, *Unlimited Liability in Early American Corporations*, 43 J. POL. ECON. 674 (1935).

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but a form of business organization generally available to all enterprises.[18] By the beginning of the 1920s, the idea that the main purpose of the business corporation was to make profits for shareholders was widely accepted and sanctioned by case law.[19]

In the following decades, however, the competing conception of stakeholderism would evolve. It received support from scholars (in law, management, and finance), practitioners, and thought leaders, and had influence on lawmaking.

In legal scholarship, support for stakeholderism goes back to the seminal and influential work of Merrick Dodd.[20] In the modern era, notable supporters of stakeholderism are Margaret Blair and Lynn Stout, who have argued forcefully for abandoning shareholder primacy in a series of well-known works.[21] Other notable works by legal scholars in support of stakeholderism include those by Einer Elhauge, Simon Deakin, and Cynthia Williams.[22]

In management studies, an important strain of literature has developed a "stakeholder approach" to strategic management. In a highly influential book that has had a long-lasting impact on the management literature, R. Edward Freeman introduces this approach, according to which managers of business organizations must take into account the interests and the role of "any group or individual who can affect or is affected by the achievement of an organization's purpose."[23] To help turn this approach into measurable

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[18] HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW 1836-1937 (1991) at 13.

[19] *See, e.g.,* Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) ("A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself.").

[20] E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932). Dodd's paper is one of the most cited law review article ever. *See* Fred R. Shapiro & Michelle Pearse, *The Most-Cited Law Review Articles of All Time*, 110 MICH. L. REV. 1483, 1499 (2012) (listing Dodd's paper as the fifth most cited corporate and securities law paper as of November 2011).

[21] *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999) (advocating that directors be viewed as "mediating hierarchs" who should balance the interests of shareholders, employees, creditors, and other stakeholders); LYNN A. STOUT, THE SHAREHOLDER VALUE MYTH (2012) (arguing against "shareholder value maximization" from both a doctrinal and normative standpoint).

[22] Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005); Simon Deakin, *The Corporation as Commons: Rethinking Property Rights, Governance and Sustainability in the Business Enterprise*, 37 QUEEN'S L. J. 339 (2011-2012); Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197 (1999).

[23] R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH 53 (1984).

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management practices, subsequent studies have proposed various metrics for scoring performance with respect to stakeholder welfare.[24]

Finally, prominent financial economists have recently devoted their attention to the purpose of the corporation. In a book published two years ago, for example, Colin Mayer argues against the doctrine according to which the purpose of the corporation is to make profits for its shareholders; instead, his view is that the purpose of business should be to "produc[e] profitable solutions to problems of people and planet."[25] Alex Edmans, in a new book published this year, rejects the notion that corporations have the only goal of maximizing shareholder value and proposes that the purpose of corporations should be to create value for society—and, by doing so, increase profits as a by-product.[26]

In lawmaking, stakeholderism has already had a significant impact. During the hostile takeover era of the 1980s and 1990s, stakeholderism provided the basis for antitakeover legislation: most states adopted statutes that explicitly allowed directors to consider the interests of other constituencies when making a decision on an acquisition of the company or, more generally, on any issue.[27] Importantly, as documented by Roberta Romano and Mark Roe, this legislative development was in part the result of lobbying efforts by management interests seeking to insulate managers from the threat of hostile takeovers.[28]

These statutes—commonly known as stakeholder statutes, constituency statutes, or other constituency statutes—are often presented as a clarification of the "interests of the corporation" that directors have the duty to serve. The interests of the corporation, the law makes clear, include the interests of employees, customers, suppliers, and sometimes creditors, local

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[24] *See, e.g.*, JOHN ELKINGTON, CANNIBAL WITH FORKS: THE TRIPLE BOTTOM LINE OF THE 21ST CENTURY BUSINESS 70 (1998) (proposing that companies should consider a "triple bottom line"—that is, economic, environmental, and social performance); *and* Erik G. Hansen & Stefan Schaltegger, *The Sustainability Balanced Scorecard: A Systematic Review of Architectures*, 133 J. BUS. ETHICS 193 (2016) (reviewing the literature on the "sustainability balanced scorecard," a performance measurement method that balances financial and operational measures with environmental, social, and ethical goals).

[25] COLIN MAYER, PROSPERITY 39 (2018).

[26] ALEX EDMANS, GROW THE PIE: CREATING PROFIT FOR INVESTORS AND VALUE FOR SOCIETY (2020).

[27] For an excellent review and analysis of constituency statutes, *see* Michal Barzuza, *The State of State Antitakeover Law*, 95 VA. L. REV. 1973, 1973 (2009).

[28] *See* Mark J. Roe, Takeover Politics, *in* THE DEAL DECADE 338–52 (Margaret Blair ed., 1993); *and* Roberta Romano, *The Future of Hostile Takeovers: Legislation and Public Opinion,* 57 U. CIN. L. REV. 457, 458–65 (1988). During this period, the BRT contributed to the efforts to obtain takeover protections on stakeholderist grounds by stating that "[c]orporations are chartered to serve both their shareholders and society as a whole." Business Roundtable, *Corporate Governance and American Competitiveness*, 46 BUS. LAW. 241, 244 (1990).

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communities, or even the whole economy or nation.[28a]

B. A Critical Juncture

Despite the academic support for stakeholderism and its impact on legislation of the 1980s, at the turn of the 21st century shareholder primacy was still the dominant view. At that time, both supporters of shareholder primacy and proponents of stakeholderism agreed that the consensus among scholars leaned toward the former.[29] And although management interests played a key role in the adoption of constituency statutes, the BRT's 1997 statement on corporate purpose declared that serving shareholders was "the paramount duty of . . . directors."[30]

In the past decade, however, stakeholderism has been on the rise, especially in terms of its acceptance by corporate executives, management advisors, and policy thought-leaders. The 2019 statement of the BRT, which committed to "deliver value to all [stakeholders],"[31] has been widely viewed as a significant milestone in this trend, a break with decades of orthodoxy, and a turning point for corporate America.[32] The significance of the BRT statement was reinforced by the fact that its U.S.-based signatories lead corporations with an aggregate market capitalization exceeding $11 trillion and over one-third of total market capitalization in the U.S. equity markets.[33]

In the following months, other prominent organizations officially backed stakeholderism. The World Economic Forum—an international organization

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[28a] *See, e.g.,* Conn. Gen. Stat. § 33-756 ("a director […] may consider, in determining what the director reasonably believes to be in the best interests of the corporation […] the interests of the corporation's employees, customers, creditors and suppliers, and […] community and societal considerations, including those of any community in which any office or other facility of the corporation is located").

[29] See Stout, THE SHAREHOLDER VALUE MYTH, *supra* note 21, at 21 ("[B]y the close of the millennium . . . [m]ost scholars, regulators and business leaders accepted without question that shareholder wealth maximization was the only proper goal of corporate governance."); *and* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L. J. 439, 440 (2001) ("[T]here is convergence on a consensus that the best means to this end (that is, the pursuit of aggregate social welfare) is to make corporate managers strongly accountable to shareholder interests and, at least in direct terms, only to those interests.").

[30] Business Roundtable, Statement on Corporate Governance, *supra* note 7, at 3.

[31] Business Roundtable, Statement on the Purpose of a Corporation, *supra* note 2.

[32] *See* sources cited *supra* note 6.

[33] Market capitalization of the public companies led by the signatories of the BRT statement, as well as all other public companies, is based on data collected from Compustat as of December 1, 2019. We excluded the private companies that signed the BRT statement (for which market capitalization is not available). As of that date, total market capitalization was $11.6 trillion for all U.S.-incorporated signatories and $13.3 trillion for all public companies.

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comprising many major global corporations and thought-leaders—issued a manifesto urging companies to abandon the traditional model of "shareholder capitalism." The manifesto called instead for a model of "stakeholder capitalism."[34]

The British Academy—the United Kingdom's national body for the humanities and social sciences—issued a report championing a "revisit[ed] […] contract between business and society."[34a] The report promoted accountability to all constituencies and advocated changes in corporate law and governance that would require directors to consider the interests of all stakeholders.[35]

These developments have been accompanied by growing support for stakeholderism among institutional investors as well. For example, Larry Fink, the CEO of BlackRock, the world's largest asset manager, has urged directors of its portfolio companies to have a "social purpose" and to "benefit all of their stakeholders."[36] Given these developments, it is unsurprising that, when the American Law Institute began its project to draft a *Restatement of Corporate Law* last year, the project started examining the question of corporate purpose and the appropriate role that stakeholder interests should play in director decision-making.[37] In short, it seems that, as a post co-authored by Martin Lipton recently stated, 2019 was a "watershed year in the evolution of corporate governance" due to the "advent of stakeholder governance."[38]

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What is driving the growing support for stakeholderism over the past decade? One driver, we believe, is the increasing concerns about the effects that companies and the corporate economy have on stakeholders, as well as the interest in, and demand for, reforms to address them.[39] This makes stakeholderism, which relies on private decision-making and avoids regulation, potentially appealing to many. A second driver is the interest among some corporate leaders and their advisors to use stakeholderism "strategically," to insulate corporate leaders from shareholder oversight and to impede or delay stakeholder-protecting reforms that would constrain

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[34] Davos Manifesto 2020, *supra* note 8.

[34a] British Academy, PRINCIPLES FOR PURPOSEFUL BUSINESS 11 (November 2019).

[35] *Id.*

[36] Larry Fink, *A Sense of Purpose*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 17, 2019), https://corpgov.law.harvard.edu/2018/01/17/a-sense-of-purpose/. For evidence on the dominant position of BlackRock, see Lucian A. Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721 (2019).

[37] *See supra* note 10.

[38] *See supra* note 11.

[39] For discussions expressing such concerns, *see* sources cited *infra* notes 150-156.

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companies' choices.

We discuss both of these aspects in Part VI. In any event, whatever the drivers of the rise of stakeholderism, the debate might well have reached a critical juncture. These developments motivate this Article. As we explain in the following pages, despite its appeal to many, stakeholderism would actually be detrimental for shareholders, stakeholders, and society alike.

III. Alternative Versions and Conceptual Problems

This Part distinguishes between two basic versions of stakeholderism and discusses the conceptual problems of each. Although defenses of stakeholderism are often unclear on which version they support,[40] the two approaches are conceptually distinct; a separate discussion of them is thus useful. In Sections A and B below, we describe "instrumental stakeholderism" and "pluralistic stakeholderism," respectively, and the conceptual problems afflicting them.

A. Instrumental Stakeholderism

1. Enlightened Shareholder Value

The relationship between a corporation and its stakeholders is, to some extent, mutually beneficial. Stakeholders depend on the corporation for jobs, salaries, sale orders, products and services, loan payments, and positive spillover effects.[41] At the same time, the corporation depends on its stakeholders for financial and human capital, institutional infrastructure, and revenues, and it cannot operate and make profit without a certain degree of social and political recognition and trust.

It is thus unsurprising that maximizing long-term value for shareholders requires paying close attention to the effects of the company's operations on stakeholders. For example, how the company treats employees could well affect its ability to attract, retain, and motivate the members of its labor force; how the company deals with customers could affect its ability to attract and retain them; and how the company deals with local communities or the environment could well affect its reputation and standing in ways that could be important for its success. Thus, it is undeniable that, to effectively serve the goal of enhancing long-term shareholder value, corporate leaders should take into account stakeholder effects—as they should consider any other relevant factors.

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[40] For a discussion of how the BRT statement is unclear on this matter, *see infra* Section IV.A.

[41] *See, e.g.*, Enrico Moretti, *Local Multipliers*, 100 AM. ECON. REV. 373 (2010) (examining the economic effects that new businesses or new jobs can have on a community).

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In light of the relevance of stakeholder effects for shareholder value, the "enlightened shareholder value" approach proposes that corporate leaders follow a decision rule that contains an explicit reference to the interests of stakeholders. A prominent example of this approach is the 2006 UK Companies Act, which lists factors that directors should consider in seeking to enhance shareholder value. These factors, which include "the interests of the company's employees" and "the impact of the company's operations on the community and the environment," are meant to be non-exhaustive examples of potentially relevant stakeholder effects.[40a] Importantly, directors are called to consider such factors in order "to promote the success of the company for the benefit of its [shareholders]."[42] In other words, consideration of these factors is a means to the end of shareholder welfare.[43] Another important development is that the American Law Institute is currently considering an enlightened shareholder value approach for the *Restatement of Corporate Law*.[44]

2. Different from Shareholder Value?

Given the positive connotations of the term "enlightened," enlightened shareholder value sounds better than shareholder value. However, enlightened shareholder value is not conceptually different from the "old-fashioned" shareholder value (i.e., shareholder primacy) view. Whenever treating stakeholders well in a given way would be useful for long-term shareholder value, such treatment would be called for under either enlightened shareholder value or shareholder value. And whenever treating stakeholders well would not be useful for long-term shareholder value, such treatment would not be called for under either enlightened shareholder value or old-fashioned shareholder value.

In other words, enlightened shareholder value is only a particular articulation of shareholder value. Maximizing long-term shareholder value would sometimes call for closing plants, and other times for improving employment terms. Such stakeholder-favoring decisions, however—exactly like their stakeholder-disfavoring counterparts—would only be as good as their instrumental value to shareholders. Enlightened shareholder value is

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[40a] Companies Act (UK) §172(1).

[42] *Id.*

[43] *See* Company Law Review Steering Group, Developing the Framework (Mar. 2000) at 14 (explaining that the directors' duty to take into account stakeholder interests should not be viewed as an independent goal). For an analysis of the UK statutory provision of "enlightened shareholder value," *see* Joan Loughrey, Andrew Keay & Luca Cerioni, *Legal Practitioners, Enlightened Shareholder Value and the Shaping of Corporate Governance*, 8 J. CORP. L. STUD. 79 (2008).

[44] *See supra* note 10.

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thus no different from shareholder value *tout court*.

Even Milton Friedman, the Nobel laureate who famously opposed corporate social responsibility, acknowledged that shareholder value maximization may sometimes call for stakeholder-friendly decisions.[45] As long as such decisions are taken to increase shareholder value, he did not view them as a deviation from the exclusive focus on shareholder value maximization he strongly advocated. Thus, Friedman would not have a problem with any choices made under enlightened shareholder value, as they would also be choices required by shareholder value.

3. Why Move to Enlightened Shareholder Value?

Having shown that enlightened shareholder value is conceptually equivalent to shareholder value, are there good reasons to restate the latter using the particular language of the former? Below we identify and discuss three potential reasons (not mutually exclusive) for such a move.

First, some supporters of enlightened shareholder value might hold the view that referring explicitly to stakeholder effects would have *informational and educational value* that would improve corporate decision-making. According to this view, corporate leaders have tended to systematically under-appreciate the significance of stakeholder effects for long-term value. Moving to a principle of enlightened shareholder value could thus potentially highlight and make salient the relevance of stakeholder effects and thereby make corporate leaders more likely to take them fully into account.

But is there a basis for believing that corporate leaders have systematically under-estimated the relevance of stakeholder effects for shareholder value maximization? Supporters of enlightened shareholder value have not provided any evidence that corporate leaders suffer from a cognitive bias that leads them to systematically under-estimate the relevance of some factors (namely, stakeholder effects) but not others.

Consider the language of the British company law provision whose example the *Restatement of Corporate Law* project is considering following.[46] This provision instructs directors to pursue shareholder value, but reminds them that in pursuing this goal they might want to take into account the relevance of stakeholder effects. Stakeholder effects are the only relevant factors that the provision explicitly mentions, even if pursuing shareholder value unquestionably requires the consideration of many other

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[45] Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970 at SM12 (observing that, for example, "providing amenities to [the local] community or to improving its government […] may make it easier to attract desirable employees, it may reduce the wage bill or lessen losses from pilferage and sabotage or have other worthwhile effects.").

[46] *See supra* notes 42-43 and accompanying text.

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factors. Why does this provision assume that corporate leaders are perfectly able to identify and assess those implicit factors but need to be reminded that how the company treats its employees, customers, or suppliers could well have consequences for long-term success? We do not see a good reason for doing so.

Second, some might reason that enlightened shareholder value, although formally preserving directors' loyalty to shareholders, would provide moral support and practical coverage for directors who wish to offer some benefits to stakeholders at the expense of shareholders. According to this view, because courts are generally prevented from second-guessing the decisions of directors, the language of enlightened shareholder value would enable and perhaps encourage directors to protect stakeholders beyond what would be desirable for long-term shareholder value maximization.

This reasoning, however, is flawed. Under both enlightened shareholder value and shareholder value, directors are able to justify a stakeholder-friendly decision on the grounds that it would contribute to long-term shareholder value. Thus, a move to the language of enlightened shareholder value would not expand the justifications available to corporate leaders for favoring stakeholders. Furthermore, given the broad deference that Delaware law—the law governing most public companies[47]—gives to managerial decisions under the business judgment rule, directors do not practically face a significant risk of not being able to justify their decision to a reviewing court.[48]

Moreover, it is doubtful that there are many corporate leaders interested in finding ways to justify stakeholder-friendly decisions beyond those that really serve long-term shareholder value. As we will show in Part V, corporate leaders have incentives not to favor stakeholders at the expense of shareholders.

Third, a move to a principle of enlightened shareholder value might be favored on the grounds that it would yield rhetorical and political gains. Whereas the first two motivations discussed above focus on how the move could potentially affect corporate decisions (despite the conceptual equivalence between enlightened shareholder value and shareholder value), this third motivation focuses on how the move could improve the way companies are perceived by outsiders. The prospect of improved corporate image could motivate the adoption of the enlightened shareholder value

[47] As of the end of July 2019, 1,791 Russell 3000 companies were incorporated in Delaware (out of a total of 2970 Russell 3000 companies matched with Compustat).

[48] *See, e.g.*, STEPHEN M. BAINBRIDGE, CORPORATE LAW 248 (2015) ("[t]he 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.").

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principle even if it should not be expected to have a material effect on the substance of corporate decisions.

Business leaders and their advisors have long recognized the importance of how outsiders perceive corporations and their impact on stakeholders and society. About five decades ago, the Committee for Economic Development, a think-tank established by business leaders, warned that "the corporation is dependent on the goodwill of society, which can sustain or impair its existence through public pressures on government."[49] Fast forwarding to the present, BlackRock CEO Larry Fink recently stated that companies "without a sense of purpose" will "lose the license to operate from key stakeholders."[50] Given these concerns, some corporate decision-makers might hope that a formal recognition of the enlightened shareholder value view would allay outsiders' concerns for the adverse effects of corporate decisions on stakeholders and society.

However, to those interested in stakeholder protection this should be a reason for opposing this form of stakeholderism, not for supporting it. Our earlier conclusion that the conceptual difference between shareholder value and enlightened shareholder value is trivial could, by itself, lead to a perception that the move from the first to the second would be neutral and inconsequential. But to the extent that it would lead outsiders to be less concerned about the effects of corporations on stakeholders, the move could well have significant adverse effects. As we explain in detail in Section V.B, one of these effects might be a reduced demand for meaningful legal and regulatory reforms that could effectively protect stakeholders. In this case, the adoption of the enlightened shareholder value principle would not only fail to directly improve stakeholder protection but also indirectly deteriorate the overall level of such protection.

B. Pluralistic Stakeholderism

1. Stakeholder Welfare as an End

A conceptually different version of stakeholderism treats stakeholder welfare as an end in itself rather than a mere means. According to this view, the welfare of each group of stakeholders is relevant and valuable independently of its effect on the welfare of shareholders. We call this approach "pluralistic," because it provides directors with a plurality of independent constituencies and requires them to weigh and balance a

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[49] Committee for Economic Development, Social Responsibilities of Business Corporations (June 1, 1971), at 27.

[50] Larry Fink, *A Sense of Purpose*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 17, 2019), https://corpgov.law.harvard.edu/2018/01/17/a-sense-of-purpose/.

Electronic copy available at: https://ssrn.com/abstract=3544978

plurality of autonomous ends.

Some important examples of the pluralistic approach are the constituency statutes adopted by many U.S. states in the late 1980s and early 1990s. As noted in Part II, these statutes allow directors to take into account the interests of stakeholders without limiting the relevance of these interests to their effect on shareholders. Some statutes even explicitly specify that the rule does not require that any particular interests be given priority over others.[51] Similarly, there are academics who advocate that corporate leaders must aggregate and balance the interests of their multiple constituencies. Thus, for example, Blair and Stout argue that directors should play the role of "mediating hierarchs" who decide how to allocate the value created by the corporation between shareholders and stakeholders.[52] Other well-known supporters of the pluralistic approach include Elhauge and Deakin.[53]

A variation within pluralistic theories is whether directors are required or merely allowed to consider the interests of stakeholders and balance them against the interests of shareholders. The states that have adopted constituency statutes permit—but do not obligate—directors to do so.[54] We believe, however, that this difference between the two versions is not practically consequential. The business judgment rule prevents courts from second-guessing the decisions of directors, and stakeholderists in any event do not wish to provide stakeholders with the right to sue directors. Therefore, even with a rule mandating directors to give weight to stakeholder interests, the extent to which they would do so would ultimately depend on their own discretion.

This reliance on the role of discretion is significant because the task that stakeholderism assigns to corporate leaders is Herculean.[55] As we explain in

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[51] *See,* Ariz. Rev. Stat. § 10-830 (LexisNexis), Iowa Code § 490.1108A (LexisNexis), N.Y. Bus. Corp. Law § 717 (Consol., Lexis Advance), 15 Pa. Cons. Stat. Ann. § 1715 (LexisNexis).

[52] *See, e.g*., Blair & Stout, *supra* note 21, at 251, 281 (arguing that the board of directors should "coordinate the activities of the team members [that is, shareholders and various groups of stakeholders], allocate the resulting production, and mediate disputes among team members over that allocation.").

[53] *See* Elhauge *supra* note 22; Deakin, *supra* note 22.

[54] Originally, Connecticut obligated directors to consider the interests of stakeholders. In 2010, however, the state legislature amended its constituency statute and adopted a permissive approach as well. HB 5530, 2010 ALS 35 (Conn. 2010) (amending Conn. Gen. Stat. §33-756 from "a director […] shall consider, in determining what the director reasonably believes to be in the best interests of the corporation, [the interests of stakeholders]" to "a director […] may consider, in determining what the director reasonably believes to be in the best interests of the corporation, [the interests of stakeholders].").

[55] We use this adjective as a reference to Ronald Dworkin's ideal judge, Hercules, a person "of superhuman skill, learning, patience, and acumen" who has the difficult task of deciding hard cases based on the correct interpretation of the whole body of the law. *See* Ronald Dworkin, *Hard Cases*, 88 HARV. L. REV. 1057, 1083 (1975).

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the next Section, 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. This task would be immensely difficult even if corporate leaders were highly motivated to take it on, which, as we shall show in Part V, is not the case.

2. Conceptual Problems

(a) Who Is a Stakeholder?

The first difficulty in the implementation of pluralistic stakeholderism is the determination of the stakeholder groups whose interests should be taken into account. Without first making such a determination, directors cannot proceed to aggregate and balance the relevant interests.

To highlight the difficulty involved in this task, Table 1 lists all groups of stakeholders specified by the 32 constituency statutes in force in the United States as of December 2019.

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Table 1. Stakeholder Groups in the Constituency Statutes

Group or factor	***States***	***No. of statutes***
Employees	AZ, CT, FL, GA, HI, ID, IL, IN, IA, KY, ME, MD, MA, MN, MS, MO, NE, NV, NJ, NM, NY, ND, OH, OR, PA, RI, SD, TN, VT, WI, WY	31
Customers	AZ, CT, FL, GA, HI, ID, IL, IN, IA, KY, ME, MD, MA, MN, MS, MO, NE, NV, NJ, NM, NY, ND, OH, OR, PA, RI, SD, TN, VT, WI, WY	31
Suppliers	CT, FL, GA, HI, ID, IL, IN, IA, KY, ME, MD, MA, MN, MS, NE, NV, NJ, NM, ND, OH, OR, PA, RI, SD, TN, VT, WI, WY	28
Creditors	CT, GA, HI, IA, KY, MD, MA, MN, MS, MO, NE, NV, NJ, NM, NY, ND, OH, PA, RI, SD, VT, WY	22
Local community	CT, FL, GA, HI, ID, IL, IN, ME, MD, MO, NE, NJ, NM, NY, OR, PA, RI, SD, TN, VT, WI, WY	22
Society	AZ, CT, HI, KY, MA, MN, MS, NV, ND, OH, OR, TX, VT	13
Economy of the state or the nation	FL, HI, KY, MA, MN, MS, NV, NM, ND, OH, SD, VT	12
Environment	AZ, TX	2
Other	MO ("similar contractual relations"), NY (retired employees and other benefit recipients)	2
Catch-all	AZ, CT, FL, GA, IL, IN, ME, NV, OR, PA, TN, VT, WI, WY	14

The table summarizes which groups of stakeholders are identified in the constituency statutes in force as of December 2019.

All statutes list employees and customers as stakeholders, and most include suppliers as well. As for other groups, however, the statutes vary significantly. Many states mention creditors and local communities, but many do not. Some states allow directors to consider the effect of their decisions on society in general or on the economy of the state or the nation, but most do not. And some provisions are especially idiosyncratic; the New York statute, for example, allows directors to consider "the corporation's retired employees and other beneficiaries receiving or entitled to receive" benefits sponsored by the corporation.

Most notably, almost half of the states include an explicit catch-all phrase that permits directors to consider any other (unidentified) groups or factors

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not listed in the statute.[56] The existence of this phrase indicates that the lawmakers were uncertain regarding the appropriate delineation of the set of stakeholder groups.

As commonly understood, the term "stakeholders" refers to individuals who are affected by corporate decisions.[57] But what counts as being affected by corporate decisions? Clearly, for many public companies, the set of individuals who are directly and indirectly affected by the activities of the corporation is very large indeed. Furthermore, as the examples below indicate, any attempt to delineate the set of relevant stakeholders will confront difficult and challenging questions that have no clear answer.

Consider, for example, a plan to relocate a plant to another region. In addition to the negative effects of the plant relocation on the plant's current workers and the community in which the plant is currently located, should the company's leaders also take into account the positive effects on the workers of the new plant and on the community in which the new plant would operate? Would the answer to this question change if the new location were overseas?

To consider another example, suppose that a company is contemplating a plan that would expand its market share and the number of its employees and would result in a decline in a competitor's revenues and number of employees. Should corporate leaders pay attention to the plan's negative effects on the competitor's employees, suppliers, or shareholders? For yet another example, consider the environmental impact of a company's operations. Should the company's leaders take into account the effects on the residents of faraway countries or only on those living in the United States?

Finally, consider the dimension of time. It is common to include a company's current employees, suppliers, and customers among relevant stakeholders. But should former (or at least recent) employees, suppliers, and customers count as well? And what about potential future employees, suppliers, and customers?

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[56] *See, e.g.*, the statutes of Illinois, Maine, and Pennsylvania, allowing directors to consider "all other pertinent factors." 805 Ill. Comp. Stat. Ann. 5/8.85 (LexisNexis) ; Me. Rev. Stat. tit. 13-C, § 831 (LexisNexis) ; 15 Pa. Cons. Stat. Ann. § 1715 (LexisNexis). *See also,* the statute of Vermont, which allows directors to consider "any other factors the director in his or her discretion reasonably considers appropriate in determining what he or she reasonably believes to be in the best interests of the corporation." Vt. Stat. Ann. tit. 11A, § 8-30 (Lexis Advance).

[57] According to the Black's Law Dictionary (11th ed. 2019), a stakeholder is "[s]omeone who has an interest or concern in a business or enterprise, though not necessarily as an owner," or (more generally) "[a] person who has an interest or concern (not necessarily financial) in the success or failure of an organization, system, plan, or strategy, or who is affected by a course of action." In the strategic management literature, a stakeholder is any individual or group "that can affect, or [is] affected by, the accomplishment of organizational purpose." R. Edward Freeman *supra* note 23, at 25.

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Such questions must be resolved for any implementation of pluralistic stakeholderism. However, they are clearly difficult to answer, and any answers to them would likely be highly contestable. Stakeholderists have largely avoided offering answers for these questions, or even a methodology for reaching such answers. Instead, supporters of pluralistic stakeholderism have largely dealt with these questions by assigning them to corporate leaders to resolve at their discretion. Similarly, state constituency statutes have chosen to delegate to directors a broad discretion to identify the relevant stakeholders.[58] Thus, on this matter, as in others to be presently discussed, stakeholderism critically relies on the discretion of corporate leaders and thus reinforces the importance of assessing (as we do in Part V) how corporate leaders should be expected to use their discretion.

(b) The Ubiquity of Trade-Offs

Once the relevant stakeholders are identified, stakeholderism requires that their interests be weighed and balanced. Such an exercise raises very difficult questions regarding conflicts between groups of stakeholders and between stakeholders and shareholders, which stakeholderists have largely avoided by leaving their solution, again, to the discretion of corporate leaders. We conjecture that the limited attention devoted to this problem is due to an inaccurate perception that conflicts and trade-offs between shareholders and stakeholders are infrequent. The BRT statement, for example, explicitly denies the possibility that the interests of shareholders and stakeholders can clash in the long run.[59]

This view, however, is unsupported. In fact, potential trade-offs between shareholders and stakeholders are ubiquitous. Even after adopting all the stakeholder-friendly policies that are expected to improve long-term shareholder value (that is, after carrying out instrumental stakeholderism to its fullest extent), companies will commonly face many opportunities to provide some stakeholders with benefits that will come at the expense of shareholders.

Consider a company that provides its employees with compensation and benefits at levels that fully enable it to attract and retain talented and productive employees. And suppose that this company has, as many major

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[58] *See, e.g.* JAMES D. COX, THOMAS LEE HAZEN, & F. HODGE O'NEAL, §4:10 TREATISE ON THE LAW OF CORPORATIONS (3d ed. 2010) ("[constituency statutes] commit complete discretion to the board of directors without any reliable method to adjudge the appropriateness of its exercise.").

[59] Business Roundtable, *Redefined Purpose of a Corporation*, *supra* note 67 ("While we acknowledge that different stakeholders may have competing interests in the short term, it is important to recognize that the interests of all stakeholders are inseparable in the long term.").

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public companies do, a significant stream of profits that enables it to fund all necessary investments and to also pay dividends. In this common situation, if the directors were to follow pluralistic stakeholderism, they would face a trade-off. Financing an increase in employee compensation by reducing dividends would make employees somewhat better off and shareholders somewhat worse off. Trade-offs and conflicts of this kind are likely to be very common.

In forming the view that trade-offs are rare and that win-win choices are generally available, stakeholderists might have been influenced by empirical work documenting an association between employee satisfaction and shareholder return,[60] as well as between social responsibility scores and company valuation.[61] However, such associations can simply be explained by the fact that some firms find it value-maximizing to take certain stakeholder-friendly actions. This in no way implies, however, that all or even most potential stakeholder-friendly options would be good for shareholders. The empirical evidence is thus fully consistent with the ubiquitous presence of trade-offs.

(c) How to Resolve Trade-Offs?

How should corporate leaders resolve the ubiquitous trade-offs they would face under a pluralistic rule? This is another challenging question that must be addressed by whoever wishes to implement pluralistic stakeholderism.

Consider the following questions. How are directors supposed to assess the effects of their decisions on the various stakeholders? Should all stakeholder effects be converted into a monetary equivalent to enable comparison? If so, how should directors monetarize nonfinancial effects such as employees' psychological well-being, the effects of increased employment on local crime rates, or the expected effects of the company's emissions on global warming?[62] Furthermore, how should directors do the balancing? Should they seek to maximize the aggregate welfare of the different groups regardless of where the gains and losses from decisions fall? Or should they

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[60] *See Alex* Edmans, *Does the stock market fully value intangibles? Employee satisfaction and equity prices*, 101 J. FIN. ECON. 621, 622 (2011).

[61] *See* Allen Ferrell, Liang Hao, & Luc Renneboog, *Socially Responsible Firms*, 122 J. FIN. ECON. 585, 586 (2016).

[62] For a discussion of the complexity of estimating climate change effects, see William D. Nordhaus & Andrew Moffat, A survey of global impacts of climate change: Replication, survey methods, and a statistical analysis, NBER Working Paper (July 2017); Richard L. Revesz et al., *Global warming: Improve economic models of climate change*, 508 NATURE 173 (2014); Katharine Ricke et al., *Country-level social cost of carbon*, 8 NATURE CLIMATE CHANGE 895 (2018).

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try to ensure that value is distributed among various constituencies in a certain way?

Rather 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. For example, Blair and Stout expressly oppose the adoption of a rule or a criterion for resolving trade-offs, arguing that directors should be accorded broad discretion on this matter.[63] It is left unsaid, however, how directors should use their discretion to make these decisions, and how outsiders should evaluate how well directors perform their role.

Thus, when stakeholderists confront difficulties and indeterminacies in implementation, all roads seem to lead to the discretionary judgment of decision-makers. With stakeholderism critically depending on the discretion of corporate leaders, evaluating stakeholderism requires assessing how corporate leaders should be expected to use their discretion. We carry out such an assessment in the subsequent two Parts.

IV. The BRT Statement: A Meaningful Change or a PR Move?

As we emphasized earlier, the BRT statement was widely viewed as a major milestone and a turning point for corporate America.[64] The CEOs who signed the statement head companies with an aggregate market capitalization exceeding $13 trillion, including such major companies as Apple, Amazon, JPMorgan Chase, Walmart, Procter & Gamble, Exxon-Mobil, and Pfizer.[65] If the companies led by the signatories of the BRT statements actually delivered large benefits to their stakeholders, the impact on society would be considerable.

Therefore, before taking up the question of whether stakeholderism in general should be expected to benefit stakeholders, we discuss in this Part the narrower question of whether the BRT statement can be expected to produce such benefits. Below we examine this question based on a close reading of the statement and on evidence that we collected. We conclude that the BRT statement should be viewed largely as a PR move rather than as the harbinger

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[63] Blair & Stout, *supra* note 21, at 325 ("corporate directors as mediating hierarchs enjoy considerable discretion in deciding which members of the corporate coalition receive what portion of the economic surplus resulting from team production. Although the board must meet the minimum demands of each team member to keep the coalition together, beyond that threshold any number of possible allocations among groups is possible.")

[64] *See* sources cited *supra* note 6.

[65] *See supra* note 33.

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of a major change.[66]

A. Pluralistic or Merely Instrumental?

The statement, and the additional details published by the BRT in an explanatory note a few days later,[67] are remarkably vague as to the nature and content of the commitment that is being made. The statement starts with the unobjectionable claim that corporations have effects that are socially beneficial ("creating jobs, fostering innovation and providing essential goods and services") and then famously declares a "fundamental commitment to all of our stakeholders."[66a] However, when the statement turns to describe how the signatories will treat several groups of stakeholders, the specifics of these commitments are quite vague and elusive. The statement offers non-specific and underdefined commitments such as "meeting or exceeding customer expectations," compensating employees "fairly" and treating them with "dignity and respect," fostering "diversity and inclusion," and treating suppliers "fairly and ethically."[66b]

It is perhaps excessively demanding to expect detailed guidance from such a short statement. Importantly, however, the statement also fails to provide clarity on a critical question:which basic version of stakeholderism the BRT purports to endorse. Is it the instrumental approach, which supports taking stakeholder interests into account only to the extent that doing so would contribute to shareholder value? Or is it the pluralistic approach, which allows or requires directors to treat stakeholder welfare as an end in itself? The BRT statement remains ambiguous on this critical question.

Some aspects of the statement might encourage readers to infer that the CEOs plan to protect stakeholders beyond what would be called for by

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[66] Although many of the immediate reactions to the BRT statement commended it as a major milestone, *see* sources cited in supra note 6, some of the op-eds and blog posts commenting on the statement expressed skepticism. For op-eds and blog posts expressing skepticism with respect to the motivation behind or the expected consequences of the statement, *see, e.g.*, Luca Enriques, *The Business Roundtable CEOs' Statement: Same Old, Same Old*, PROMARKET (Sept. 9, 2019); Luigi Zingales, *Don't Trust CEOs Who Say They Don't Care About Shareholder Value Anymore*WASH. POST (Aug. 20, 2019), https://www.washingtonpost.com/opinions/2019/08/20/dont-trust-ceos-who-say-they-dont-care-about-shareholder-value-anymore/. In this Part, however, we seek to ground such skepticism in empirical evidence and in a detailed analysis of five dimensions of the statement and the choices made by signatories.

[67] Business Roundtable, *Redefined Purpose of a Corporation: Welcoming the Debate* (Aug. 25, 2019), https://medium.com/@BizRoundtable/redefined-purpose-of-a-corporation-welcoming-the-debate-8f03176f7ad8.

[66a] Business Roundtable, *Business Roundtable Redefines the Purpose of a Corporation*, *supra* note 4.

[66b] *Id.*

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shareholder value maximization. In addition to the expression of a "fundamental commitment to all of our stakeholders," the statement also describes all stakeholders as "essential," suggesting that the statement does not accord shareholders any priority over other constituencies.[66c] Furthermore, the BRT describes the statement as "a call to action to ensure that the benefits of capitalism are shared more broadly," thus suggesting that implementing the commitments expressed in the statement will lead to a redistribution among constituencies relative to the current allocation of value.[66d]

Furthermore, the BRT statement and the accompanying press release emphatically present the new statement as a radical change from the BRT's prior position: the statement is described as "redefining the purpose of the corporation," "superseding previous statements," and "moving away from shareholder primacy."[66e] However, the earlier 1997 statement, which proclaimed that "the paramount duty of management and of boards of directors is to the corporation's stockholders," already explicitly endorsed "tak[ing] into account the interests of the corporation's other stakeholders" as an instrument for shareholder value maximization.[68] Thus, if the BRT statement were to be read as a significant move away from the earlier version, then it would be difficult to interpret it as requiring merely instrumental stakeholderism.

The BRT statement, however, does not explicitly endorse benefitting stakeholders beyond what would be useful for shareholder value maximization. In particular, addressing the concern that the BRT statement could be interpreted as "abandoning shareholders," the BRT explanatory note indicates that creating long-term value for shareholders is a clear goal of corporations and that "for corporations to be successful [and] durable and return value to shareholders, they need to consider the interests and meet the fair expectations of a wide range of stakeholders."[69]

Moreover, when the BRT provides examples of how companies "will meet . . . [the] commitments of this statement," it does not include any case that suggests that directors should put the interests of stakeholders above

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[66c] *Id.*

[66d] *Id.*

[66e] *Id.*

[68] According to the 1997 Statement, taking stakeholders into account was worthwhile from a shareholder perspective because "[it] is in the long-term interests of stockholders for a corporation to treat its employees well, to serve its customers well, to encourage its suppliers to continue to supply it, to honor its debts, and to have a reputation for civic responsibility." Business Roundtable, Statement on Corporate Governance, *supra* note 7, at 3.

[69] Business Roundtable, Redefined Purpose of a Corporation, *supra* note 67.

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those of shareholders.[68a] Two of the examples call for the government to adopt measures in favor of current and future employees (raising the federal minimum wage and facilitating access of part-time students to federal financial aid) rather than for companies to benefit employees directly.[68b] The other two examples (apprenticeships and internships programs for students and workers, and moving away from quarterly earnings guidance) might be perfectly consistent with shareholder value, and the language used does not suggest that those policies can be pursued beyond what would be desirable for shareholder value maximization.[68c]

Thus, despite the change in rhetoric, the BRT's revision of its statement of corporate purpose does not seem to be a move from the shareholder primacy or enlightened shareholder value of its 1997 statement to pluralistic stakeholderism.

B. Denial of Trade-Offs

Another telling sign is that the BRT largely denies the possibility of trade-offs. In fact, it states that "while we acknowledge that different stakeholders may have competing interests in the short term, it is important to recognize that the interests of all stakeholders are inseparable in the long term."[70]

As discussed in Section III.2.b, however, trade-offs are inevitable and arise frequently. Companies constantly face choices that might favor one group at the expense of another and must pick winners and losers.

The language used by the BRT, in contrast, suggests that companies will generally face "win-win" outcomes in which a certain choice will be better than all alternative choices from the perspective of each of the company's constituencies. This is at best a naïve misunderstanding or, more realistically, a mischaracterization of economic reality. If companies faced only win-win situations, there would be no practical difference between stakeholderism and shareholder value maximization; in a world of only win-win situations, companies making choices that maximize shareholder value would necessarily pick the options that would be best not only from the perspective of shareholders but also from the perspective of every other constituency.

Insisting on a world of win-win situations is consistent with the expectation that signatories will generally treat stakeholders in whatever way would best serve shareholders. By assuming win-win situations, the BRT creates an inaccurate impression that signatories will treat all stakeholders as

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[68a] *Id.*
[68b] *See id.*
[68c] *See id.*
[70] *Id.*

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well as possible.

C. Lack of Board Approval

In assessing the extent to which the BRT statement is expected to bring about major changes, it is useful to examine whether the decision to join the statement was approved by each company's board of directors. The most important corporate decisions (such as approving a major transaction, amending by-laws, or making a major change in the corporate strategy) require or at least commonly receive approval by a vote at a meeting of the board of directors. Thus, if the commitment expressed by joining the BRT statement had been expected to bring about major changes in a company's choices and practices, it would have been expected to be approved by the board of directors. [71]

Therefore, to examine this issue, we contacted the public relations offices of 173 companies whose CEOs signed the BRT statement.[72] We asked each company to indicate who was the highest-level decision-maker who approved the decision to join the BRT statement, whether the CEO, the board of directors, or an executive below the CEO. 48 companies responded to our inquiry.[73] Of the responding companies, 47 companies indicated that the decision was approved by the CEO and not by the board of directors.[74] Only one responding company indicated that the decision was approved by the board of directors. Thus, among responding companies, about 98% had no

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[71] Robert Eccles and Tim Youmans have led an initiative aimed at encouraging boards of directors of public companies to adopt a "statement of purpose" or "statement of significant audiences and materiality," which should identify the company's significant constituencies and the company's priorities and time frames to deliver value to these constituencies. Robert G. Eccles & Tim Youmans, *Materiality in Corporate Governance: The Statement of Significant Audiences and Materiality*, 28 J. APPLIED CORP. FIN. 29 (2016). These thought leaders believe that the board of directors is the corporate organ that should approve such a statement. It seems equally natural that the board should also be the organ that approves a company's joining a collective statement of purpose such as the BRT statement.

[72] The initial signatories of the BRT statement were 181. As of December 17, 2019, we identified 3 additional companies that publicly joined the BRT statement, for a total of 184. Of these 184 companies, we contacted all the 173 companies for which we found a public relations / media inquiries email address on the corporate website.

[73] We also received two ambiguous responses that we did not include in the total of 48. For example, one company responded that the decision was "a collaborative effort," declining to specify a particular decision-maker.

[74] Of these 48 companies, two added that while the decision was taken by the CEO, the CEO consulted (or "usually consults") with the board of directors. However, important corporate decisions are generally approved by the board of directors through a formal vote at a board meeting. We therefore did not classify these two companies as having received board approval for the decision to join the BRT statement.

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approval by the board of directors.

To be sure, a majority of the companies declined to answer even after a follow up. Still there is no reason to expect that the companies that did not answer were more likely than responding companies to have had the decision approved by the board. Thus, the strong results we obtained for our sample of 48 are telling.

What can explain the common CEO decision to join the BRT statement without seeking approval by the board of directors? It is implausible that CEOs chose not to seek approval for decisions that they viewed as sufficiently important to merit board consideration. Even "imperial" CEOs are unlikely to disregard the formal location of the board of directors at the top of the corporate pyramid; instead, such CEOs are likely to use their power and influence to get the board to approve the choice they favor.

Similarly, it is implausible that CEOs did not seek board approval because they viewed joining the BRT Statement as a matter of personal belief rather than a statement made in their "official" capacity as corporate head. The BRT described the CEO signatories as committing "to lead their companies for the benefit of all stakeholders."[75] Thus, the BRT statement did not seek to express a shared personal belief by a group of individuals but a commitment regarding the goals that the companies led by these individuals will pursue.[76]

In our view, the most plausible explanation for CEOs choosing to join the BRT statement without board approval has to do with their view of the content of the statement. Indeed, two of the companies that responded to our survey stated that joining the BRT statement reflected an affirmation that the company's past practices have been consistent with the principles of the BRT statement rather than an expectation that the company would make major changes in its future treatment of stakeholders. Furthermore, JPMorgan, the company headed by the chairman of the BRT at the time the statement was issued, also expressed the view that no significant future changes would be necessary to implement the principles of the BRT statement. In fact, in response to the submission of a shareholder proposal asking directors to report on the changes necessary to implement the principles of the BRT statement, JPMorgan stated that the company already "operated in accordance with the principles set forth in the BRT Statement before its publication, and continues to do so after its publication."[77]

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[75] Business Roundtable, *Business Roundtable Redefines the Purpose of a Corporation*, *supra* note 4.

[76] We note that no CEO would be expected to announce a commitment to lead the CEO's company to acquire another company without approval of the acquisition plan by the board.

[77] JPMorgan Chase & Co., SEC No-Action Letter, 2020 WL 255796 (Feb. 5, 2020). The SEC concurred with the company's view and decided to recommend no enforcement action in case the company excluded the shareholder proposal from its proxy statement.

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To the extent that this view was widely shared among other signatories to the statement, it can explain well why the decision to join the statement was commonly not approved by the company's board of directors. In this case, however, the BRT statement merely reflected (i) the CEOs' positive assessment of how their companies have been treating stakeholders thus far, as well as, importantly, (ii) the CEOs' expectation that the statement will not lead to substantial changes in how stakeholders are treated.

Thus, the lack of board approval is consistent with, and reinforces, the conclusion that the BRT statement was not expected by signatories to bring about major changes.

D. Corporate Governance Guidelines

Another telling sign is whether companies whose CEOs signed the BRT statement subsequently amended their corporate governance guidelines and, if so, how. To examine this aspect, we reviewed the board-approved corporate governance guidelines of the companies whose CEO sits on the board of the directors of the BRT (the "BRT Board Sample").[78] In each case, we examined when the corporate governance guidelines were last amended and how they address the welfare of stakeholders.

Our review indicated that, following the issuance of the BRT statement, none of the twenty companies amended its corporate governance guidelines to incorporate stakeholder welfare as an independent end of the corporation. Only three companies—Boeing, Stryker, and Marriott International—amended their corporate guidelines, but none of them seems affected by the BRT statement.

Boeing's guidelines state that "[d]irectors' basic responsibility is to exercise their business judgment to act in what they reasonably believe to be the best interests of the Company and its shareholders."[79] Stryker's guidelines use the traditional formulation according to which the board's responsibility is to "serve the best interests of the Company and its shareholders" without

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[78] Our review was based on the corporate governance guidelines and principles available on the companies' websites as of January 7, 2020.

[79] *See* The Boeing Company, *Corporate Governance Principles* (Aug. 26, 2019), https://perma.cc/2T2X-R75H. As to stakeholders, the guidelines merely acknowledge that their interests may be taken into account instrumentally for shareholder value maximization, stating that "[t]he Board and the officers recognize that the long-term interests of the Company and its shareholders are advanced when they take into account the concerns of employees, customers, suppliers and communities." Note that this is the same language contained in the company's corporate governance principles that were in place in 2007. The Boeing Company, *Corporate Governance Principles*, Exhibit 99.2 to the Form 8-K (Feb. 27, 2007).

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any mention of stakeholder interests.[80] Marriott International's corporate governance guidelines state that directors are elected "to enhance long term value for [the company's] shareholders," and that stakeholder interest should be enhanced only "[t]o the extent consistent with their primary obligation to [the company's] shareholders."[81]

Most importantly, reviewing the corporate governance guidelines of all the other seventeen companies in the BRT Board Sample, we find that many of them contain a strong endorsement of the shareholder primacy principle. This pattern is notable, because the BRT describes its statement as "mov[ing] away from shareholder primacy."[82]

Strikingly, explicit endorsements of shareholder primacy can be found in the corporate governance guidelines of the two companies whose CEOs played a key leadership role in the BRT's adoption of its statement. JPMorgan Chase, whose CEO Jamie Dimon is the chairman of the BRT, states that "[t]he Board as a whole is responsible for the oversight of management *on behalf of the Firm's shareholders*."[83] And Johnson & Johnson, whose CEO Alex Gorsky serves as chairman of the BRT's Corporate Governance Committee, states in quite clear terms that "[t]he business judgment of the Board must be exercised . . . in the long-term interests of our shareholders."[84]

Other companies have corporate guidelines that similarly endorse shareholder primacy.[85] The guidelines of a few companies contain some cautious references to the interests of stakeholders without recognizing

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[80] *See* Stryker Corp., *Corporate Governance Guidelines* (Nov. 6, 2019), https://perma.cc/MWS6-F873/.

[81] *See* Marriott International, Inc., *Governance Principles* (Nov. 7, 2019), https://perma.cc/R8QV-4TV3.

[82] Business Roundtable, *Business Roundtable Redefines the Purpose of a Corporation*, *supra* note 4.

[83] JPMorgan Chase & Co., Corporate Governance Principles (Jan. 1, 2019), https://perma.cc/JR9Q-82R7 (emphasis added).

[84] Johnson & Johnson, Inc., *Principles of Corporate Governance*, https://perma.cc/57GX-VTXC. The company's guidelines do repeat the company's 1947 credo, which mentions the corporation's responsibility to four groups of stakeholders (customers, employees, communities, and shareholders), but makes it clear that business judgment must be exercised in the interests of shareholders.

[85] For example, AECOM's corporate governance guidelines affirm that "[t]he primary responsibility of the Board of Directors […] is to oversee the affairs of the Company for the benefit of stockholders,"[85] and Lockheed Martin's corporate governance guidelines state that "[t]he role of the Board is to oversee the management of the Corporation and to represent the interests of all the Corporation's stockholders." See AECOM, Inc., *Corporate Governance Guidelines* (Nov. 14, 2018), https://perma.cc/79KZ-WHNJ; Lockheed Martin Corp., *Corporate Governance Guidelines* (Apr. 25, 2019), https://perma.cc/A64R-BYJT.

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stakeholders as having an equal status as shareholders.[86] Among the twenty companies in the BRT Board Sample, only two companies have in place, and in fact had in place long before the BRT statement, corporate governance guidelines that follow a pluralistic approach to stakeholderism. However, these two companies—Cummins and International Paper Company—are incorporated in states with constituency statutes (Indiana and New York, respectively) and the language their guidelines use echoes the statutory language about stakeholders.[87]

Clearly, most of the companies in the BRT Board Sample have guidelines that are inconsistent with the intention of moving away from shareholder primacy. This pattern is instead consistent with the conclusion that the BRT statement was neither expected nor intended to produce major changes in the treatment of stakeholders.

E. Disregard of Legal Constraints

Finally, we will note yet another sign that the BRT signatories do not intend to adopt pluralistic stakeholderism. Remarkably, the statement does not discuss or even acknowledge the fact that public companies are subject to different state corporate laws, which vary significantly with respect to the power of directors and executives to embrace stakeholderism.

Most importantly, our review indicates that about 70% of the U.S. companies that joined the BRT statement are incorporated in Delaware, which is widely viewed as a state with strong shareholder-centric corporate law. A recent article by Leo Strine, who served as the chief justice of the Delaware Supreme Court at the time of the publication of the BRT statement, concludes that "a clear-eyed look at the law of corporations in Delaware reveals that, within the limits of their discretion, directors must make stockholder welfare their sole end,"[88] and that Delaware corporations can consider stakeholder interests "only as a means of promoting stockholder welfare."[89] Similarly, at a recent roundtable on the subject of Delaware law's approach to stakeholders, organized by Columbia Law School and Gibson

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[86] *See, e.g.*, Cisco Systems, Inc., Corporate Governance Policies (Aug. 1, 2019), https://perma.cc/GV7P-MCRK (mentioning, among the "overall corporate goals," "high customer satisfaction and superior employee working environment," but also requiring that "[n]ominees for the Board should be committed to enhancing long-term shareholder value").

[87] Cummins, *Corporate Governance Principles* (Feb 12, 2019), https://perma.cc/6CNV-EELU; International Paper Co., *Corporate Governance* Guidelines (Dec. 13, 2016), https://perma.cc/G54D-3QWK Interestingly, even companies incorporated in states with a constituency statute have corporate governance guidelines with strong shareholder-centric principles. *See, e.g.*, Lockheed Martin, *supra* note 85.

[88] Strine, *supra* note 12.

[89] *Id*.

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Dunn, the consensus of the participants was in line with Chief Justice Strine's view.[90]

Given the concerns about the compatibility of stakeholderism with Delaware law, Martin Lipton, one of the most vocal supporters of stakeholderism, co-authored a client memorandum that purports to address "a number of questions [that] have been raised about the legal responsibilities of directors in . . . taking into account . . . [stakeholder] interests."[91] What is most interesting about the memorandum is not what it includes but what it does not. The memorandum cautiously avoids opining that taking into account stakeholder interests beyond what would be useful for shareholder value is permissible under Delaware law, thus eluding a critical legal question.

Therefore, it seems likely that Delaware corporations (and therefore a substantial majority of the companies joining the BRT statement) may not balance the interests of shareholders and stakeholders, or at least would face significant legal issues if they explicitly chose to do so. For present purposes, however, what is most important is that neither the BRT nor the numerous Delaware companies that joined the BRT statement acknowledged or addressed this legal issue. This disregard of the issue is, once again, consistent with the view that the BRT statement was expected to be largely a rhetorical public relations move rather than an actual change in corporate strategy.

V. An Illusory Promise

In Part III we showed that the "enlightened shareholder value" version of stakeholderism (instrumental stakeholderism) is conceptually equivalent to the traditional shareholder primacy view and that implementing the other version (pluralistic stakeholderism) would face serious conceptual problems and indeterminacy. Still, pluralistic stakeholderism could in theory produce substantially different outcomes if corporate leaders were to use their discretion to protect stakeholders at shareholders' expense in a significant number of cases. In this Part, we examine whether pluralistic stakeholderism should be expected to lead corporate leaders to act in this way. We show that this is not the case.

In Sections A and B we analyze the incentives of directors and CEOs, respectively, and we demonstrate that they have incentives, and should be

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[90] Brea Hinricks, *Does (and Should) Delaware Law Allow "Long Term Stakeholder Governance"?* Colum. L. Sch. Millstein Center Blog, http://blogs.cuit.columbia.edu/millsteincenter/2019/06/26/does-and-should-delaware-law-allow-long-term-stakeholder-governance/.

[91] Martin Lipton et al., *Stakeholder Governance—Some Legal Points*, Harv. L. Sch. F. on Corp. Governance (Sept. 20, 2019), https://corpgov.law.harvard.edu/2019/09/20/stakeholder-governance-some-legal-points/.

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expected, to avoid serving stakeholder interests beyond what would be desirable for shareholder value. In Section C we present empirical evidence suggesting that corporate leaders in fact have not used their discretion to protect stakeholders when state constituency statutes have authorized them to do so. This evidence is consistent with, and reinforces, the conclusions of the incentive analysis in Sections A and B.

Finally, in Section D we examine whether the identified incentive problems could be addressed by supplementing stakeholderism with arrangements aimed at providing corporate leaders with significant incentives to protect stakeholders. Providing such incentives, we show, would require not only changes in executive pay arrangements but also giving stakeholders influence over the election of directors. Although such reforms are commonly not included in the proposals advanced by stakeholderists, we examine them and we show their limitations and considerable costs.

Before proceeding, we note that it might be argued that, even in the absence of economic incentives, stakeholderism would create internal corporate norms that would effectively lead corporate leaders to give independent weight to stakeholder interests.[92] However, the development of corporate rules and arrangements has long been based on the premise that incentives matter and that norms cannot by themselves be relied upon to ensure that corporate leaders would focus on socially desirable goals.

Were such norms sufficient, it would not have been necessary, for example, to award large executive pay packages designed to produce incentives to serve shareholders, as well as to provide shareholders with rights to vote and sue designed to mitigate the under-performance or opportunism of corporate leaders. Incentives play an important role in shaping the behavior of corporate leaders, and the incentives produced by corporate rules and arrangements have contributed substantially to the success of the business corporation. Thus, it is important to determine whether the incentives of corporate leaders would encourage or discourage managerial discretion to balance shareholder and stakeholder interests.

A. Director Incentives

1. Compensation

An important source of incentives for corporate directors is their

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[92] For a related discussion of whether norms could be relied on to induce investment managers to make stewardship decisions that would serve the interests of their beneficial investors, see Lucian A. Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy* 119 COL. L. REV. 2029, 2071-2072 (2019).

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compensation. Historically, the largest fraction of compensation for non-employee directors was represented by a fixed cash payment. [93] In recent times, however, companies have increasingly compensated directors with equity-based compensation to align their interests with those of shareholders. Under current compensation practices, 99% of S&P 500 companies give directors substantial equity compensation, mainly in the form of restricted or deferred stock.[94] Furthermore, equity pay represents more than half of total director compensation in S&P 500 companies.[95]

This practice is strongly considered a positive development for corporate governance, and it is supported by the two major proxy advisors, ISS and Glass Lewis. ISS's policies on director pay support "reasonable practices that adequately align the interests of directors with those of shareholders" and suggests that director compensation "should incorporate meaningful director stock ownership."[96] Glass Lewis typically "recommend[s] support for compensation plans that include option grants or other equity-based awards."[97] Both proxy firms favor fixed stock grants over performance-based equity plans.

The most conspicuous aspect to notice is that, while director compensation practices are designed to align the interests of directors with shareholder interests, they produce no alignment of director interests with the interests of stakeholders. This aspect of director compensation practices is supported by ISS and Glass Lewis, which do not even mention stakeholder welfare in their compensation guidelines.

To highlight the incentives produced by director compensation practices, we examine below these practices in twenty companies in the BRT Board Sample. We seek to determine whether these practices provide directors with any incentives to balance the interests of shareholders with those of stakeholders.

Table 2 describes the structure of director compensation in the twenty companies in the BRT Board Sample. The data in the table is based on our review of the 2019 proxy statements of these companies. Consistent with market practice, these companies pay non-executive directors a fixed cash

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[93] *See, e.g.*, Sanjai Bhagat, Dennis C. Carey & Charles M. Elson *Performance, and Management Turnover*, 54 BUS. LAW. 885, 886-88 (1999) (discussing the low level of stock ownership of directors in large public companies for most of the twentieth century).

[94] Rebecca Burton & Peter Kim, *Board Pay Under the Microscope*, HARV. L. SCH. F. ON CORP. GOVERNANCE (NOV. 17, 2019), https://corpgov.law.harvard.edu/2019/11/17/board-pay-under-the-microscope/.

[95] *Id.* (presenting evidence that in 2018 median outside director compensation for S&P 500 companies was $105,000 cash and $166,743 equity).

[96] Institutional Shareholder Services, *U.S. Compensation Policies: Questions & Answers* 23 (Dec. 6, 2019), https://perma.cc/TA7S-D65Q.

[97] Glass Lewis, *United States Guidelines* 44 (2019), https://perma.cc/J9LT-NDAJ.

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salary, additional fixed cash payments in connection with committee duties, and an equity award.

Importantly, equity compensation accounts for 56% of the average compensation of non-executive directors. These stock holdings are intended to provide directors with incentives to increase stock value. According to the proxy statements we reviewed, the level of both the fixed cash payments and the equity awards were determined based on the compensation practices at peer firms.

Whereas the above compensation practices align the interests of directors with those of shareholders, they in no way contribute to any alignment of interest between directors and stakeholders. Consistent with this shareholder-centric approach, in no case did the 2019 proxy statements of these companies mention stakeholders or stakeholder interests as criteria taken into consideration to determine or review the amount of cash or stock paid to directors.

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Table 2. 2018 Director Compensation in Companies with CEO on the BRT Board of Directors

Company	***Cash Retainer and Fees***	***Equity Comp.***	***% of Equity Comp.***
JP Morgan	$152,947	$250,000	62%
*General Motors**	$168,055	$126,073	43%
AECOM	$133,000	$160,008	55%
Oracle	$88,658	$444,566	82%
Eastman	$119,750	$85,073	42%
Duke Energy	$140,000	$160,000	53%
Johnson & Johnson	$130,556	$184,940	59%
United Technologies	$183,321	$180,000	50%
Lockheed Martin	$170,500	$155,000	48%
Cummins	$137,000	$149,885	52%
Stryker	$127,143	$175,121	58%
Walmart	$140,825	$174,970	55%
CVS Health	$102,918	$209,917	67%
Boeing	$144,167	$180,000	56%
S&P Global	$119,636	$150,000	56%
Cisco Systems	$130,000	$224,960	63%
IBM	$138,338	$195,000	58%
Marriott International	$95,667	$165,032	63%
AT&T	$152,917	$170,000	53%
International Paper	$140,942	$163,000	54%
Average	*$135,817*	*$182,577*	*56%*

This table reports director compensation as disclosed by the company in its annual proxy statement, filed with the SEC in 2019. The amount in each column is the average compensation paid to directors who served for the entire fiscal year. *Some directors chose to receive deferred stock units in lieu of part of their cash compensation.

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2. Labor and Control Markets

In addition to pay arrangements, labor and control markets are an important source of incentives for directors. Individuals serving on a board of directors are interested in retaining their position. In addition, they may wish to increase their chances to serve on the boards of other companies.

The effects of the labor and control markets on director decisions have long been studied in the corporate governance literature.[98] This literature has concluded that directors' interest in their current and future board positions provides them with strong incentives to be viewed favorably by, and not displease, both shareholders and the company's CEO.[99] The election of directors is usually dependent on being nominated by the board, which is normally influenced in this matter by the company's CEO. However, shareholders register their preferences by supporting or withholding support from the candidates nominated by the board and may actively propose their own candidates when they are sufficiently displeased.

Labor and control markets provide incentives for shareholder-friendly decisions in four different ways, each of which is supported by the empirical literature. First, building a shareholder-friendly reputation increases the chances for a director to keep their position and acquire other directorships. Jeffrey Coles and Chung Keung Hoi, for example, have found that, following the enactment of certain antitakeover provisions by the Pennsylvania legislature in 1990, non-executive directors who decided to opt out of some or all of these provisions were three times as likely, in the following three years, to acquire at least another external directorship as were directors who decided to keep all the antitakeover provisions.[100] And Yonca Ertimur, Fabrizio Ferri, and Stephen Stubben have found that directors implementing precatory proposals voted by a majority of shareholders are one-fifth less likely to lose their seat and other directorships.[101]

Second, a low shareholder value increases the likelihood of a successful proxy fight, resulting in some management-proposed directors losing the

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[98] For early important contributions, *see, e.g.*, Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980) (discussing how the managerial labor market disciplines directors and incentivizes them to enhance firm value); Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J. L. & ECON. 301 (1983) (discussing the disciplinary effect of the market for control)>

[99] For a recent economic analysis demonstrating this point, *see* Doron Levit & Nadya Malenko, *The Labor Market for Directors and Externalities in Corporate Governance*, 71 J. FIN. 775 775–76 (2016).

[100] Jeffrey L. Coles & Chun & Keung Hoi, *New Evidence on the Market for Directors: Board Membership and Pennsylvania Senate Bill 1310,* 58 J. FIN. 197, 198 (2003).

[101] Yonca Ertimur, Fabrizio Ferri, & Stephen R. Stubben, *Board of Directors' Responsiveness to Shareholders: Evidence from Shareholder Proposals*, 16 J. CORP. FIN. 53 (2010).

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election. A recent paper by Alon Brav and co-authors, for example, shows that mutual funds' support for dissident candidates in a contested election is higher when certain measures of shareholder value are lower.[102] An empirical study of proxy contests from 1996 to 2010 also shows that following a proxy contest, directors lose seats at targeted companies as well as in other companies. In the aggregate, the authors of the study estimate $1.3 - $2.9 million in forgone income for the median incumbent director.[103] Thus, a director who wants to minimize the chances of being targeted in a proxy contest, and possibly lose her position and other profitable job opportunities, has strong reason to pursue high shareholder value.

Third, a low stock price and poor performance for shareholders increase the likelihood of a takeover bid, which would threaten directors' positions. Alex Edmans, Itay Goldstein, and Wei Jiang present evidence that an interquartile decline in valuation leads to a 7% increase in acquisition likelihood, relative to a 6% unconditional takeover probability.[104] In addition, there is empirical evidence that a completed takeover has a negative financial impact on outside directors, who typically lose their seats and are less likely to acquire other directorships in the future.[105]

Finally, low shareholder value increases the chances of intervention by a hedge fund activist and, if the company is targeted, the likelihood that the hedge fund will obtain a settlement. There is considerable empirical evidence that the odds of activist engagement and the threat it poses are higher when stock returns have been lagging and metrics of shareholder value such as Tobin's q are low relative to industry peers.[106] Furthermore, a recent study co-authored by one of us shows that settlements with activists are associated with board turnover (an increase in the number of directors connected with or approved by activists and a decrease in the number of long-tenured directors) and that poor Tobin's q and stock returns increase the likelihood that the activist intervention will result in a settlement.[107]

The labor and control markets therefore provide directors with significant incentives to enhance shareholder value. To be sure, there are

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[102] Alon Brav et al., Picking Friends Before Picking (Proxy) Fights: How Mutual Fund Voting Shapes Proxy Contests 2–3 (unpublished working paper) (Mar. 2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3101473.

[103] Vyacheslav Fos & Margarita Tsoutsoura, *Shareholder Democracy in Play: Career Consequences of Proxy Contests*, 114 J. FIN. ECON. 316, 317 (2014).

[104] Alex Edmans, Itay Goldstein, & Wei Jiang, *The Real Effects of Financial Markets: The Impact of Prices on Takeovers*, 67 J. FIN. 933, 953–956 (2012).

[105] Jarrad Harford, *Takeover bids and target directors' incentives: the impact of a bid on directors' wealth and board seats*, 69 J. FIN. ECON. 51, 53 (2003).

[106] *See* Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1752 (2008).

[107] Lucian A. Bebchuk et al., *Dancing with Activists*, J. FIN. ECON. (forthcoming 2020) (on file with authors).

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studies indicating that directors also face incentives to be on the CEO's good side.[108] Thus, in those situations in which the interests of shareholders and the CEO do not coincide, the labor and control markets would require directors to trade-off and balance the competing goals of pleasing both shareholders and top management.[109]

What is clear, however, is that the labor and control markets do not provide directors with any incentives to protect or benefit stakeholders. Unlike shareholders and management, though, stakeholders play no role in, and have no power with respect to, the selection or removal of directors. They have no voting rights and no other tool to influence the election of directors. As a consequence, making choices that would benefit stakeholders would not improve directors' chances of retaining their position or obtaining positions on other boards. To the contrary, to the extent that certain stakeholder-friendly decisions would come at the expense of shareholders and managers, making these decisions could hurt directors' chances of retaining their positions.

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What we have shown in this Section is not intended to suggest that the interests of directors and shareholders are perfectly aligned. In fact, we believe that agency problems between shareholders and directors are significant, that director incentives are still insufficiently aligned with shareholder interests, and that shareholders' tools to monitor corporate decisions are weaker than is desirable. Specifically, there is substantial literature, including by one of us, on how to strengthen directors' incentives to be attentive to the interests of shareholders.[110]

However, while directors obtain some direct benefits from increases in shareholder value, they obtain no or little direct benefits from increases in stakeholder welfare. The literature has identified specific mechanisms that encourage shareholder-friendly decisions, and empirical studies have supported some of these hypotheses. In contrast, no such mechanisms are in place to incentivize directors to benefit stakeholders beyond what would be desirable for shareholder value.

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[108] For empirical findings consistent with the view that directors have incentives to please the CEO, *see, e.g.*, Christa H. S. Bouwman, *Corporate Governance Propagation through Overlapping Directors*, 24 REV. FIN. STUD. 2358 (2011) (presenting findings that companies controlled by management are more likely to appoint directors who have demonstrated management-friendliness in their previous position).

[109] For a theoretical model of this trade-off, *see* Levit & Malenko, *supra* note 99.

[110] *See, e.g.*, Lucian A. Bebchuk, *The Case against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973 (2002) (explaining that arrangements that facilitate hostile takeovers strengthen the incentives of directors to pay attention to shareholder interests); Bhagat, Carey & Elson, *supra* note 93 (discussing how stock ownership by directors strengthens such incentives).

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To be sure, it might sometimes be the case that directors prefer a certain outcome that is not in the interests of shareholders but is in the directors' own self-interest and that, coincidentally, this outcome may benefit employees or other stakeholders. But while there are factors that systematically tie the interests of directors and shareholders, there are no such factors with respect to the interests of stakeholders. Thus, an analysis of director incentives does not provide support for the hopes of the advocates of stakeholderism.

B. CEO Incentives

Like directors, CEOs have little or no incentive to ever favor stakeholders at the expense of shareholders. Many observations made above with respect to directors apply to CEOs as well. Furthermore, there are some additional elements that reinforce CEO incentives to avoid treating stakeholders better than what is called for by shareholder value maximization.

1. Compensation

The median CEO of the 500 largest companies in the United States receives nearly $12 million a year in compensation.[111] These large pay packages are intended to have a powerful influence on CEOs' behavior and decision-making.

A substantial fraction of this sum (48.5%) is paid in the form of restricted stock or units, whose eventual value is, by definition, fully driven by shareholder value.[112] An additional fraction of compensation (11.8%) is paid through stock options, which have an even greater sensitivity to stock value.[113] Furthermore, equity awards are often conditional on the achievements of performance goals that are based on measures of profit, revenues, cash flow, or shareholder return.[114] Therefore, more than 60% of the average CEO pay in large corporations is directly linked to shareholder value and provides strong incentives to enhance it.[115]

The second largest component of CEO pay for the largest companies is

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[111] Equilar, *CEO Pay Trends* 14 (2018). These and the other data points in this paragraph and the next refer to the companies included in the Equilar 500 index for the fiscal year 2017.

[112] *Id.* at 18.

[113] *Id.*

[114] Meridian Compensation Partners, *Trends and Development in Executive Compensation* 21 (2018) (presenting data from a survey of 127 companies).

[115] The compensation mix for CEOs of small companies looks quite different, with a much greater use of stock options. In 2018, CEOs of companies with revenues under $100 million, for example, received 43% of their total pay in stock options, 25% in fixed salary, 15.7% in stock awards, and 14% in cash bonuses. The Conference Board, *CEO and Executive Compensation Practices* 18 (2019).

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cash bonuses.[116] Most firms grant bonuses on the basis of a performance-based plan, which identifies qualitative and quantitative goals to achieve. The vast majority of these goals, in turn, are financial metrics that are relevant to performance for shareholders such as profit, revenues, capital efficiency, total shareholder return, and cash flow. According to a recent report by the Conference Board, only 77 Russell 3000 companies (that is, 2.6% of the total) use nonfinancial metrics to award bonuses.[117]

A minority of public companies use discretionary bonuses, which are not based on criteria known in advance but rather determined *ex post* at the discretion of the board of directors or its compensation committee. As discussed in the preceding Section, directors have incentives to be favorably viewed by shareholders and top managers. Thus, discretionary bonuses should be expected to incentivize shareholder-friendly decisions or to provide little incentive at all, depending on the weight directors attach to shareholder interests relative to the interests of managers; they should not be expected, however, to give CEOs any incentive to attach independent value to stakeholder benefits.

To examine the effects of CEO pay in more detail, we reviewed the 2019 proxy statements of the companies in the BRT Board Sample. Table 3 presents a summary of CEOs' total compensation, the level of compensation for each main component (salary, bonuses, and equity incentives), and the fraction of total compensation that is linked to the performance of the company.

As the table shows, a very large fraction of CEO compensation—91% on average—is linked to performance. This kind of compensation takes many shapes, including stock-based compensation and bonuses. The realization value of stock compensation is intrinsically linked to shareholder value, and bonuses are based on the achievement of performance goals that are largely related to financial performance.

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[116] In 2017, bonuses represented 23.3% of the average CEO compensation in the Equilar 500 companies. Equilar, *supra* note 111, at 18.

[117] The Conference Board, *supra* note 115, at 27.

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Table 3. 2018 Compensation of CEOs on the BRT Board

Company (CEO)	***Salary***	***Bonus***	***Equity***	***PBC***
JPMorgan (Dimon)	$1,500,000	$5,000,000	$23,000,000	95%
General Motors (Barra)	$2,100,000	$4,452,000	$14,506,766	90%
AECOM (Burke)	$1,466,357	$2,475,000	$11,307,440	90%
*Oracle (Catz & Hurd)**	$950,000	-	-	95%
Eastman (Costa)	$1,226,110	$1,540,625	$12,592,479	90%
Duke Energy (Good)	$1,350,000	$2,268,961	$9,873,135	90%
Johnson & Johnson (Gorsky)	$1,642,308	$3,570,497	$14,625,057	91%
United Technologies (Hayes)	$1,575,000	$3,500,000	$12,044,070	91%
Lockheed Martin (Hewson)	$1,769,262	$8,758,727	$9,788,097	90%
Cummins (Linebarger)	$1,442,500	$6,574,400	$4,510,275	87%
Stryker (Lobo)	$1,194,833	$2,709,720	$9,592,795	91%
Walmart (McMillon)	$1,276,892	$5,088,000	$15,592,404	94%
CVS Health (Merlo)	$1,630,000	$2,605,000	$13,499,942	91%
Boeing (Muilenburg)	$1,700,000	$13,076,350	$7,330,916	90%
S&P Global (Peterson)	$1,000,000	$2,047,000	$8,820,000	90%
Cisco Systems (Robbins)	$1,325,000	$5,795,550	$18,576,568	94%
IBM (Rometty)	$1,600,000	$4,050,000	$10,801,392	92%
Marriott Int'l (Sorenson)	$1,300,000	$2,925,000	$8,429,788	90%
AT&T (Stephenson)	$1,800,000	$5,192,000	$17,069,774	93%
International Paper (Sutton)	$1,433,333	$3,364,700	$9,821,775	89%
Average	*$1,464,080*	*$4,473,344*	*$12,199,088*	*91%*

This table reports CEO compensation as disclosed by the company in its annual proxy statement, filed with the SEC in 2019. Column "PBC" reports the fraction of performance-based compensation over the total compensation. *Performance goals for cash and equity incentives were not achieved.

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In only three cases—those of Eastman, Duke Energy, and Marriott International—is the bonus linked to a quantified stakeholder metric, and even then in a rather limited way. In the case of Eastman, the annual bonus is determined on the basis of various corporate and individual performance goals that include three measures of employee safety, but no specific weighting is assigned to the various metrics; therefore, the compensation committee has broad discretion in deciding how each of these aspects affects compensation.[118]

At Marriott, the metrics determining the CEO's annual bonus include satisfaction of employees and guests (as measured by external surveys), but the weights of these stakeholder metrics on the total CEO compensation are negligible: 1% and 2%, respectively.[119] At Duke Energy, the annual bonus is partly linked to three stakeholder metrics, with two of them getting negligible weights of 0.5% (environment) and 1.6% (customer satisfaction) and only the metric related to employee safety getting a meaningful weight of 19%.[120]

Note that, even in these three cases, the metrics refer only to some groups of stakeholders and to significant but limited aspects of their welfare. With respect to employees, the metric is limited to safety, which could have implications for financial performance, but does not take into account key aspects of employee welfare such as pay, benefits, or job protection. With respect to the environment, the metric adopted by Duke Energy concerns "reportable events" that require notification to or enforcement action by a regulatory agency—which again could have implications for the company's financial performance—but ignores other kinds of environmental events and the general environmental impact of the firm.[121]

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[118] In particular, the company established specific goals for (a) days away from work per 200,000 hours worked; (b) number of injuries that must be reported to the Occupational Safety and Health Administration per 200,000 hours worked; and (c) process safety incident rate. Eastman Chemical Company, 2019 Proxy Statement (Schedule 14A) 44 (Mar. 19, 2019).

[119] The quantitative goals are not explicitly indicated in the proxy materials, but it seems that bonus payments are determined on the basis of quantified objectives. Marriott International, Inc., 2019 Proxy Statement (Schedule 14A) 40 (Apr. 10, 2019).

[120] Specifically, the target goals concern the incident rate for employees and contractors, the number of environmental events reportable to authorities, and the results of internal and external consumer satisfaction surveys. Duke Energy Corp., 2019 Proxy Statement (Schedule 14A) 42-43 (Mar. 21, 2019).

[121] *Id.* Several companies in the sample mention the welfare of employees or other stakeholders as a generic corporate value or performance goal in the proxy statement's discussion and analysis of the company's executive compensation. In all of these cases, however, there is no specification of how stakeholder interests affect the choices that are made at the discretion of the compensation committee. As we discussed in the preceding Section, independent directors serving on the compensation committee should not be expected to encourage CEOs to provide stakeholders with any benefits that would come at the expense of shareholders.

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Such a shareholder-centric pattern is unsurprising. In setting executive pay arrangements, directors seek to avoid shareholder disapproval that could result in a relatively low "say-on-pay" vote. And shareholders and their proxy advisors are interested in performance for shareholders.

The quantitative model used by the largest proxy adviser, ISS, to assess executive compensation in public companies is based entirely on financial metrics connected with shareholder value. Specifically, ISS uses four different measures, over periods of one, three, or five years, to evaluate the alignment of executive pay with corporate performance.[119a] Two of the three primary measures are based on total shareholder return, while the third is a measure of compensation relative to the median compensation among comparable firms.[119b] The fourth measure is a combination of four metrics based on "economic value added"—that is, net operating profit before taxes, less cost of capital.[122] None of these metrics register the effects of corporate decisions on stakeholder welfare.[123]

In brief, actual compensation practices (including those at the companies whose CEOs sit on the board of directors of the BRT), and the evaluation of these practices by shareholders and proxy advisors, are strongly focused on shareholder value.[124] Thus, executive pay arrangements, and their evaluation by shareholders and proxy advisors, provide executives with incentives not to ever sacrifice shareholder value to provide benefits to stakeholders.

[119a] Institutional Shareholder Services, *Pay-For-Performance Mechanics* 3–4 (United States) (Dec. 11, 2019).

[119b] *Id.* at 5–6.

[122] *Id.* at 6–7. Until 2019, GAAP-based measures were used instead of economic value added measures, namely return on invested capital, return on assets, return on equity, EBITDA growth, and cash flow growth. Institutional Shareholder Services, Pay-For-Performance Mechanics (United States) (Feb. 2019).

[123] Glass Lewis, the main competitor of ISS, does not disclose the details of the metrics used for its evaluation of compensation packages.

[124] The current sentiment is described by the law firm of Wachtell, Lipton, Rosen & Katz in a recent memorandum:

> We find that company boards are deeply engaged in [environmental, social, and governance (ESG)] issues and expect that there will be an increased focus on these matters through shareholder proposals and requests for disclosure in the coming years. We do not currently expect to see the use of ESG measures as stand-alone performance goals in incentive programs (other than in a unique circumstance where such a measure is integral to business performance), although ESG-type goals may be used for purposes of the qualitative or individual performance aspect of incentive awards or as a modifier within specified parameters.

Jeannemarie O'Brien et al., *Compensation Season 2020*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 23, 2020), https://corpgov.law.harvard.edu/2020/01/23/compensation-season-2020/.

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2. Labor and Control Markets

As was shown in Section V.A to be the case with respect to directors, value-enhancing decisions increase the likelihood of CEOs keeping their jobs or finding similar jobs with other companies. By contrast, poor stock price performance increases the likelihood of CEOs being replaced. As a result, CEOs who care about their job and job market prospects have strong incentives not to protect stakeholders beyond what would be useful for shareholder value maximization.

The theoretical reasons underlying these points are similar to those discussed with respect to director incentives. Shareholder discontent with performance may put pressure on the board to replace the CEO or may lead to hedge fund intervention or even a proxy fight. At the same time, providing stakeholders with only what would be useful for shareholder value maximization would not have any such consequences.

The analysis above is consistent with a large body of empirical work. To begin with, the empirical literature on CEO turnover confirms that poor stock performance is associated with CEO turnover. Steven Kaplan and Bernadette Minton, for example, have found that CEO turnover—both internal (decided by the board) and external (resulting from a takeover or bankruptcy) is significantly related to stock performance.[125] A subsequent study by Dirk Jenter and Katharina Lewellen estimates that total turnover probabilities for CEOs increase significantly as industry-adjusted stock returns decrease.[126] The rich literature on this topic presents different estimates of the economic significance of the correlation between firm performance and CEO turnover, as well as different findings regarding the relative importance of the company's industry-adjusted stock performance. There is, however, a solid consensus that CEOs who are successful in increasing shareholder return are more likely to keep their jobs.[127]

Furthermore, the above analysis is consistent with the empirical evidence

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[125] Steven N. Kaplan & Bernadette A. Minton, *How Has CEO Turnover Changed?*, 12 INT'L. REV. FIN. 57,58 (2012).

[126] Dirk Jenter & Katharina Lewellen, Performance-Induced CEO Turnover (working paper) 1–2 (June 2019), at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1570635.

[127] For studies contributing to the literature and this consensus, *see, e.g.*, Jeff Brookman & Paul D. Thistle, *CEO Tenure, the Risk of Termination and Firm Value*, 15 J. CORP. FIN. 331, 332 (2009) (finding that stock returns are positively correlated with tenure); Dirk Jenter & Fadi Kanaan, *CEO Turnover and Relative Performance Evaluation*, 70 J. FIN. 2155, 2155–56 (2015) (finding that directors fire CEOs for bad stock performance but are not particularly effective in screening out the effects due to industry or market negative shocks); Andrea L. Eisfeldt & Camelia M. Kuhnen, *CEO Turnover in a Competitive Assignment Framework*, 109 J. FIN. ECON. 351, 352 (2013) (proposing a competitive assignment model and finding that CEO turnover probabilities increase in negative absolute and relative performance, measured as stock returns and return on assets).

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on hedge fund activism. As pointed out with respect to director incentives, a poor shareholder return increases the chances of an engagement by an activist hedge fund, of the company's being forced to enter into a settlement agreement with the activist, and of the activist's winning a proxy contest.[128]

Finally, a study by C. Edward Fee, Charles Hadlock, and Joshua Pierce shows that losing a CEO position has a negative effect on subsequent employment prospects. The researchers document that, when CEOs find new executive employment in other firms, the new positions "tend to be substantially inferior to prior positions measured along a variety of dimensions."[129] This effect operates to strengthen CEOs' interest in retaining their position, and this interest is served by avoiding any decisions that would benefit stakeholders at the expense of shareholders.[130]

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To be sure, the analysis above and the evidence supporting it do not indicate that the interests of CEOs and shareholders generally overlap.[131] In fact, the private interests of CEOs introduce agency problems and produce in some situations a significant divergence between the interests of CEOs and shareholders. Notwithstanding these agency problems, there is at least a robust link and substantial alignment between CEO and shareholder interests. As a result, CEOs have strong incentives to take the interests of shareholders very seriously.

In contrast, no such link exists between CEO interests and stakeholder interests. Consequently, CEOs do not have incentives to regard stakeholder interests as an independent end. With strong incentives to care about shareholder value, and little incentive to care about stakeholder interests, CEOs are discouraged from making any decisions that would benefit or protect stakeholders beyond what would be necessary for shareholder value maximization. Thus, once the actual structure of incentives is taken into account, there is no basis for stakeholderist claims and hopes that CEOs

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[128] *See* studies cited *supra* notes 106-107.

[129] C. Edward Fee et al., *New Evidence on Managerial Labor Markets: An Analysis of CEO Retreads*, 48 J. CORP. FIN. 428, 429 (2018).

[130] Another empirical study that is worth noting is Taekjin Shin & Jihae You, *Changing Words: How Temporal Consistency in a CEO's Use of Language toward Shareholders and Stakeholders Affects CEO Dismissal*, 28 CORP. GOV. INT'L. REV. 47, 48 (2020). This study documents that CEO interests are advanced by using shareholder-centric language, rather than a stakeholder-oriented language in their annual letters to shareholders. The researchers found that, controlling for CEO characteristics and shareholder return, CEOs who use consistently shareholder-centric rhetoric are less likely to be replaced than those who use stakeholder-oriented language.

[131] *See supra* note 110 and accompanying text.

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would use their discretion in such a stakeholder-friendly way.[132]

C. Have Corporate Leaders Used Discretion to Protect Stakeholders?

We have thus far shown that directors and executives have incentives not to provide stakeholder benefits that would come at the expense of shareholders. We now turn to examine whether the past behavior of corporate leaders has been consistent with the conclusions of our incentive analysis.

Acquisitions of companies in states with constituency statutes provide a good laboratory for examining this question. As discussed in Section II.A, most U.S. states passed constituency statutes, mainly during the late 1980s and early 1990s. Justified as a tool for protecting stakeholders from the adverse effects of acquisitions, these statutes authorize corporate leaders to take into account the interests of stakeholders and not only of shareholders. Thus, examining whether corporate leaders indeed used their discretion to protect stakeholders can inform any assessment of whether stakeholderism can be expected to benefit stakeholders.

We have therefore set out to investigate the universe of all significant acquisitions of companies incorporated in a state with a constituency statute. The patterns we observe in this research are that, consistent with our incentive analysis above, corporate leaders negotiating a sale of their company used their power to bargain for benefits to shareholders, as well as for top executives and directors, but bargained very little for stakeholders.

To illustrate these patterns we present below evidence regarding the terms of the ten largest transactions from 2010 to 2019 in which private equity firms acquired a public company incorporated in any of the twenty-eight states with a constituency statute that does not provide opt-in or opt-out

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[132] It might be argued that, even if corporate leaders have an interest to give weight to shareholder interests but little incentive to give independent weight to stakeholder interests, to the extent that some shareholders have certain pro-stakeholder preferences, the incentive to attach weight to shareholder interests might also provide corporate leaders with incentives to give weight to these pro-stakeholder preferences. For an analysis that relies on the presence of such pro-stakeholder preferences on the part of some shareholders, *see* Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J. L. FIN. & ACCT. 247, 248–49 (2017). However, the current incentives of directors and executives, as shown in this Section, encourage corporate leaders to give independent weight only to the financial interests of shareholders. For example, director and executive pay arrangements tie their payoffs to shareholders' financial return but not to the satisfaction of any pro-stakeholder preferences of shareholders. We note that even Hart & Zingales doubt that corporate managers have incentives to benefit stakeholders beyond what would maximize share value, and therefore focus on binding shareholder voting on social and environmental proposals as a potential mechanism for implementing pro-stakeholder preferences that shareholders might have. *See id*. at 258-261.

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mechanisms.[133]

We focus on acquisitions by private equity firms because such acquisitions clearly pose risks for stakeholders that corporate leaders concerned about stakeholder welfare should consider. Private equity acquisitions move companies into the hands of managers with high-powered incentives to cut costs and maximize shareholder value. Indeed, a recent comprehensive study shows that a private equity acquisition reduces employment in public companies by 13%.[134] Thus, even though not all private equity acquisitions necessarily harm employees, they clearly pose potential risks to stakeholders, and corporate leaders authorized to protect stakeholders have strong reasons to negotiate protections that would address such risks.

Table 4 lists the ten transactions and some key aspects of them. As the table indicates, in all these transactions there is evidence that the target company's leaders followed a process intended to obtain good contractual terms (see last column). In some cases, the negotiation started with an offer put forward by a given buyer, and in other cases there was a competitive process in which several potential buyers presented competing offers.

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[133] We exclude companies incorporated in a state with an opt-in or opt-out constituency statute in order to ensure that the companies in our sample are governed by the constituency statute. The FactSet M&A dataset that we use to identify the transactions for our empirical investigation defines a private equity acquisition as any acquisition by a private equity firm or by a buyer backed by a private equity sponsor (owning an interest in the acquirer of at least 15%).

[134] Steven J. Davis et al., The Economic Effects of Private Equity Buyouts 2, NBER Working Paper 26370 (October 2019), https://www.nber.org/papers/w26371.pdf.

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Table 4. 10 Largest Private Equity Acquisitions Subject to Constituency Statutes

Target	**Year**	**State of Inc.**	**Value (Billions)**	**Bargaining Process**
EMC	2015	Massachusetts	$64.7	Improved offer
Heinz	2013	Pennsylvania	$27.2	Improved offer
Kinetic Concepts	2011	Texas	$5.7	Improved offer
Parexel	2017	Massachusetts	$4.9	Competitive process
Life Time Fitness	2015	Minnesota	$4.1	Competitive process
Buffalo Wild Wings	2017	Minnesota	$2.8	Price negotiation
ClubCorp	2017	Nevada	$2.5	Competitive process
Multi-Color	2019	Ohio	$2.5	Improved offer
The Jones Group	2013	Pennsylvania	$2.2	Competitive process
American Railcar Industries	2018	North Dakota	$1.8	Terms negotiation

This table reports the ten largest acquisitions by private equity buyers or by strategic buyers backed by private equity sponsors, from 2010 to 2019, in a state with a constituency statute in force at the time of the transaction without an opt-in or opt-out feature, Data were collected from the FactSet M&A database. The "Year" column shows the year when the merger agreement was signed. The "Value" column shows the transaction value in billions. The "Bargaining Process" column summarizes the most significant evidence that target's corporate leaders sought favorable terms for the transaction.

Table 5 reports the benefits obtained by shareholders, top executives, and directors in each of the transactions. To begin with, shareholders obtained large monetary benefits. Premia for shareholders, compared to the unaffected stock price before the deal was announced, had a mean of 25% and a median of 22%.

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Table 5. Main Benefits for Shareholders, Top Executives, and Directors

Target	***Premium***	***Benefits to Top Executives***	***Benefits to Directors***
EMC	23.46%	▪ Gains from stock/options ▪ Severance/parachutes ($32M) ▪ Employment for 6 execs	Gains from stock/options
Heinz	19.87%	▪ Gains from stock/options ▪ Severance/parachutes ($70M) ▪ Employment for 9 execs	Gains from stock/options
Kinetic Concepts	6.22%	▪ Gains from stock/options ▪ Severance/parachutes ($60M)* ▪ Employment for CEO	Gains from stock/options
Parexel	27.94%	▪ Gains from stock/options ▪ Employment for 13 execs	Gains from stock/options
Life Time Fitness	73.32%	▪ Gains from stock/options ▪ Severance/parachutes ($47M)* ▪ Employment for CEO	Gains from stock/options
Buffalo Wild Wings	32.10%	▪ Gains from stock/options ▪ Severance/parachutes ($14M)*	Gains from stock/options
ClubCorp	30.69%	▪ Gains from stock/options ▪ Severance/parachutes ($27M)*	Gains from stock/options
Multi-Color	16.33%	▪ Gains from stock/options ▪ Severance/parachutes ($42M)* ▪ Advisory contract for CEO	Gains from stock/options
The Jones Group	3.23%	▪ Gains from stock/options ▪ Severance/parachutes ($71M)*	Gains from stock/options
American Railcar Industries	51.22%	▪ Gains from stock/options	Gains from stock/options

This table summarizes the main contractual benefits for shareholders (premium compared to unaffected stock price), top executive officers identified in deal filings, and directors. The term "severance/parachutes" includes severance payments, golden parachutes, and other transaction-related payments negotiated with the buyer or negotiated ex ante in anticipation of a future sale. *Missing data on continuing/discontinued executives: the amount represents the total potential payments to executives discontinued upon completion of the merger or within a specified period after the merger.

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Top executives also were provided with considerable benefits in each of the transactions. Because the executives had substantial equity holdings as a result of compensation practices, they made substantial gains from the premia paid for their equity holdings. In addition, in eight out of the ten transactions, top executives obtained substantial transaction-related payments, exceeding $45 million per transaction on average, from golden parachutes and severance arrangements. Furthermore, in five out of the ten cases, the CEO or a group of several executives obtained a contractual commitment to hold a managerial role in the company after the acquisition, and in a sixth case the CEO obtained a contract to serve as an advisor post-acquisition. Finally, the transactions also made all the directors better off. In each of the ten cases, the directors made significant monetary gains from the equity holdings they had as a result of their compensation.

Table 6 turns to how stakeholders fared, and here the picture is quite different. To begin with, consider customers and suppliers, which are specifically referred to as constituencies in the states of incorporation of nine of the ten acquired companies. In each of the acquisitions, the transaction documents provide no protections whatsoever for these two groups.

As to local communities, despite the potentially disruptive effects of a private equity acquisition, in eight out of the ten cases, the transaction documents provide no protection or benefits in this respect. In two cases, EMC and Heinz, the agreements include a "soft" promise to maintain the current location of headquarters.

We consider this commitment to be soft for two reasons. First, there is no contractual definition of "headquarters," nor a detailed specification of what minimum assets, employees, or operations must be maintained in Massachusetts (EMC) or Pittsburgh (Heinz) in order to keep the promise. On the contrary, the language of this covenant is very short and underspecified, unlike the detailed and highly specified clauses that regulate payments and obligations to shareholders and top executives. In addition, the agreement does not enable local authorities or other interested parties to enforce compliance with the commitment. In fact, the agreement contains an unqualified provision that excludes any rights of action by third-party beneficiaries except those specifically identified in the agreement. Therefore, no one would have had standing to sue the buyer in the event it chooses to retain no assets or employees in the pre-transaction location of the company's headquarters.[135]

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[135] In one case (Heinz), the acquirer also committed to maintain the existing philanthropic activity in a manner consistent with past practice. However, the provision does not specify what such consistency with past practices would require and, in any event, does not allow any potential beneficiary to enforce this provision.

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Table 6. Main Benefits for Stakeholders

Target	*Benefits to Stakeholders*			
	Employees	***Community***	***Suppliers/ Customers***	***Others***
EMC	Transition clause	▪ HQ in Mass.	None	None
Heinz	Transition clause	▪ HQ in Pittsburgh ▪ Philanthropy	None	None
Kinetic Concepts	Transition clause	None	None	None
Parexel	Transition clause	None	None	None
Life Time Fitness	Transition clause	None	None	None
Buffalo Wild Wings	Transition clause	None	None	None
ClubCorp	Transition clause	None	None	None
Multi-Color	Transition clause	None	None	None
The Jones Group	Transition clause	None	None	None
American Railcar Industries	Transition clause	None	None	None

This table summarizes the main contractual covenants of the buyer in favor of employees, local communities in which the company operates, suppliers or customers, and other groups of stakeholders.

Finally, with respect to employees, all the agreements have a transition provision that we view as cosmetic. The provision requires the buyer to maintain for a transition period of six to eighteen months the same compensation and benefits for employees who continue working for the company. However, these clauses explicitly exclude any right for the employees to sue the buyer or the surviving company for a violation of the provision.

Furthermore, and importantly, the effect of the provision is limited to

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continuing employees, and the agreements do not limit in any way the freedom of the acquirer to discontinue the employment of any employees it chooses to fire, and does not secure any benefits to employees that would be fired. Finally, the agreement does not constrain the acquirer in any way from worsening the employment terms of long-standing employees after the short transition period.

It is important to note that, if the corporate leaders negotiating the transactions were interested in providing employees or other stakeholders with enforceable rights, this could have been done in the same way as for other third-party beneficiaries. For example, in the ten transactions examined, executives who continued their employment with the acquirer obtained enforceable contractual rights under separate agreements, and directors and officers obtained explicitly enforceable rights with respect to the obligation of indemnification and exculpation undertook by the acquirer.

In each of the ten transactions analyzed above, corporate leaders could have allocated gains from the transactions differently to obtain meaningful protections for stakeholders. For example, the negotiators could have conditioned the decision to sell the company on receiving some substantial protections for stakeholders, such as enforceable hard limits on layoffs, or enforceable benefits to employees whose positions would be discontinued. However, corporate leaders chose not to use their bargaining power in this way, notwithstanding the constituency statutes in force explicitly authorizing them to do so. Thus, the above evidence is consistent with our earlier conclusion that corporate leaders have incentives not to provide stakeholders with any benefits that would come at the expense of shareholders—and that corporate leaders should thus be expected not to use their discretion to provide stakeholders with any such benefits.

D. Fixing Incentives?

Stakeholderists commonly advocate giving corporate leaders discretion to protect stakeholders while otherwise retaining basic corporate law rules. We have therefore examined in the preceding sections how corporate leaders should be expected to use such discretion, and how they have in fact used it in the past, under the existing systems of incentives. However, it might be argued that, even if stakeholderism as commonly proposed would not deliver material benefits for stakeholders, it would be possible to increase stakeholder welfare by supplementing standard stakeholderism with additional arrangements that would substantially alter the incentives of corporate leaders.

According to this possible view, it would be desirable to adopt arrangements that would align the interests of corporate leaders with those of stakeholders and thereby incentivize leaders to deliver value to stakeholders.

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Although a comprehensive analysis of all the possible designs of such an approach is beyond the scope of this Article, we briefly explain in this Section the challenges and difficulties with which any attempt to develop such an approach would have to wrestle. In particular, we discuss below both (i) how difficult it would be to design arrangements that would incentivize corporate leaders to focus on the aggregate interests of all corporate constituencies, and (ii) the substantial costs that such arrangements would likely produce.

1. Redesigning Executive Pay?

It is natural to begin this discussion with the design of executive and director pay. In Sections A and B we discussed how compensation practices commonly tie the payoffs of corporate leaders directly to shareholder value but not to stakeholder welfare. However, stakeholderists have expressed support for redesigning pay arrangements,[136] and compensation consultants have publicly discussed the possibility of substantial incorporation of stakeholder metrics in pay arrangements.[137] As explained below, however, such changes in pay arrangements should not be expected to enable stakeholderism to produce its purported benefits for three reasons.

First, it would be rather difficult to design pay schemes that would serve well the goals of stakeholderism. Designing schemes that tie payoffs to the interests of shareholders is itself far from straightforward even though the interests of shareholders are relatively well-defined and measurable.[138] Because the interests of some stakeholders are difficult to fully define and accurately measure, tying payoffs to the aggregate interests of all the relevant constituencies of a company would likely be orders of magnitude more challenging.

For some constituencies, there would be no available metric that could

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[136] *See, e.g.*, World Economic Forum, *Why We Need The 'Davos Manifesto' for a Better Kind of Capitalism* (Dec. 1, 2019), https://www.weforum.org/agenda/2019/12/why-we-need-the-davos-manifesto-for-better-kind-of-capitalism/ ("Since the 1970s, executive pay has skyrocketed, mostly to "align" management decision-making with shareholder interests. In the new stakeholder paradigm, salaries should instead align with the new measure of long-term shared value creation.").

[137] For recent posts by compensation advisors discussing such redesign of pay arrangements, *see, e.g.,* Seymour Burchman, *A New Framework of Executive Compensation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 13, 2020), https://corpgov.law.harvard.edu/2020/03/13/a-new-framework-for-executive-compensation/; *and* Don Delves & Ryan Resch, *Stakeholder Capitalism and Executive Compensation,* HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 2, 2019), https://corpgov.law.harvard.edu/2019/10/02/stakeholder-capitalism-and-executive-compensation/.

[138] For a discussion of the complexities of such design, *see*, Lucian A. Bebchuk & Jesse M. Fried, *Paying for Long-Term Performance*, 158 U. PA. L. REV. 1915, 1919 (2010).

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reliably and effectively measure the company's effects on their welfare. For example, even if a company were to focus solely on the effects of its decisions on climate change, it would have to choose among competing metrics that were developed by different organizations and that often lead to considerably different estimates of the company's climate change impact.[139] And climate changes effects might represent only part of the environmental effects of a company.

Similarly, it would be difficult to develop quantitative metrics that would measure with reasonable accuracy a company's effects on all of its suppliers, or its effects on all relevant communities, or its aggregate effects on the company's various types of customers. Note that tying compensation to the interests of one group of stakeholders but not to the interests of a second relevant group of stakeholders might strengthen, not weaken, the incentive of corporate leaders not to give independent weight to the interests of the second group.

Furthermore, even if reliable metrics were available for each of the relevant groups of stakeholders, the formidable challenge of combining them would remain. What weight would be given to each of the metrics? As discussed in Section III.B, stakeholderists have largely avoided proposing ways for aggregating the interests of all stakeholders, leaving this decision to the discretion of corporate leaders. Any attempt to design pay arrangements that would induce corporate leaders to serve all stakeholders would require the adoption of some methodology for aggregating and balancing the interests of the various constituencies.

Second, corporate leaders might have private interests in setting pay arrangements that would enhance their own pay.[140] For this reason, policymakers have long paid attention to how pay is determined, including by mandating independent compensation committees and say-on-pay votes.[141] Since identifying and incorporating stakeholder metrics into pay arrangements would involve substantial discretionary choices, executives and their advisors would have the opportunity to influence pay-setting in

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[139] For an analysis of different metrics used by public companies to measure corporate sustainability and the problem of their comparability, *see* Sustainability Accounting Standards Board (SASB), THE STATE OF DISCLOSURE 11–16 2016. For a discussion of the lack of standardization in sustainability metrics and data developed by data providers, *see* Jennifer Bender et al., *A Blueprint for Integrating ESG into Equity Portfolios*, 16 J. INVESTMENT MGMT. 44 (2018).

[140] For a discussion of the agency problems generally afflicting the setting of executive pay arrangements, see Bebchuk & Fried, PAY WITHOUT PERFORMANCE, *supra* note 110, at 80-86.

[141] For a discussion of these two mandates, s*ee* Securities Act Release No. 9199, Securities Exchange Act Release No. 64149 (March 30, 2011), 76 FR 18966 (April 6, 2011) *and* Securities Act Release No. 9330, Securities Exchange Act Release No. 67220 (June 20, 2012), 77 FR 38422 (June 27, 2012).

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ways that would favor executives' private interests.

For example, executives might choose stakeholder-related targets that are expected to be reached anyway or are inconsequential, thus increasing executive pay while contributing little to stakeholder welfare and weakening the link of pay with performance. Thus, we have to recognize the risk that the primary effect of the advocated redesign of executive pay would be to increase executive payoffs and weaken performance incentives.

Third, as long as shareholders exclusively have voting rights, effective oversight of how well pay arrangements incentivize maximizing the aggregate welfare of all constituencies would likely be lacking. Independent directors elected by shareholders would have limited incentives to oversee and shape effective executive pay arrangements that provide strong stakeholderist incentives. Similarly, shareholders casting say-on-pay votes could be more interested in how pay arrangements would affect their own interests rather than those of stakeholders. Therefore, shareholders and independent directors elected by them should not be expected to encourage or monitor the adoption of stakeholder-related metrics with the same effectiveness that they have thus far done with respect to shareholder-related metrics.

Finally, as long as shareholders have the exclusive power with respect to director elections, labor and control markets will provide both directors and executives with strong incentives not to benefit stakeholders beyond the point that would best serve shareholder value maximization. Thus, without major changes in how corporate directors are appointed, the incentives of corporate leaders would retain a significant pro-shareholder tilt.

2. Changing How Directors are Elected?

Supporters of stakeholderism have thus far largely accepted shareholders' exclusive voting power as a received premise.[142] Below, however, we examine the possibility of advancing the interests of stakeholders by providing them with voting rights with respect to director elections. For example, a widely discussed recent bill would reserve some seats on U.S. corporate boards to labor representatives,[143] similarly to what

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[142] For discussions by supporters of stakeholderism accepting this premise, *see, e.g.*, Martin Lipton & William Savitt, *Stakeholder Governance—Issues and Answers*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 25, 2019),https://corpgov.law.harvard.edu/2019/10/25/stakeholder-governance-issues-and-answers/ ("Insightful commentators accurately emphasize that shareholders alone enjoy the corporate franchise, and with it the power to select directors.").

[143] The Accountable Capitalism Act, S. 3348, 115th Cong. (2018). For discussion of this bill, *see* David J. Berger, *Reconsidering Stockholder Primacy in an Era of Corporate*

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some European countries mandate for large corporations.[144] Since stakeholderists view employees as only one group of stakeholders, let us consider the possibility of enabling all corporate constituencies to participate in the election of directors.

One approach would be to have each corporate constituency elect a subset of the company's directors who would then represent its perspective and interests. An alternative approach would be to have all stakeholder groups participate together with shareholders in the election of all directors. To conserve space, we will only discuss below several serious problems that would afflict the latter approach, but the former approach would suffer from similarly severe problems.

First, note that if any significant group of stakeholders does not get its "own" subset of directors, then no director would have an incentive to give independent weight to the interest of this stakeholder group. Assuming that all stakeholder groups will get representation, however, raises the difficult question of how many directors to allocate to each constituency—shareholders, employees, customers, suppliers, and so on. How will the allocation be determined in the case of each company and through what process?

Second, it would be difficult to design an effective method to allow some stakeholder groups to elect their representatives. This would be especially so for those groups that are dispersed, uninformed, or ever-changing. How will customers or suppliers elect their respective representatives to the board of a company that has a broad national and ever-changing customer base and a large number of suppliers of different sizes and types? And how will voting power be distributed among the members of such groups? And who will elect the directors that will represent the interests of local communities or the interests of society in slowing global climate change?

Third, what mechanisms would ensure that a director elected by a certain constituency will focus on the interests of that constituency? In the current system, directors elected by shareholders are incentivized to be attentive to shareholder interests by the prospect of proxy fights, their own equity holdings, and the oversight by institutional investors. But such mechanisms

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Purpose, 74 BUS. LAW. 659, 672-673 (2019); Elizabeth Warren, *Companies Shouldn't Be Accountable Only to Shareholders*, WALL ST. J. (Aug. 14, 2018), https://www.wsj.com/articles/companies-shouldnt-be-accountable-onlyto-shareholders-1534287687; Matthew Yglesias, Elizabeth Warren Has a Plan to Save Capitalism, Vox (Aug. 15, 2018), https://Www.Vox.Com/2018/8/15/17683022/Elizabeth-Warren-Accountable-Capitalism-Corporations.

[144] For a recent discussion of the German model of co-determination and the difficulty of implementing it in the United States, *see* Jens Dammans & Horst Eidenmueller, *Codetermination: A Poor Fit for U.S. Corporations*, ECGI Working Paper (Apr. 9, 2020), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3565955.

Electronic copy available at: https://ssrn.com/abstract=3544978

might not be readily available for some other stakeholder groups.

Finally, let us consider a hypothetical case in which shareholders and each stakeholder group elect a subset of directors and in which the elected directors can all be expected to focus on the interests of the corporate constituency that they represent. Given that the board can be controlled by a majority, the directors representing a particular stakeholder group could be marginalized and its interests would enjoy little protection. Furthermore, with the board made of directors that focus on very different and sometimes conflicting objectives, the decision-making process on the board could lead to deadlocks and friction and be highly dysfunctional.

We wish to conclude by noting an alternative approach to addressing the current asymmetry in the power over directors that shareholders and stakeholders have. Instead of seeking to counterbalance the power of shareholders by giving stakeholders the power to elect some of the company's directors, one could support addressing the current imbalance by weakening the power of shareholders. This could be done by adopting arrangements that limit shareholder intervention, and thereby insulate directors from shareholder power, or by persuading institutional investors to be more deferential to directors. We shall discuss the perils of this approach in Section V.A: As we will explain, this approach would make directors less accountable to shareholders without making them more accountable to stakeholders, which would be costly to shareholders, stakeholders, and society.

VI. THE PERILS OF STAKEHOLDERISM

The preceding two Parts have shown that the promise of stakeholderism is illusory. At this stage of the discussion, however, some readers might take the view that, even if it does not produce significant benefits for stakeholders, stakeholderism cannot hurt. According to this view, to the extent that protecting stakeholders is considered a valuable goal, stakeholderism cannot move corporate behavior in the wrong direction and could even move it marginally in the right direction. As this Part explains, however, this is not the case.

We show below that embracing stakeholderism would have substantial and broad detrimental consequences. Section A discusses the adverse effects that stakeholderism would produce on economic performance and society, by increasing the insulation of corporate leaders, their lack of accountability, and managerial slack. Section B in turn explains that accepting stakeholderism would adversely affect the interests of stakeholders by impeding, limiting, or delaying policy reforms that, unlike stakeholderism, would provide stakeholders with substantial protection; stakeholderism would thus hurt the stakeholder constituencies that it purports to serve.

Electronic copy available at: https://ssrn.com/abstract=3544978

A. Increased Insulation and Reduced Accountability

Stakeholderism would increase the insulation of corporate leaders from shareholders and make them less accountable to them. The reduced accountability to shareholders would not be accompanied by the introduction of a novel accountability to stakeholders: stakeholderism does not advocate granting stakeholders the right to vote or to sue unfaithful directors and officers, but rather relies—as explained in Parts III and V—on well-meaning corporate leaders using their discretion to incorporate stakeholder interests into their objectives.[145]

As a matter of fact, therefore, stakeholderism would make corporate leaders freer in their decision-making. Indeed, these expected consequences might at least partly motivate the support for stakeholderism of some corporate leaders and their advisors. For them, support for stakeholderism may well be strategic: an attempt to advance a managerialist agenda dressed in stakeholder clothing to make it more appealing to the general public.

Stakeholderism can be expected to contribute to increased insulation and reduced accountability in two ways. First, it could induce institutional investors to become more deferential to corporate leaders, less willing to support hedge fund activists that challenge these leaders, and more willing to support or accept corporate governance arrangements that shield management from market pressure.

Second, stakeholderism could induce policymakers and groups concerned about stakeholder interests to support or even initiate legal reforms that would have such an effect. Recall that during the era of hostile takeovers, stakeholderism provided a basis for and facilitated the passage of antitakeover constituency statutes that helped management fend off unwanted bidders.

Indeed, for 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. For example, Lipton has argued for the right of directors to reject a takeover on the grounds of concern for employees and the local community; for having a longer, five-year term for directors as a system to benefit non-shareholder constituencies; against facilitating shareholder nomination of directors, on the grounds that shareholders are not the only

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[145] An earlier work by one of us challenges the use of "short-termism" arguments to support insulation of corporate leaders form market pressures and the claim that such insulation would serve the long-term interests of *shareholders*. *See* Bebchuk, *The Myth That Insulating Boards Serves Long-Term Value*, *supra* note 149. Here our concern is different—that stakeholderism is used to support the insulation of corporate leaders in the name of *stakeholders*.

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constituency to which directors must be responsible; and against a proposal to strengthen shareholders' ability to replace directors, on the rationale that shareholders are no more entitled to control the corporation than are other stakeholders.[146]

Today, corporate leaders face increased activity by hedge fund activists and larger ownership blocks of institutional investors, as well as a more frequent alliance between these two classes of shareholders. Stakeholderism could justify or facilitate the adoption of legal rules that would help management in dealing with these challenges.

Consider, for example, the restrictions on hedge fund activists included in the 2017 Brokaw Act proposal by Senators Baldwin and Perdue.[147] The bill would make activist intervention more difficult (and therefore less frequent) by expanding disclosure duties for hedge funds buying stocks or derivatives in a public company. The justification for these restrictions used by the bill's sponsors was precisely that hedge fund activism comes "at the expense of workers, taxpayers, and local communities."[148] It might not be a coincidence that support for stakeholderism among some management advisors and corporate leaders has been growing in recent years in which hedge fund activism has intensified.

Increased insulation and reduced accountability may serve the private interests of corporate leaders but would also have substantial adverse effects on the interests of other parties. Specifically, they would increase managerial slack, worsen corporate performance, and reduce economic efficiency and value-creation. Indeed, there is a substantial body of empirical evidence that increased insulation and reduced accountability are associated with worse

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[146] *See, e.g.*, Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 102 (1979) *and* Martin Lipton, *Twenty-Five Years after Takeover Bids in the Target's Boardroom: Old Battles, New Attacks and the Continuing War*, 60 BUS. LAW. 1369 (2005) (arguing that directors should have the power to reject a premium takeover because of the effects on the company's employees, communities, and other constituencies); Martin Lipton, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 227 (1991) ("The quinquennial system would benefit the corporation's other constituencies, which prosper if the enterprise's business operations prosper over the long term."); Martin Lipton, & Steven A. Rosenblum, *Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come,* BUS. LAW. 67, 67–68(2003) (arguing that shareholders are one of many constituencies that invest in the corporation and that their powers should be balanced against the goal of board independence, for the benefit of all stakeholders); and Martin Lipton & William Savitt, *The many myths of Lucian Bebchuk*, VA. L. REV 733, 744–45 (2007) (opposing proposals to strengthen shareholder power to replace directors on the grounds that, among other things, doing so would have an adverse impact on stakeholders).

[147] S. 1744, 115th Congress (2017).

[148] U.S. Senator Tammy Baldwin Introduces Bipartisan Legislation to Strengthen Oversight of Predatory Hedge Funds, https://www.baldwin.senate.gov/press-releases/brokaw-act2017

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managerial decisions and worse corporate performance.[149] These effects would be obviously bad for shareholders. However, by hurting corporate performance and the economic value produced by corporations, these managerial inefficiencies would also reduce the aggregate wealth available to society as a whole. If the economic pie produced by the corporate sector becomes smaller, all who benefit from slices of it (whether contractually, through tax revenues, or thanks to positive externalities) might end up worse off. These include employees, suppliers, local residents, and other stakeholders.

To be sure, executives and directors who use their greater decisional slack to extract private benefits might happen to benefit stakeholders in the process. For example, managers working under a lower level of pressure might choose less challenging projects and a lower workload for themselves, and this might entail a looser supervision and quieter life for lower-level employees as well. Similarly, if corporate efficiency requires a painful restructuring, including a reduction of personnel, a CEO able to avoid hard choices for her own benefit (large-scale projects, and restructurings in particular, require considerable effort) would indirectly benefit those employees who would have otherwise lost their jobs.

However, these are just coincidental effects. As explained in the preceding Part, there is little systematic overlap between the private interests of a company's leaders and the interests of the company's stakeholders. Thus, there is no reason to expect that expanding the freedom of corporate leaders to pursue their own preferences would systematically operate to the benefit of the company's stakeholders.

To illustrate, suppose that, with reduced accountability to shareholders, corporate leaders decide to sell the company to the buyer that would retain and reward them, rather than to the competing bidder willing to pay a higher price to shareholders. It might just so happen that management's favored buyer would be good for employees (say, because it would be more likely to retain them); but it might also so happen that the acquisition would hurt the interests of the company's employees (say, because the buyer would be less likely to retain current employees). Thus, in addition to the generally negative effects on shareholders and the performance of the economy, the increased insulation produced by stakeholderism would have effects on stakeholders that should not be expected to be systematically positive.

B. Chilling Stakeholder-Oriented Reforms

Part V showed that stakeholderism should not be expected to provide

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[149] For a survey of this empirical evidence, *see* Lucian A. Bebchuk, *The Myth That Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1673-86, (2013).

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material benefits for stakeholders. We now turn to show that acceptance of stakeholderism could well have an additional direct negative effect on stakeholder interests that would likely make them overall worse off. As explained below, by raising illusory expectations about its ability to remedy corporate externalities, stakeholderism would impede, limit, or delay policy reforms that could offer effective protection to stakeholders.

There is currently a widespread and growing recognition that, although corporations have been a major engine for growth, their profit-seeking operations contribute to a wide array of society's problems and impose serious negative externalities on employees, communities, consumers, and the environment.[150] Indeed, politicians and policymakers in the United States seem to recognize and respond to what is viewed as a dissatisfaction with some of the results produced by the corporate economy. Below we briefly list some concerns that have been raised and some policy measures that could be considered for addressing them. This brief discussion, of course, does not attempt to provide an exhaustive account of stakeholder-oriented measures that could be adopted or to assess their merits. We only seek to highlight that there are a number of possible reform efforts that advocates of stakeholder welfare could pursue, which might be impaired by the illusory expectations created by stakeholderism.[151]

Consider the impact of corporations on employees and communities.[152] Some commentators decry the slow or even stagnant growth in wages compared with the returns to shareholders (and the effects of this phenomenon on the inequality of wealth and income); the loss of jobs and the transfer of operations to off-shore locations in certain sectors and regions;

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[150] For recent discussions of such societal problems and negative externalities, *see, e.g.*, the papers presented at the conference "A New Deal for this New Century: Making Our Economy Work for All", October 3-4, 2019, available at https://www.law.nyu.edu/centers/icgf/events/new-deal-new-century; Jeffrey N. Gordon, *Addressing Economic Insecurity: Why Social Insurance Is Better Than Corporate Governance Reform*, CLS BLUE SKY BLOG, (August 21, 2019), https://clsbluesky.law.columbia.edu/2019/08/21/addressing-economic-insecurity-why-social-insurance-isbetter-than-corporate-governance-reform; *and* Matteo Gatti & Chrystin Ondersma, *Can a Broader Corporate Purpose Redress Inequality? The Stakeholder Approach Chimera* (unpublished working paper) (April 2020), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3547791.

[151] Of course, some might oppose the measures discussed in the text and take the view that it would be best to let markets continue operating as they have done thus far. For them, stakeholder protection is not a problem that needs to be addressed through policy measures, and therefore impeding stakeholder-oriented reforms would not represent a cost of stakeholderism. The costs discussed in this section are thus relevant only to those who do view the effects of companies on their stakeholders as an important issue for public policy.

[152] For a discussion of these issues, *see* Leo E. Strine, Jr., Toward Fair and Sustainable Capitalism (October 2019) (unpublished working paper), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3461924.

Electronic copy available at: https://ssrn.com/abstract=3544978

and the risks and uncertainties imposed on employees by the disruptive forces of globalization and technological progress. Some measures that have been considered to address these issues include changes in corporate and personal income taxes, measures to strengthen the bargaining power of workers, and rules that would give employees certain rights and benefits during the employment relationship or upon its termination.

Next, consider the impact of corporations on their customers. Some experts denounce the increasing concentration and reduced competition in many sectors of the economy and the growing market power of the largest digital platforms.[153] Measures that have been considered for addressing such issues include forcing interoperability among various market players, tightening antitrust policy and enforcement, regulating the portability and accessibility of data, and strengthening the privacy protection of consumers.[154]

Finally, consider the impact of corporations on the environment.[155] Large companies are believed to be responsible for a substantial fraction of greenhouse gas emissions, thereby playing a major role in climate change.[156] Among the policy proposals discussed on this issue are taxes on the use of fossil fuels (carbon tax) and on other polluting activities, subsidies for the production of renewable energies, funding for research in green technologies, and regulatory constraints on some of the technological and operational choices made by companies.

To be sure, it is understandable that those concerned about these problems might find the idea of stakeholderism appealing. Indeed, if stakeholderism could be expected to deliver on its promise, stakeholders' welfare would be enhanced through private ordering and with no need (or at least a reduced need) for government intervention. Furthermore, corporate leaders would become an ally rather than an adversary to be overcome to enable the imposition of outside constraints.

However, the very acceptance of this view by those concerned about

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[153] For a discussion of some of adverse effects that companies have on customers, *see*, *e.g.*, Gustavo Grullon, Yelena Larkin, & Roni Michaely, *Are US Industries Becoming More Concentrated?*, 23 REV. FIN. 697 (2019); *and* Stigler Committee on Digital Platforms, Final Report (September 2019), available at https://research.chicagobooth.edu/stigler/media/news/committee-on-digital-platforms-final-report.

[154] Stigler Committee *supra* note 153.

[155] For a comprehensive report on climate risk, *see* McKinsey Global Institute, *Climate Risk and Response: Physical Hazards and Socioeconomic Impact* (January 2020), https://www.mckinsey.com/business-functions/sustainability/our-insights/climate-risk-and-response-physical-hazards-and-socioeconomic-impacts.

[156] Climate Accountability Institute, *Carbon Majors Report* 8 (July 2017) (presenting evidence that 71% of greenhouse gas emissions since 1988 can be traced back to 100 large fossil fuel companies).

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stakeholders would adversely affect the prospect of adopting stakeholder-oriented policies.[157] This would happen for at least three reasons. First, advocates might reduce the total resources and time they devote to some of the causes mentioned above due to the expectation that corporate leaders would on their own make substantial progress on those issues. Second, such expectations could lead other advocates to allocate some of their resources and time to support and expand the adoption of stakeholderism, at the expense of other policy proposals. Third, if policymakers and lawmakers came to share these inaccurate expectations about stakeholderism, they could become less receptive to policy solutions and rely instead, at least in part, on corporate self-regulation.

Indeed, whereas some corporate leaders and their advisors might genuinely believe that stakeholderism would contribute to stakeholder welfare, others might use this theory strategically to deflect the demand for legal and regulatory reforms.[158] In any event, regardless of the motivations of supporters, the chilling effect of stakeholderism on regulation is a significant peril and should be recognized as such by those concerned for the effects of corporate externalities on society.

Stakeholderism might seem attractive to those who are pessimistic about the prospects of obtaining stakeholder-protecting regulations and policies due to political gridlock or the political power of the foes of such reforms.[159] Such pessimists might argue that the analysis in this Section reflects an unjustified optimism about the prospects of such reforms. But our view is not based on a rosy assessment of the prospects of such reforms; we recognize the substantial impediments they face. Rather, our view is based on a realistic assessment of the hopes that stakeholderism would produce material benefits for stakeholders; Part V's analysis showed that such hopes are unfounded.

To be sure, our analysis is based on the premise that the possibility of stakeholder-protecting reforms is not completely blocked. That is, we believe that, at least in the absence of illusory hopes introduced by stakeholderism, some significant reforms protecting stakeholders—whether employees, customers, or the environment—would be eventually possible even if they

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[157] *See* Leo E. Strine, Jr., C*orporate Power is Corporate Purpose I: Evidence from My Hometown*, 33 OXFORD REV. ECON POL'Y 176, 177 (2017) (expressing concern that support for stakeholderism may obscure the need for legal protections for other constituencies and for other legal reforms that give these constituencies the means to more effectively protect themselves).

[158] *Cfr*. Murray, *supra* note 6 (describing how the BRT statement was partly a response to growing dissatisfaction about the operation of capitalism).

[159] For a discussion of the potential value of corporate social responsibility as a decentralized remedy for corporate externalities in the face of government failure, *see* Roland Bénabou & Jean Tirole, *Individual and Corporate Social Responsibility*, 77 ECONOMICA 1, 2 (2009).

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would face impediments and would not be adopted to the fullest extent desirable. Therefore, given the conclusion of our analysis regarding the expected effects of stakeholderism, we believe that the only plausible route for stakeholder protection is through politics, regulations, and public policies. And because stakeholderism would impede progress on this route but would not by itself directly produce stakeholder benefits, it would be detrimental to the protection of stakeholders.

A recent joint statement by more than 70 law professors and other academics asserts: "With less than a decade left in which to address the catastrophic threat of climate change, and with investors, companies, accountants, policymakers and academics expressing a shared sense of urgency, now is the time to act to reform corporate governance."[160] We strongly disagree. Our analysis indicates that, for all those with such a "shared sense of urgency," it would be a mistake to focus on reforming corporate governance. Corporate governance reforms in general, as well as stakeholderism in particular, are not an effective tool for addressing "the catastrophic threat of climate change." To the contrary, directing efforts to reforming corporate governance, rather than to policies that could effectively fight climate change, would be a serious mistake.

VII. CONCLUSION

This Article has critically examined stakeholderism, the increasingly influential view that corporate directors and officers should be required or at least allowed to consider the well-being of all stakeholders (not just of shareholders) when making corporate decisions. To this end, we have conducted a conceptual, economic, and empirical analysis of stakeholderism and its expected consequences.

There are two versions of stakeholderism, and we have discussed the conceptual problems of each. Enlightened shareholder value turns out to be conceptually the same as shareholder value maximization. Pluralistic stakeholderism views stakeholder welfare as an autonomous end, but its supporters have overlooked issues that are critical to its implementation; ultimately, it amounts to no more than hoping that corporate leaders would use their discretion to balance the interests of stakeholders and shareholders in a socially desirable way. However, such reliance on managerial discretion is not warranted. Our appraisal of directors' and CEOs' incentives and our empirical analysis indicate that directors and officers should not be expected to use the discretion awarded to them to protect stakeholder interests.

Furthermore, embracing stakeholderism could well impose substantial

[160] Andrew Johnston et al., Corporate Governance for Sustainability Statement (Jan. 7, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3502101.

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costs. Stakeholderism would increase the insulation of corporate leaders from shareholders, reduce their accountability, and serve their private interests; the resulting increase in managerial slack would hurt shareholders, economic performance, and many stakeholders.

In addition, by raising illusory hopes that corporate leaders would on their own provide substantial protection to stakeholders, stakeholderism would deflect or delay reforms that could provide meaningful protection to stakeholders; stakeholderism would thereby be contrary to the interests of stakeholders it purports to serve. Indeed, although many supporters of stakeholderism are genuinely interested in stakeholder welfare, some others could actually be motivated, at least in part, by the prospect of insulating corporate leaders from shareholders and impeding stakeholder-protecting legal reforms.

The stakes in this debate are large. Despite the noble motivations of many supporters of stakeholderism, its acceptance would have broad detrimental effects. We have attempted to expose and highlight the perils of stakeholderism. We hope that our analysis will provide a foundation for future assessments of stakeholderism, as well as future examinations of the best ways for addressing the effects that the modern corporation inevitably has for its stakeholders.

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