The Illusory Promise of Stakeholder Governance

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Motivation

- Growing support for “stakeholderism”—the view that corporate leaders should give weight to the well-being of stakeholders (not just of shareholders) as an independent end when making business decisions.

Examples of the growing support:
- The Business Roundtable (BRT) Statement on the Purpose of a Corporation;
- The Davos World Economic Forum manifesto on stakeholder capitalism.
- Larry Fink letter to CEOs;
  etc. etc.
Main Points

- First, the benefits of stakeholderism are illusory: Stakeholderism should not be expected to produce material benefit for stakeholders.

- Second, the perils of stakeholderism are considerable: Embracing stakeholderism would impose substantial costs, including on stakeholders themselves.

=> Stakeholderism should be rejected, including by those (like us) who take stakeholder interests seriously.
Two versions of Stakeholderism: (1) Enlightened Shareholder Value

- Under this version, corporate leaders should recognize and take into account that treating stakeholders well can facilitate long-term value maximization.

- Under this version of stakeholderism, consideration of stakeholder interests is a means to shareholder value maximization, and therefore this version is not conceptually different from shareholder value maximization.
Two versions of Stakeholderism: (2) Pluralistic Stakeholderism

- This version of stakeholderism is conceptually different from maximizing shareholder value – treats stakeholder welfare as an end in itself rather than a mere means.
  - Directors have a plurality of independent constituencies and must balance a plurality of autonomous ends.
- This approach was followed by the constituency statutes adopted by many U.S. states in the late 1980s and the early 1990s.
The BRT Statement: A Meaningful Change or a PR Move?

- BRT statement was described as:
  - a “major philosophical shift” (Wall Street Journal);
  - breaking “with decades of long-held corporate orthodoxy” (New York Times); and
  - “a potential sea change” (Washington Post).

- But we provide evidence that the statement was mostly for show and not a signal of coming major changes.
Mostly for Show (1): Lack of Board Approval

- We contacted the public relations officers of the companies whose CEOs signed the BRT statement to inquire whether the signing was approved or ratified by the board (board approval/ratification is generally sought for any major corporate decisions).

- We found that CEOs generally signed the statement without seeking board approval – consistent with their perceiving the statement as not requiring any meaningful changes in the company’s approach to stakeholders.
Mostly for Show (2): Corporate Governance Guidelines

- We reviewed all the board-approved and frequently updated corporate governance guidelines of the public companies that joined the BRT statement. This review indicates that most of the guidelines still reflect a commitment to shareholder primacy.
- For example, the guidelines of JPMorgan Chase, whose CEO Jamie Dimon chaired the BRT when the statement was issued, state that “[t]he Board as a whole is responsible for the oversight of management on behalf of the Firm's shareholders.”

See our study for 3 additional pieces of evidence supporting the view that the BRT statement was mostly for show.
The Big Question

- Putting aside the BRT statement, we turn to the more general question:
  - Should we expect pluralistic stakeholderism to produce benefits for stakeholders beyond what would serve shareholder value?
- Because stakeholderism relies on the discretion of corporate leaders, the answer depend on the following question:
  - Do corporate leaders have incentives to benefit stakeholders beyond what would serve shareholder value?
The Incentives of Corporate Leaders

- We examine the incentives of directors and CEOs produced by compensation arrangements; the labor market; and the market for corporate control.

We conclude that:

- Although the interests of corporate leaders and shareholders do not fully overlap, there is at least a robust association between them.
- By contrast, no such link exists between CEO interests and stakeholder interests.
- Consequently, directors and CEOs have incentives not to protect stakeholders beyond what would be serve shareholder value maximization.
Fixing Incentives?

- Stakeholderists commonly advocate giving corporate leaders discretion to protect stakeholders **without changing other basic corporate law rules**.
- But some might argue that, even if stakeholderism as commonly proposed would not benefit stakeholders, it would be possible to obtain such benefits by supplementing standard stakeholderism with:
  - Redesign of pay arrangements to tie pay to stakeholder interest; and /or
  - Having stakeholders participate in voting on director election.
- We show that the above two types of supplemental reforms would be difficult to implement, would produce large costs, and their potential benefits for stakeholders would be limited.
Learning from the Experience with Constituency Statutes

- Is the past behavior of corporate leaders consistent with the conclusion of our incentive analysis?
- Good setting for testing: Acquisitions of companies in states with constituency statutes, which adopt a stakeholderist regime for M&A transactions by allowing (or even requiring) corporate leaders to take into account the interests of stakeholders and not only of shareholders.
- We analyzed the acquisition agreements of each of the private equity acquisitions of public companies that were governed by constituency statutes during 2000-2019.
- Present the detailed findings in a companion paper with Kobi Kastiel, “For Whom Corporate Leaders Bargain” (August 2020).
We find that corporate leaders:

- Obtained significant benefits (large premiums) for shareholders; and
- Obtained significant benefits (monetary payoffs and continued employments) for themselves.
For Whom Corporate Leaders Did Not Bargain

However, corporate leaders generally:

- Did not negotiate for constraints on the post-deal freedom to fire employees (although constituency statutes were partly justified as a way for protecting employees and private equity acquisitions often reduce employment (Davis et al. 2019)).
- Did not negotiate any protections for suppliers, customers, and creditors (other stakeholder groups explicitly noted by constituency statutes)
- Did not negotiate protections for headquarter communities except in a few cases in which cosmetic and unenforceable pledges were made.

These patterns hold also for acquisitions during the last several years in stakeholder rhetoric was substantially used by corporate leaders.
Lessons for the Future

- Stakeholderists must wrestle with the failure of the constituency statutes, identify the reasons for this failure, and examine whether they also would not undermine stakeholderism.

- After examining alternative explanations, we conclude that constituency statutes failed to deliver stakeholder benefits due to the incentives of corporate leaders – and that stakeholderism should be expected to fail to deliver its purported benefits for similar reasons.

- As George Santayana warned a century ago, “[t]hose who cannot remember the past are condemned to repeat it.” (THE LIFE OF REASON (1905))
The Perils of Stakeholderism

- Even if embracing stakeholderism cannot be expected to benefit stakeholders, some might still argue that it cannot hurt – it can only move things in the right direction even if marginally.
- However, we show that acceptance of stakeholderism would produce two major costs.
Increased Insulation and Reduced Accountability

- Stakeholderism would increase the insulation of corporate leaders from shareholders and make them less accountable to them:
  - Stakeholderism could induce institutional investors to be more deferential to corporate leaders, less willing to support hedge fund activists, and more accepting of governance arrangements that shield management from market pressure.
  - Stakeholderism could induce policymakers and groups that care about stakeholders to support legal reforms that would have such an effect. (Recall that stakeholderism provided a basis for adoption of antitakeover constituency statutes).
Increased Insulation and Reduced Accountability (2)

- Indeed, a desire to obtain increased insulation might at least partly motivate the support for stakeholderism by some corporate leaders and their advisors.
  - For them, support for stakeholderism may be strategic: an attempt to advance a managerialist agenda dressed up in stakeholder clothing.
- Indeed, in the past four decades, alleged benefits to stakeholders have been, a standard reason provided by management advisors seeking to advance arrangements that entrench and insulate corporate leaders.
- Increased insulation and entrenchment of corporate leaders would operate to increase slack and underperformance — which would hurt shareholders and the economy, and often stakeholders themselves.
Chilling Stakeholder-Oriented Reforms

- There is currently a widespread and growing recognition that, although corporations have been a major engine for growth, their profit-seeking operations contribute to society’s problems and impose serious externalities on stakeholders.
- There is a wide array of policy reforms – laws, regulations, and governmental policies that could be imposed on corporations from the outside – that would force or incentivize corporations to improve stakeholder treatment and provide real benefits to stakeholderism.
Chilling Stakeholder-Oriented Reforms (2)

- Such reforms could be impeded if acceptance of stakeholderism raises illusory hopes that corporate leaders would protect stakeholders on their own. Such expectations would:
  - Reduce the efforts of those who care about stakeholders to seek external laws, regulations, and policies that would push companies to do so; and
  - Make lawmakers and policymakers less receptive to adopting such reforms.
Conclusion

- Illusory benefits:
  - Corporate leaders should not be expected to use discretion to benefit stakeholders to protect them beyond what would serve shareholder value;
  - and in fact have in the past not used such discretion to deliver the hoped-for stakeholder benefits.
- Large costs: Embracing stakeholderism could well impose substantial costs on shareholders, the economy, and stakeholders themselves.