The Illusory Promise of Stakeholder Governance

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Overview

- A very important contribution that everyone interested in stakeholder capitalism should read, regardless of your prior belief
- Debate has become increasingly polarized and uninformed
  - Shareholder value = short-termism
  - Shareholder value = exploitation of stakeholders
- Anti-capitalist views are most likely to be given airtime, given confirmation bias
1. Stakeholder Capitalism

- The buzzword of the day, but no official definition
  - See “Can Stakeholder Capitalism Save Capitalism? First We Must Define It” with Bruce Bolger in Forbes

- Section III.B on Pluralistic Stakeholderism considers “anti-shareholder capitalism”
  - Pie-splitting mentality

- Section III.A on Enlightened Shareholder Value presents three cases:
  - Informational and educational value
  - Legal protection
  - Rhetorical and political gains
1. The Informational and Educational Value of ESV

“Supporters of ESV 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”

Very hard to test CEOs’ biases, but can test investors’. Evidence that the stock market misvalues intangibles:

- Edmans (2011, 2012) on employee satisfaction
- Khan, Serafeim, and Yoon (2016) on material stakeholder issues
- Chan, Lakonishok, and Sougiannis (2001) on R&D and advertising
- Banker et al. (2019) on SG&A
1. The Case for Stakeholder Capitalism

- Not the same as Enlightened Shareholder Value
  - ESV: profits are the end goal, stakeholder value is an *instrumental* way to create profits
  - SC: stakeholder value is the end goal, profits are a by-product

- In a world of only risk, there’s no difference. But with Knightian uncertainty, SC is *practically more useful*

- Still need a decision rule, but one based on principles. From “Grow the Pie”:
  - Multiplication
  - Comparative advantage
  - Materiality

- No rules doesn’t mean ambiguity or no accountability
2. Is Anti-Shareholder Capitalism Realistic?

- Section V.A says no due to director incentives
  - Equity pay
  - Market for corporate control
  - Labor markets

- But anti-shareholder capitalism can weaken this
  - Cai, Jin, Yang (RFS forthcoming): donations to charities affiliated with directors reduces turnover-to-performance sensitivity
  - Half of Europe’s large firms link exec pay to climate change (CDP, Feb 2019)
    - Flammer and Bansal (2017): long-term equity pay (causally) improves stock returns, innovation, various CSR metrics
Conclusion

- Big contribution: many aspects of shareholder primacy are much more supportive of stakeholder value than commonly believed
- But stakeholder capitalism, correctly defined, may have important:
  - Informational and educational value
  - Practical value