The Illusory Promise of Stakeholder Governance

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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.” In a new study, The Illusory Promise of Stakeholder Governance, we critically examine 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. 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.

Below is a more detailed overview of the analysis of our paper:

In the summer of 2019, with much fanfare and massive publicity, the Business Roundtable (BRT)—the influential association of corporate chief executive officers (CEOs)—announced a revision of its conception of corporate purpose. The BRT statement was signed by the CEOs of 181 major public companies that together have a market capitalization exceeding $13 trillion. They committed to "lead their companies to the benefit of all stakeholders," and to "deliver value" not just to shareholders but also to employees, customers, suppliers, and communities.

The BRT statement was presented by its authors, and was characterized by many commentators, as a major milestone in the evolution of the modern corporation. An earlier statement on corporate purpose that the BRT adopted in 1997 explicitly embraced the shareholder primacy view that directors should focus on the welfare of shareholders. 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 our paper to refer only to the latter.

Following the publication of the BRT statement, in December 2019 the World Economic Forum took the unusual step of publishing a manifesto that urged companies to move from the traditional model of "shareholder capitalism" to the model of "stakeholder capitalism." 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." And a memorandum by Wachtell, Lipton declared 2019 to be a "watershed year" in corporate governance due to "the advent of stakeholder governance." 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.

In our new study we wish to warn against the rise and growing acceptance of stakeholderism. To this end, we conduct an economic, empirical, and conceptual analysis of stakeholderism and the claims made by its supporters. Stakeholderism, we conclude, should not be expected to benefit stakeholders. To the contrary, it would impose substantial costs on stakeholders and society, as well as on shareholders.

Part II of our study 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. We show that the statement is largely a rhetorical public relations move rather than the harbinger of meaningful change. In particular, we discuss the statement's ambiguity regarding the intention to provide stakeholders with any benefits beyond what would be useful for shareholder value; the failure to reflect the commitment to stakeholders in corporate governance guidelines; and the lack of concern about 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 in several ways that corporate leaders (directors and CEOs

alike) 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.

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 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 shareholder expense, delegating the guardianship of stakeholder interests to corporate leaders would prove futile. The promise of pluralistic stakeholderism, we conclude, is illusory.

Part VI turns 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 we show, 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 stakeholder's 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 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 concluding, we wish to emphasize that our rejection of 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 that the protection of stakeholders is best left entirely to market forces and private contracts. 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.