The Illusory Promise of Stakeholder Capitalism

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Based on

- Bebchuk & Tallarita, The Illusory Promise of Stakeholder Governance, forthcoming Cornell Law Review, December 2020.

- Bebchuk, Kastiel, and Tallarita, For Whom Corporate Leaders Bargain, forthcoming Southern California Law Review, 2021.

The Question

- Should corporate leaders serve goals other than maximizing shareholder value?

- Stakeholder capitalism ("stakeholdersim") supports allowing and encouraging corporate leaders to do so.

Some Realism about Stakeholderism

- Stakeholderism should not be expected to produce material benefits to stakeholders.

- Illusory hopes about stakeholderism would be costly to stakeholders, shareholders, and society.

Needed: Capitalism that Works for Stakeholders

- Public companies impose substantial and growing externalities on stakeholders (e.g., climate change, inequality, etc.)
- For capitalism to work for stakeholders, the most effective way is to adopt laws, regulations and governmental policies (e.g., carbon tax, labor-protecting measures) that would constrain and incentivize companies.

Stakeholder Capitalism to the Rescue?

- A bandwagon of support from business leaders offers stakeholderism as remedy for corporate externalities.
  - The Business Roundtable Statement on Corporate Purpose;
  - The Davos World Economic Forum Manifesto on Stakeholder Capitalism.
  - Larry Fink's Letter

Competing versions

- Pluralistic stakeholderism:
  - Give independent weight to stakeholder interests and balance them with shareholder interests.

- Enlightened shareholder value:
  - Recognize that paying attention to stakeholders can be an instrumental to serving long-term shareholder value.
    - Adopted by UK Law

Neither version, including the "more ambitious" version of pluralistic stakeholderism, would produce material benefits to stakeholders.

The Appeal of Stakeholderism

- Stakeholderism seems appealing at first glance:
  - Relies on private ordering
  - Seeks to harness the power of the private corporation to address the externalities imposed by companies…
  - And to do so while leaving corporate structures intact (in particular, the exclusive power of shareholders to elect directors).

Would Stakeholderism Deliver?

- Our analysis indicates that corporate leaders have incentives **not** to protect stakeholders beyond what would be serve shareholder value maximization.

Therefore we should:

- Either change basic corporate structures, **including** shareholder power to choose directors, which would be quite costly;
- Or recognize that, with basic structures remaining in place, the promise of stakeholderism is largely illusory.

Was the BRT Statement Mostly for Show?

- Business Roundtable statement was described as a major milestone – a sign of coming shifts in treatment of stakeholders.
- But our academic work provides evidence that the statement was mostly for show.
- For example, our survey of all corporate signatories indicated that CEOs generally joined without seeking board approval – consistent with their perceiving the statement as not requiring any meaningful changes.

Testing whether Stakeholderism Can Deliver

- Good setting for testing: Acquisitions of companies in U.S. states with constituency statutes:
  - Those statutes introduce a **stakeholderist regime** by authorizing corporate leaders to take into account stakeholder interests in M&A decisions.

For Whom Corporate Leaders Bargained

- We find that corporate leaders bargained for and obtained significant benefits to
  - Shareholders (large premiums), and
  - Corporate leaders themselves (monetary payoffs and continued employments).

For Whom Corporate Leaders Did Not Bargain

However, corporate leaders generally:

- Did not negotiate for constraints on post-deal firing of employees despite the common incidence of such firing (Davis et al. 2019).
- Did not negotiate for protections for suppliers, customers, communities, or the environment.

The Perils of Stakeholderism

- Some who care deeply about stakeholders might argue that, even if stakeholderism cannot be expected to benefit stakeholders materially, it can only move things in the right direction.
- However, stakeholderism would produce two major costs.

Costs (1): Increased Insulation and Reduced Accountability

- Acceptance of stakeholderism would insulate corporate leaders from shareholders and make corporate leaders **less accountable**.
- Stakeholderists urge institutional investors to be more deferential to corporate leaders, and more accepting of arrangements insulating management from market pressure.
- Such increased insulation would raise slack and underperformance, which would benefit managers but hurt both shareholders and stakeholders.

Costs (2): Chilling Stakeholder-Oriented Reforms

- Acceptance of stakeholderism raises illusory hopes that corporate leaders would protect stakeholders on their own.

- This could substantially chill or impede efforts to obtain regulatory reforms that could produce real benefits for stakeholders.

Conclusion

To protect stakeholders and the planet, we need to constrain and incentivize companies through external rules, not count on corporate leaders to address those problems on their own.

Stakeholderism should be rejected, even by those who care deeply about stakeholders.