

Discussion of “The Corporate Governance Machine” (Lund, D., Pollman, E.)

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“The CG Machine”

- Law
- Institutions
- Culture

Shareholder Primacy

Max. shareholder value

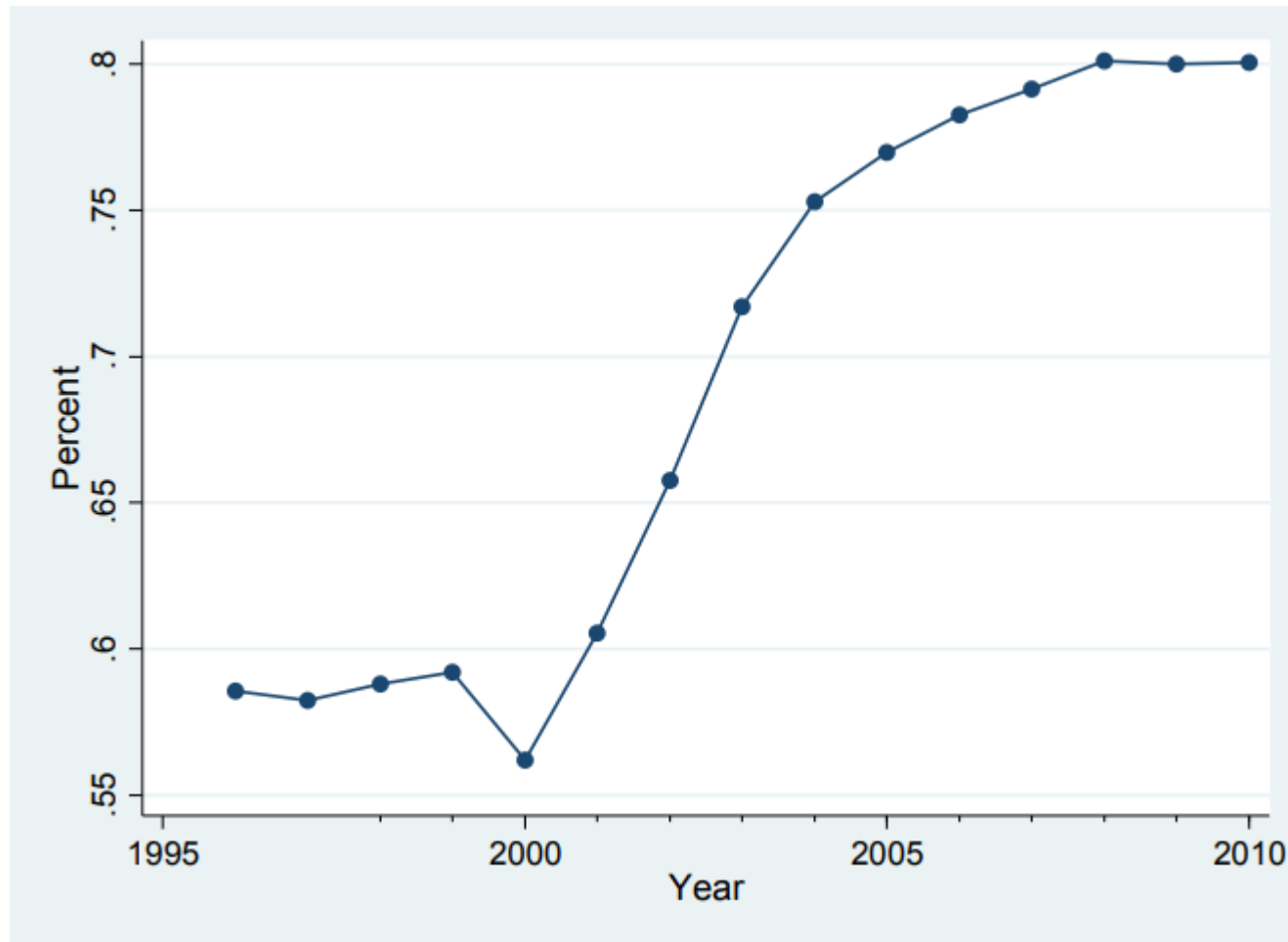


Implications

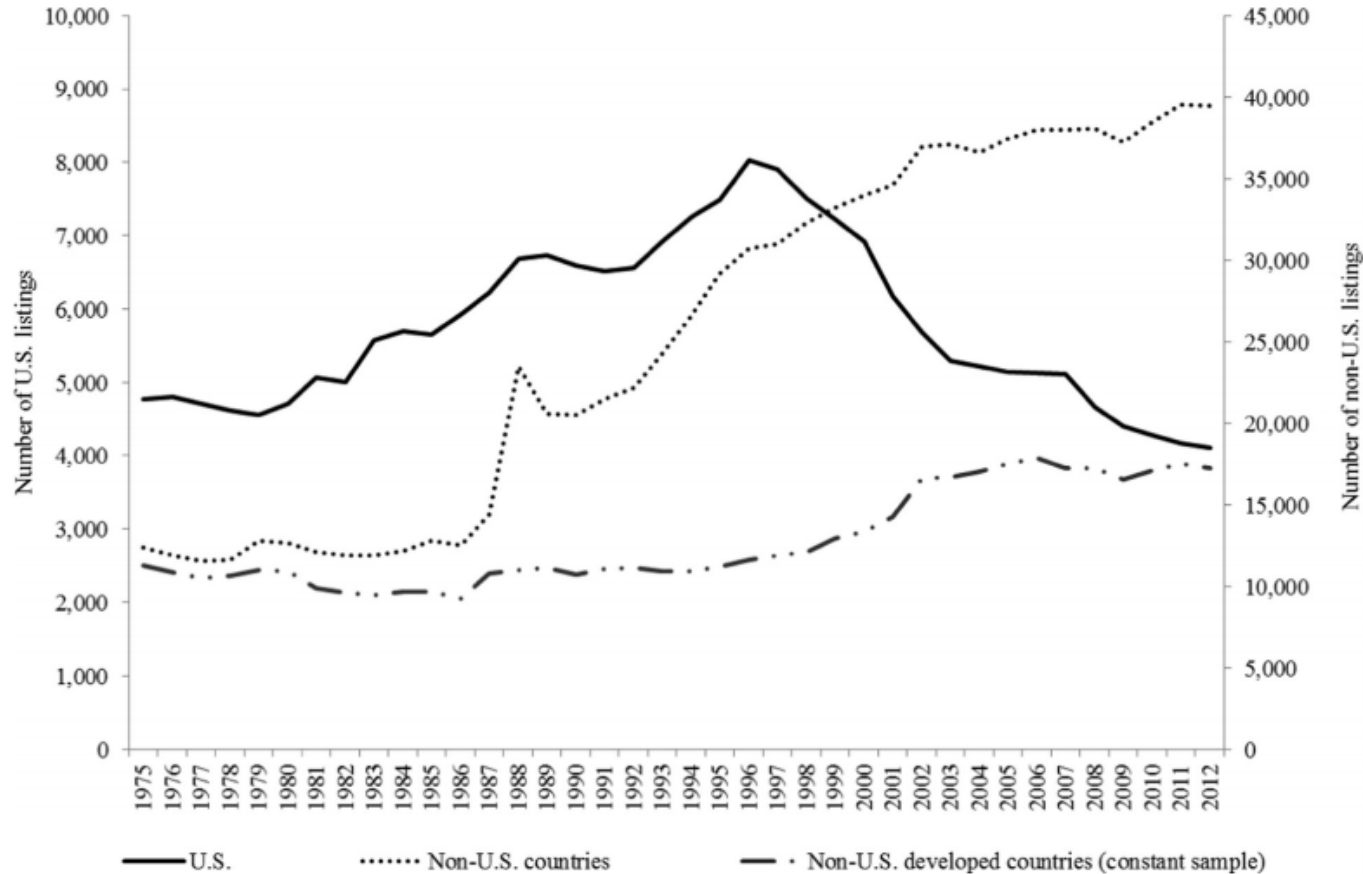
- Regulation
 - One-size-fits-all
 - Less innovation
 - Public/private divide
- Examples:
- Board independence
 - Use of ESG to increase shr. value
 - Benefit corporation

(evolution over the last decades)

More independent directors



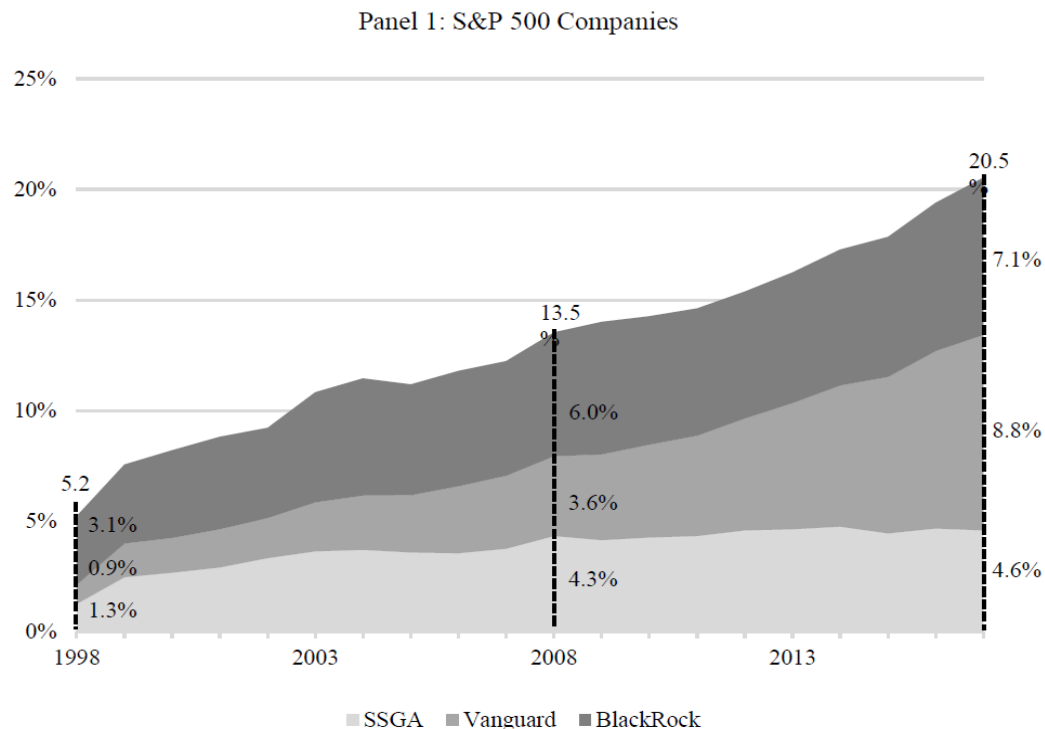
Fewer listed firms (in the US)



(Doidge, Karoly, Stulz, 2017)

Rise of index investing and large asset management firms

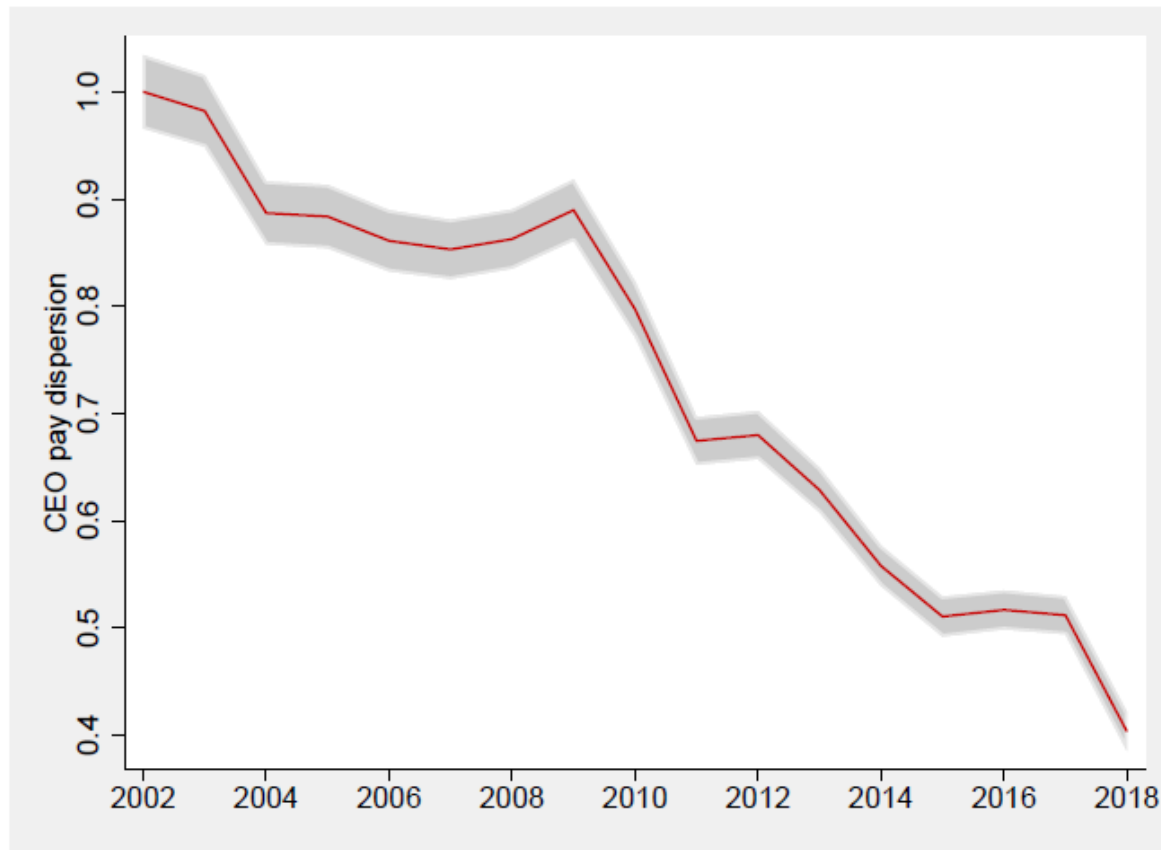
Figure 1. Percentage of Corporate Equity Held by Big Three Index Funds



(Bebchuck and Hirst, 2019)

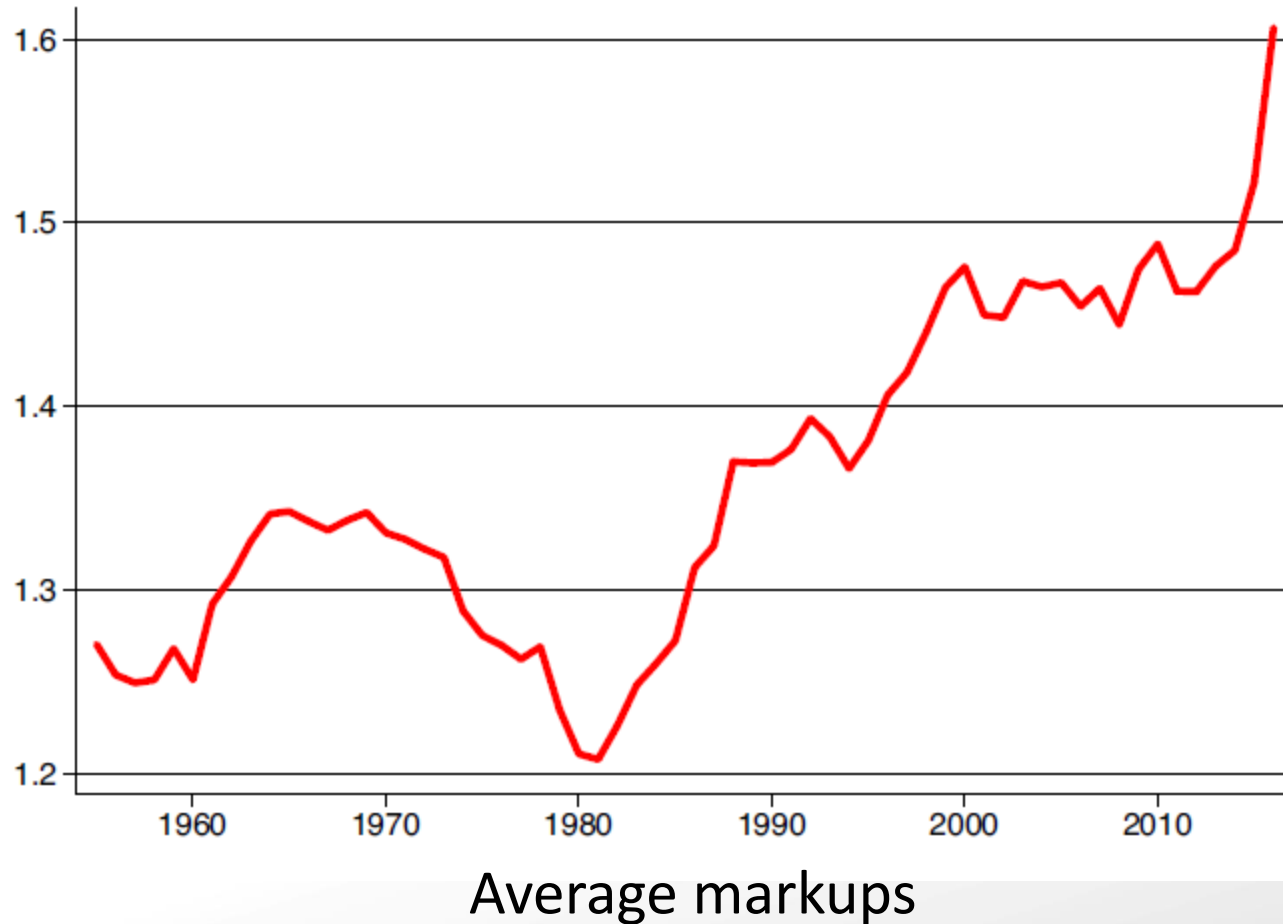
More similar compensation contracts

$$\text{Dispersion} = \frac{\text{stdev}(\text{CEO pay})}{\text{median}(\text{CEO pay})}$$



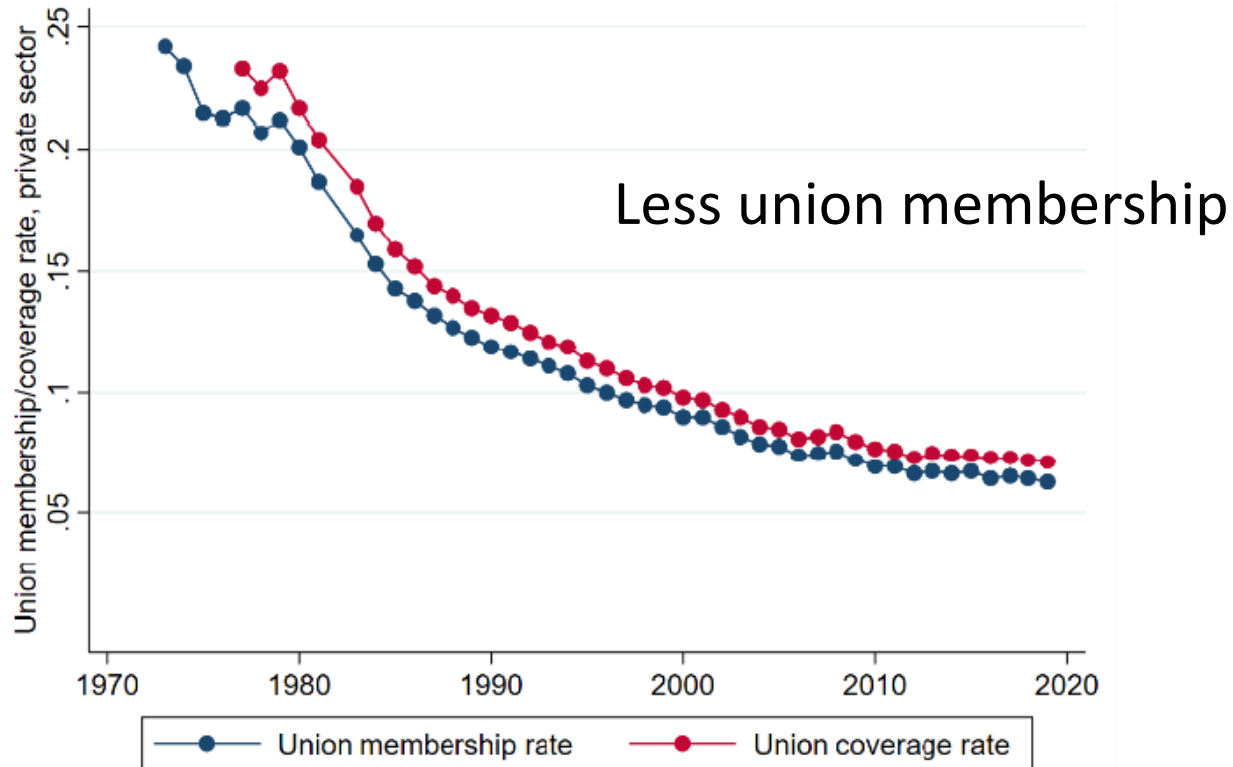
(Jochem, Ormazabal, Rajamani, 2021)

Increasing market power



(De Loecker, Eeckhout, Unger, QJE 2020)

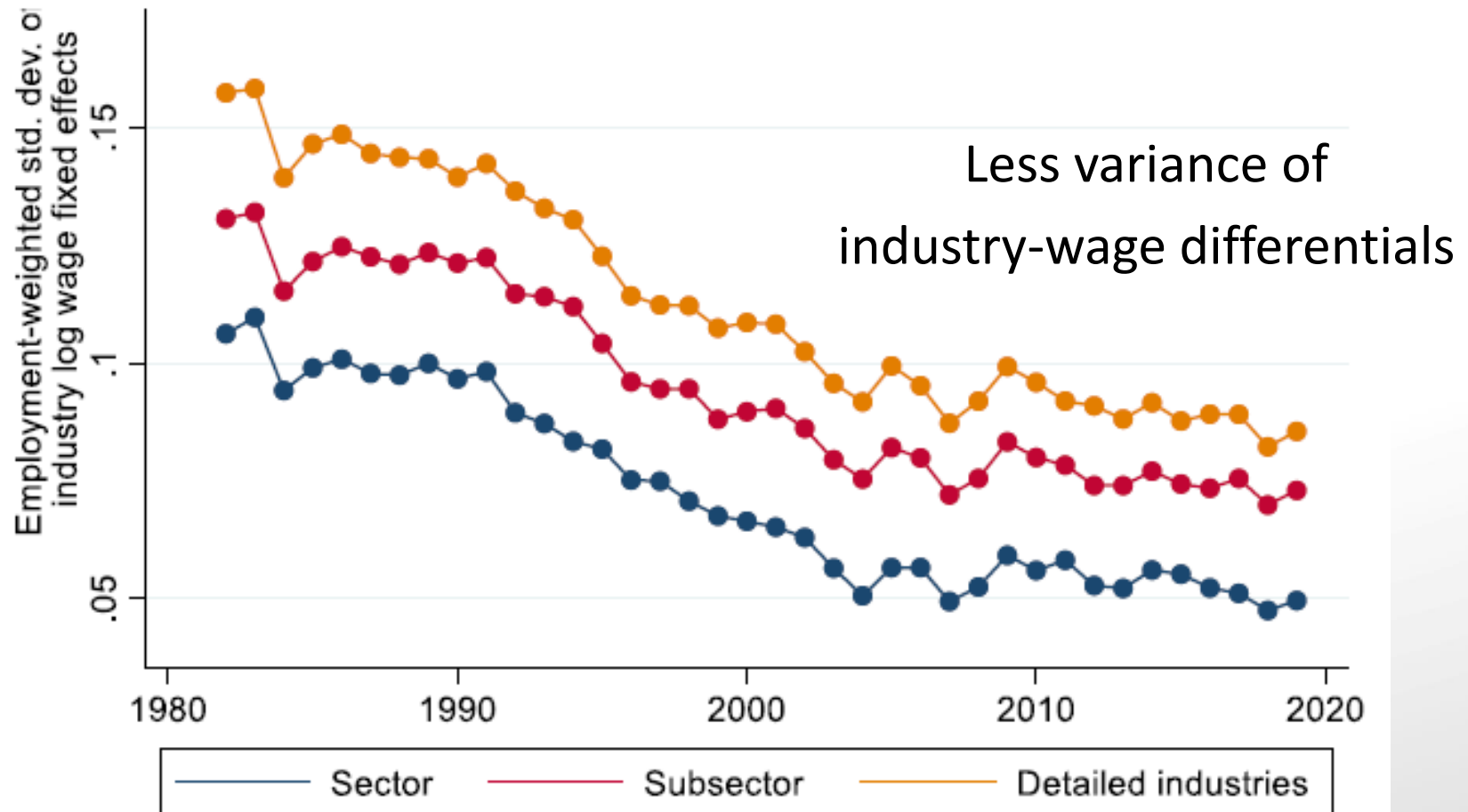
Declining worker power



Note: Union membership and coverage rate are from UnionStats.com, calculated from the CPS by Hirsch and Macpherson.

(Stansbury and Summers, 2021)

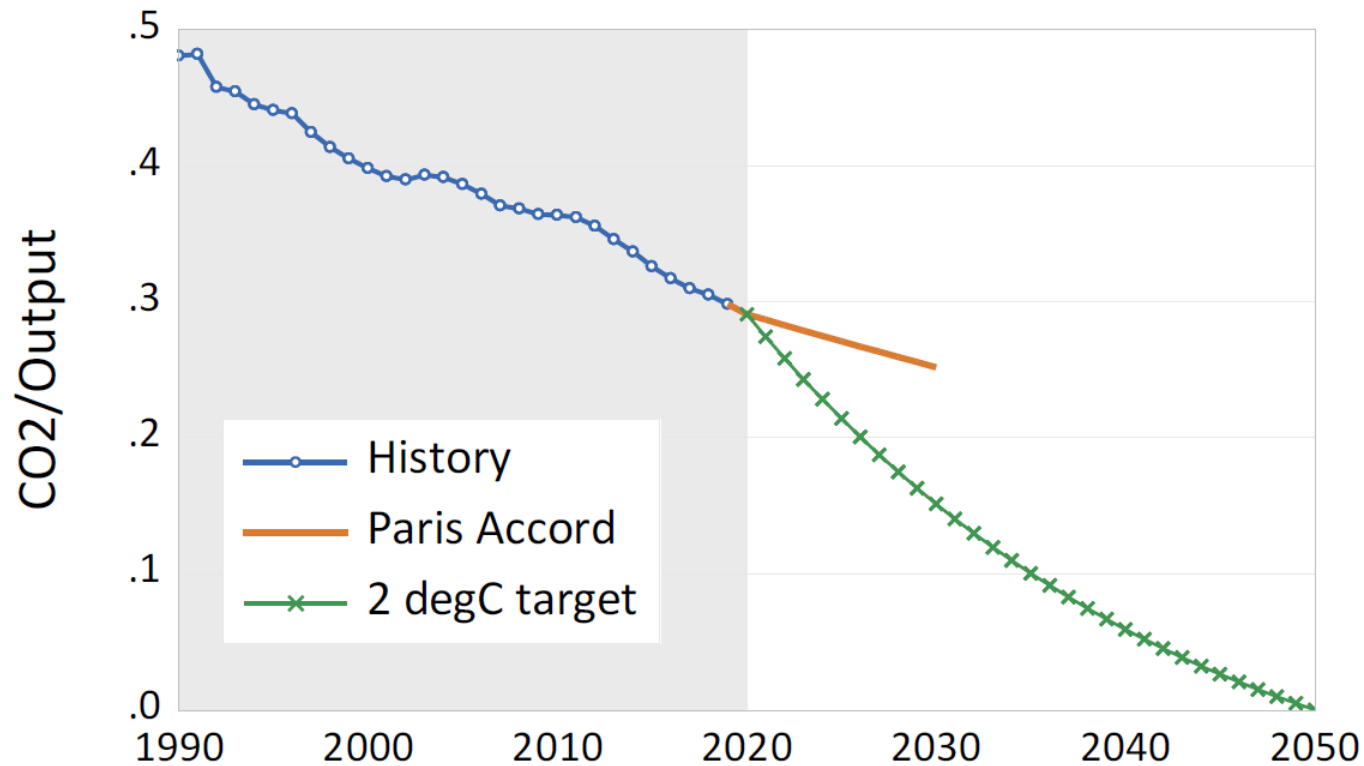
Declining worker power



(Stansbury and Summers, 2021)

Environmental efforts are not enough

Decarbonization: History and Future



(Nordhaus, 2021)

In sum:

- ✓ Overall, it looks like there is some evidence consistent with the narrative in the paper
- ✓ In any case, the evidence suggests that we're witnessing important changes. We need to make sure we understand them
- ✓ That said, I suspect that the story of "the machine" rises other questions

Does the “machine” end up increasing shareholder wealth?

Part of the machine	YES	NO
Congress	La Porta et al. (2006)	Leuz and Wysocki (2016) ; Zhang (2007); Larcker, Ormazabal, and Taylor (2011)
SEC		Larcker, Ormazabal, Taylor (2011)
Proxy advisors	Alexander, Chen, Seppi, and Spatt (2010)	Malenko and Shen (2016) Larcker, Ormazabal, McCall (2013; 2015)
Rating agencies	Anderson, Mansi, and Reeb (2004)	Griffin, Nickerson, and Tang, 2013; Barth, Ormazabal, and Taylor, 2012

Many times it doesn't. Why...?

Does the “machine” end up increasing shareholder wealth?

Part of the machine	YES	NO
Stock exchanges	Miller, 1999 ; De Carvalho and Pennacchi (2012)	DeMarzo, Fishman, and Hagerty (2005); Aggarwal, 2002
Stock indexes	Chattopadhyay, Shaffer, and Wang (2020)	Harris and Guriel, 1986; Chen et al., 2004;
Media	Dyck and Zingales, 2002; Miller, 2006; Dyck, Morse, Zingales, 2010; Dai, Parwada, and Zhang, 2015	Core, Guay, and Larcker, 2008; Miller, 2006; Dyck, Volchkova, and Zingales, 2008
Politics	Faccio, 2006; Goldman, Rocholl, and So, 2009; Cooper, Gulen, and Ovtchinnikov, 2010	Yu and Yu, 2011; Correia, 2014; Bourveau, Coulomb and Sangnier (2016); Jagolinzer et al., (2020)

Many times it doesn't. Why...?

Missing parts of the machine?

Piece	Effect
Standard setters	Fair value accounting (focus on investors, not other potential users of accounting information)
Auditors	Focus on financial materiality
Analysts	Also focused on shareholder value
Other?	Investment bankers and securities attorneys

Have “countervailing” forces become weaker?

Employees	Declining worker power They have become shareholders (ESOP, a pension plan, ETFs...) Increasing number of (potential) employees care about ESG
Politicians	Political changes in the US Rise of populism
Government agencies	Antitrust (DOJ, FTC) Environmental Protection Agency (EPA)
General public	ESG-conscious consumers ESG activism is on the rise

Not totally clear...

How did the machine react to COVID?

Executive compensation went up...

Lower SOP support (so far 12 voted down)

Virtual shareholder meetings

- ✓ Questions ignored
- ✓ Topics avoided

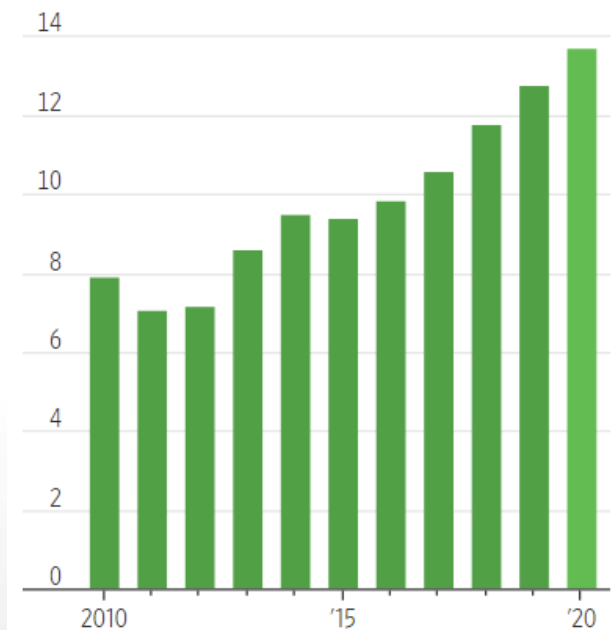
(Schwartz-Ziv, 2021)

Care for employees

What did signatories of the Business Roundtable statement do?

Median total compensation for S&P 500 CEOs on the job at least a year

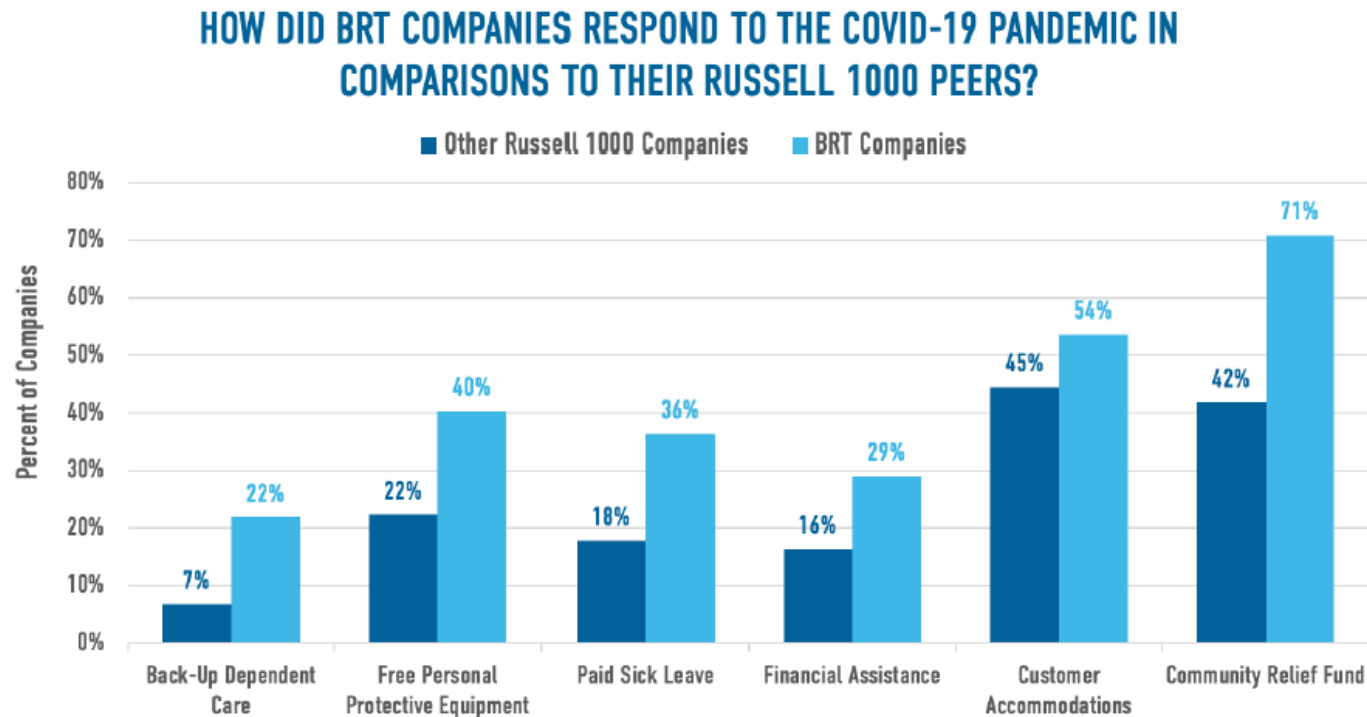
\$16 million



Note: 2020 reflects companies disclosing pay through April 8

Source: MyLogIQ

How did the machine react to COVID?



Note: BRT signatories is shorthand for companies that signed the Business Roundtable's "Statement on the Purpose of a Corporation." Out of the 206 companies whose executive(s) signed the statement as of August 2020, 151 are part of JUST Capital's 2021 Rankings universe.

Source: Forthcoming data from America's Most JUST Companies, 2021 Rankings. Data as of August 16, 2020.

BRT signatories did more than others, but not all of them...

Is “the Machine” affecting the debate on sustainability reporting?


Measuring non-financial performance is difficult

Key to monitor/curb corporate externalities

Debate on sustainability reporting:

- i. What information should firms be required to disclose?
- ii. How enforce the sustainability reporting standards?
- iii. How to avoid unintended consequences (real effects)?

What is the goal? (Leuz, 2020)

- ✓ Giving investors what they want?  Single materiality
- ✓ Driving change?  Double materiality

Is “the Machine” affecting the debate on sustainability reporting?

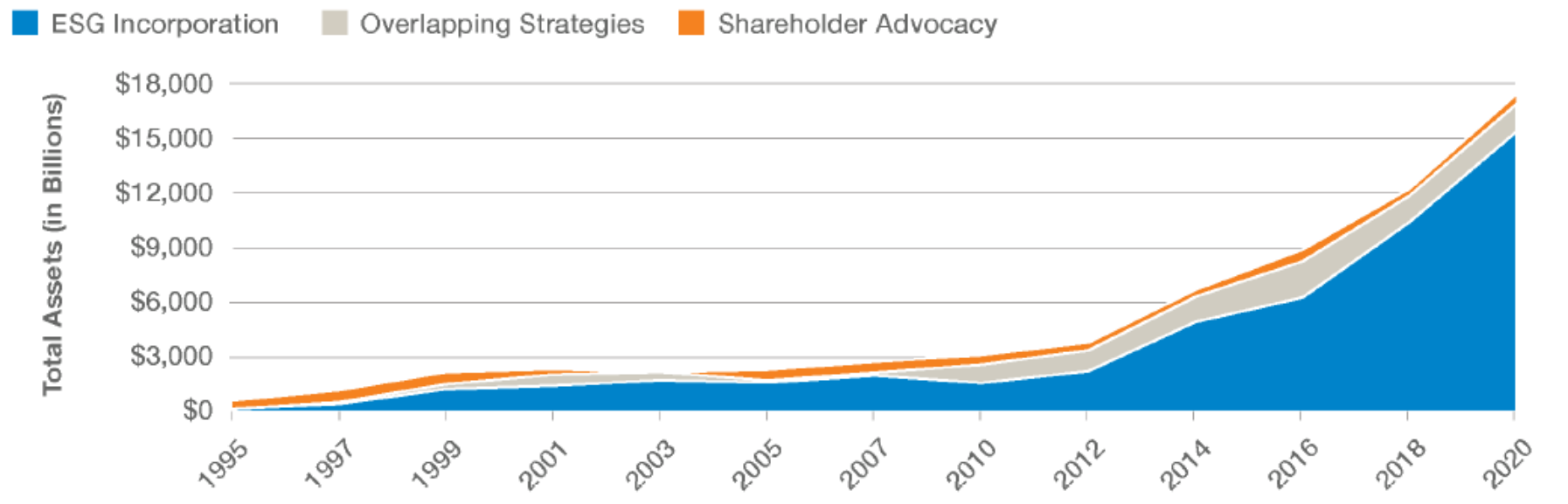
“If established, the SSB would initially focus its efforts on the sustainability information most relevant to investors and other market participants. Such information would more closely connect with the current focus of the IASB.”

Consultation Paper on Sustainability Reporting,
IFRS Foundation, December 2020

The future of “shareholderism”

Growing social pressure

Sustainable Investing in the United States 1995-2020



“Enlightened” shareholder primacy: “the machine is slowly moving in the direction of incorporating stakeholder interests, on the grounds that this is what investors want”

The future of “shareholderism”

But...are ESG efforts just “window-dressing”?



Financial Times article headline: “BlackRock accused of ESG inconsistency over Indonesia palm oil”

The image shows a screenshot of the Financial Times website. At the top, there is a navigation bar with a hamburger menu icon, a search icon, and the text "FINANCIAL TIMES". Below this is a secondary navigation bar with links for "HOME", "WORLD", "US", "COMPANIES", "TECH", "MARKETS", "CLIMATE", "OPINION", "WORK & CAREERS", "LIFE & ARTS", and "HOW TO SPEND IT". The main headline of the article is "BlackRock accused of ESG inconsistency over Indonesia palm oil", with the word "BlackRock" in a smaller font size than the rest of the headline.



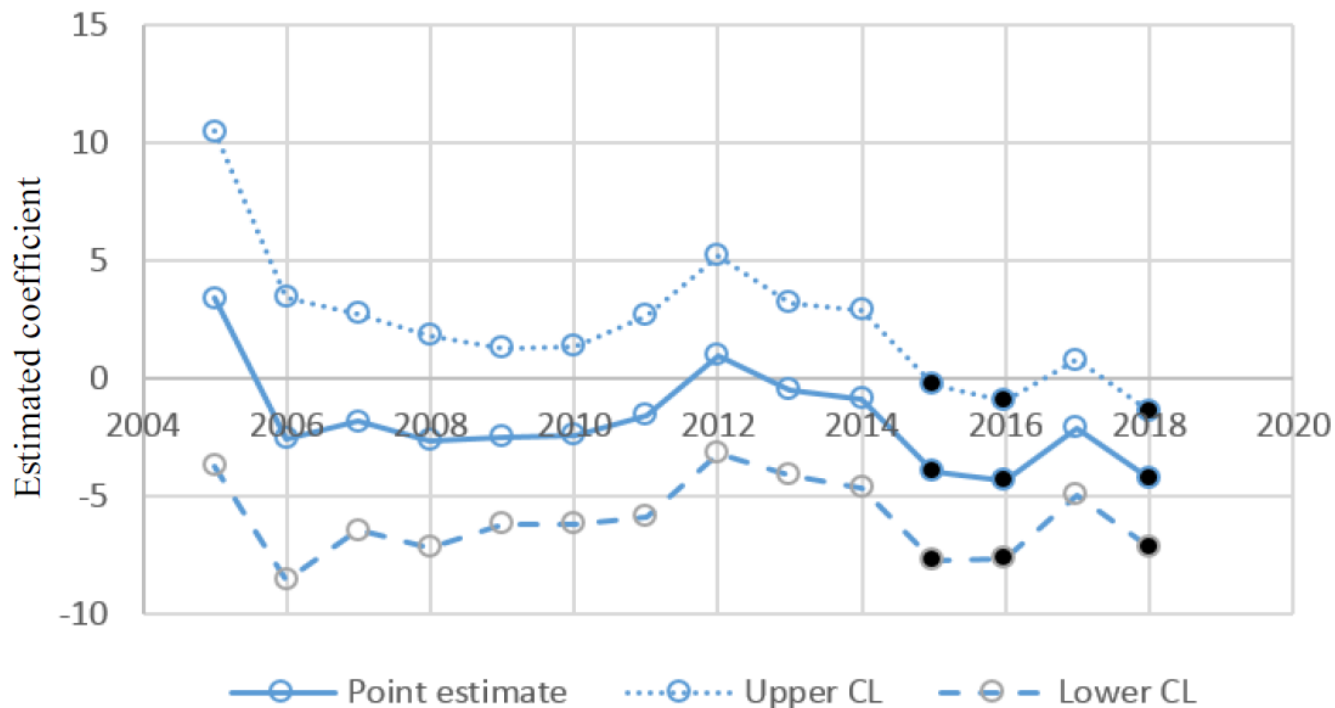
“Fink promises cultural change at BlackRock after discrimination allegations”

A light orange rectangular box containing a quote in a serif font. The quote is: “Fink promises cultural change at BlackRock after discrimination allegations”.

The future of “shareholderism”

The Big Three are effectively pushing firms to decrease emissions

$$\text{Log}(CO_2)_{it} = \alpha + \beta * \text{Big3_Hldg}_{it-1} + \gamma * \text{NonBig3_Hldg}_{it-1} + \Phi * \text{Controls}_{it-1} + \tau_t + \delta_i + \varepsilon_{it}$$



(Azar, Duro, Kadach, Ormazabal, JFE 2021)

The future of “shareholderism”

Increasing success of ESG activism,
despite negative effects on stock prices!

<https://www.wsj.com/articles/activist-wins-exxon-board-seats-after-questioning-oil-giants-climate-strategy-11622050087>

BUSINESS

Activist Wins Exxon Board Seats After Questioning Oil Giant's Climate Strategy

Engine No. 1's victory in one of the most expensive proxy fights ever is unprecedented setback for Exxon and CEO Darren Woods

WSJ, May 26, 2021

XOM -0.47% ▼

✓ **Is there anyone “behind the machine”?**

If the parts are not coordinated, perhaps the machine is not as strong/powerful as the paper claims...

✓ **The machine is different outside the US (law, institutions, culture...)**

Perhaps there will be convergence

✓ **Is ESG becoming a “social norm” (Benabou and Tirole, 2006)?**

Effect on individual behavior, regulation, market pressure...

- Implications for the debate on “Stakeholderism”?
- Will “the machine” become a “body” or an “ecosystem”?