# Corporate Conformism

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For comments and suggestions, our thanks to Allen Buchanan, Tom Christiano, Ross Emmett, Patrick Harless, John Pound, Dave Schmidtz, and participants at the Arizona State University Center for the Study of Economic Liberty PPE seminar.

## Abstract

Corporate social responsibility (CSR) has gone mainstream. Over a quarter of total assets under management are now invested in socially responsible companies. Likewise, the global demand for sustainable products continues to rise. This growing "demand for corporate morality" has prompted new optimism among scholars about corporations' ability to cater to both our economic and moral preferences. However, while scholars agree that the production of "moral goods" may benefit society as a whole, they continue to disagree on whether it can be reconciled with economic efficiency.

This Article suggests that the real cost of CSR is not economic but democratic. When a morality demand is introduced in competitive markets, there is no profitable deviation at the equilibrium for corporations as producers of moral goods, as not engaging in CSR would make them less competitive. This equilibrium prediction dispels concerns about economic efficiency—but implies a warning against the risk of "corporate conformism" and a loss of pluralism. This risk is a by-product of the divisive nature of moral goods, as a reflection of individuals' often conflicting moral preferences. Attempting to capture a larger demand, corporations conform to the morality of the capitalist majority, even though it might represent just a minority of individuals. This threatens moral pluralism, potentially explaining why CSR engagement presently tends to have an almost exclusively progressive connotation.

There are no easy answers to cure CSR's overlooked democratic dysfunction, but we conclude by attempting to identify the several tough questions that need to be asked to that end.


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# CORPORATE CONFORMISM

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## INTRODUCTION

Corporate social responsibility ("CSR"), once viewed as a largely marginal phenomenon, has gone mainstream. The numbers speak loudly. Fortune Global 500 firms now spend around $20 billion a year on environmental initiatives, fair trade, labor policies, help to disadvantaged communities, poverty aids[1]—CSR's scope expands almost by the day. Perhaps even more strikingly, socially responsible investing has grown into a staggering $40 trillion worldwide.[2] Meanwhile, two-thirds of global consumers declare they

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[1] *See* Stephan Meier and Lea Cassar, *Stop Talking About How CSR Helps Your Bottom Line*, HARV. BUS. REV. (Jan. 31, 2018), https://hbr.org/2018/01/stop-talking-about-how-csr-helps-your-bottom-line.

[2] Opimas, ESG Data Integration by Asset Managers: Targeting Alpha, Fiduciary Duty & Portfolio Risk Analysis (June 17, 2020), http://www.opimas.com/research/570/detail/. The

are willing to spend more for products and services that are sustainable.[3] Unsurprisingly, these developments have reignited the scholarly debate about the normative desirability of CSR.[4] At the core of this debate is a foundational question: that of the compatibility between capitalism and morality. This question has a long history. It goes all the way back to what has become known as "Adam Smith's problem": the issue of the relationship between *homo moralis*, who privileges sympathy (today, we would say empathy), and *homo economicus*, who focuses on self-interest.[5] Significantly, the changes that have taken place in CSR engagement have brought about a new understanding of that relationship.

Corporate scholars now largely frame CSR as a "demand issue" that revolves around project selection[6] rather than a "supply choice" left to the discretion of the corporation.[7] That is, they increasingly agree that corporations select sustainable projects in response to a "morality demand" of their stakeholders, including consumers, workers, and, with increasing frequency, also shareholders. In Smithian terms, the change is quite radical. Earlier approaches to CSR shared a common view of the preferences of *homo economicus* and *homo moralis* as being largely irreconcilable. In contrast, today's scholars partake a certain optimism that corporations have grown able to cater to a new "species": the *moralized homo economicus*. However, in spite of this optimism and a common view of CSR as beneficial to society as a whole, scholars continue to disagree on whether CSR can be reconciled with the economic efficiency of the corporation and the persistent shareholder primacy orientation of corporate law.[8]

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increase in sustainable investments has been so transformational to prompt a "rebranding" of CSR. Today, the focus has shifted to "ESG" (environmental, social and governance) criteria in the conduct of business. For an analysis of the subtle differences between CSR and ESG, see Elizabeth Pollman, Corporate Social Responsibility, ESG and Compliance, Forthcoming, Cambridge Handbook of Compliance (D. Daniel Sokol & Benjamin van Rooij eds.) (manuscript at 2-5), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3479723. In this Article, we will continue to use the term CSR to globally refer to both the interest of corporations and investors in moral and social issues.

[3] Nielsen Research, The Sustainability Imperative – New Insights on Consumer Expectations (hereafter, Nielsen Report), https://www.nielsen.com/wpcontent/uploads/sites/3/2019/04/Global20Sustainability20Report_October202015.pdf.

[4] *See infra* Part I.

[5] First exposed by a group of German scholars in the mid-nineteenth century, "das Adam Smith problem" concerns the apparent inconsistency in Smith's works on moral theory (as exposed in the "Theory of Moral Sentiments") and economic theory (as exposed in "The Wealth of Nation"). For an exhaustive treatment of the Adam Smith's problem, see James R. Otteson, *The Recurring "Adam Smith Problem,"* 17 HIST. PHILOS. Q. 51 (2000); for a law and economics perspective, see Paul G. Mahoney, Adam Smith, *Prophet of Law and Economics*, 46 J. LEG. STUD. 207, 221 (2017).

[6] *See infra* Part I.A.

[7] *See infra* Part I.B.

[8] *See, e.g.*, Stavros Gadinis and Amelia Miazaad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401, 1414-25 (2020) (reviewing arguments in favor and against CSR compatibility with shareholder primacy and economic efficiency); Dorothy Lund, *Corporate Finance for Social Good*, (forthcoming 121 COL. L. REV. (2021) (manuscript 1-2), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3511631 (arguing that managers lack

This Article shares the view that booming CSR initiatives are explained by increased stakeholder demand for corporate engagement in moral actions, to which corporations respond through the production of what we call "moral goods."[9] But it argues that the new "market for corporate morality" imports a democratic, rather than an economic, loss.

Along the economic dimension, we show that when a morality demand is introduced in competitive markets, there is no profitable deviation at the equilibrium for corporations as producers of moral goods, as this deviation would make them less competitive. Put differently, the "moralization of capitalism" becomes an endogenous market outcome, that binds all market participants. Under this outcome, the compatibility between CSR and shareholder primacy is no longer a concern, as corporations produce moral goods not in spite of shareholder value maximization, but precisely because they are held to it. On the whole this sounds as though it could be the best of all possible worlds. It *would* be if individuals could agree on the boundaries of good morals. But in a world of heterogenous and often conflicting moral preferences, moralized markets may devolve into conformity and thereby trigger a loss of pluralistic values. This occurs because in the attempt to capture a larger demand and remain competitive, corporations tend to exclusively produce the moral goods that appeal to the moral preferences of the "capitalist majority,"[10] even though it might represent just a minority of individuals.

Surprisingly, neither earlier nor more recent studies of CSR consider the possibility of moral disagreement. Instead, they rely on a representation of moral actions as producing benefits that are universally justifiable to all.[11] How is this possible, especially when one considers the increased level of polarization of the American public?[12]

In part, this assumption reflects an artificial separation in the CSR literature between "classic CSR," a category including arguably (but not necessarily actually) less divisive moral and social issues such as environmental concerns or labor policies, and "political CSR," which includes the highly

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the incentives to pursue CSR initiatives with large welfare benefits when these initiatives are value-reducing).

[9] *See infra* Part II.C.

[10] We use the term "capitalist majority" to distinguish economically-driven outcomes and influence from democratic ones. A "democratic majority" is the majority of individuals under the one-person, one-vote rule. A "capitalist majority" constitutes the majority of economic interest, that determines market outcomes. That majority of economic influence may be determined by a (possibly very small) minority of individuals. It may tie to individual purchasing power (for consumers), contractual power (for suppliers and workers) or the number of shares held (for shareholders).

[11] S*ee infra* text accompanying notes 75-79.

[12] Americans have rarely been as polarized as they are today. *See, e.g.,* Michael Dimok & Richard Wike, *America is Exceptional in the Nature of its Political Divide*, PEW RES. CTR.: FACT TANK (Nov. 13, 2020), https://www.pewresearch.org/fact-tank/2020/11/13/america-is-exceptional-in-the-nature-of-its-political-divide/.

divisive issues that are typically associated to one's political or religious beliefs.[13] Think of issues such as abortion rights, immigration same sex-marriage, race relations, and so on. What the literature overlooks is that today's corporations are increasingly taking an active stance in many of these divisive issues.[14] Target's move to gender-neutral store signage,[15] Wells Fargo's commitment to the LGBT community at large, [16] Amazon's decision to ban the sale of Confederate flag merchandise,[17] LEGO's addition of more female "minifigures" to its catalogue[18] or, still, Netflix and Disney's announcement that they would stop filming in states supporting restrictive abortion laws[19] are just a few recent examples. Likewise, investors have become increasingly willing to demand engagement on potentially divisive issues. Index funds, in particular, have grown vocal, at times even confrontational, in their engagement in salient social issues, starting with gender diversity.[20] Further, when one considers that one's morality demand is subject to trade-offs (given that individuals have budget constraints), even non-political issues such as environmental concerns may turn out to be pretty divisive in practice.[21]

Another possible explanation for this gap in the literature is that moral disagreement may not matter that much for CSR analysis, either because markets can (i) fully internalize stakeholders' heterogenous moral preferences, or (ii) provide a mechanism that can efficiently aggregate conflicting moral preferences

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13 *See, e.g.,* Jukka Mäkinen & Arno Kourula, *Pluralism in Political Corporate Social Responsibility*, 22 BUS. ETHICS Q. 649, 650 (2012) (defining political CSR as referring to "research on the political role of companies.")

14 *See, e.g.,* Global Strategy Group, Business and Politics-Do They Mix? 2 (2016) [hereafter, 2016 Global Strategy Report), https://www.globalstrategygroup.com/wp-content/uploads/2016/01/GSG-2016-Business-and-Politics-Study_1-27-16-002.pdf (reporting increasing corporate engagement in issues such as immigration, minimum wage, same-sex marriage, the environment, and race relations.).

15 In response to customer feedback, retail giant Target announced in August 2015 that it would have removed signs that suggest products based on gender. *See* Target, A Bullseye View, What's in Store: Moving Away from Gender-Based (Aug. 7, 2015), https://corporate.target.com/article/2015/08/gender-based-signs-corporate.

16 Wells Fargo became the first U.S. bank to run a national ad that includes a same-sex couple. See Jacob Passy, *Wells Fargo: Ad with Gay Couple Reflects Demography Reality*, AMERICAN BANKER (jun. 23, 2015), https://www.americanbanker.com/news/wells-fargo-ad-with-gay-couple-reflects-demographic-reality.

17 *See* Alexander C. Kaufman, *Amazon Bans Confederate Flag Merchandise: Reports*, HUFF. POST (Jun. 23, 2015), https://www.huffpost.com/entry/amazon-confederate-flag_n_7647786.

18 To address consumer demand for more female representation, in 2015 LEGO began to add more female "minifigures," including female deep sea explorers, engineers, mechanics and astronauts. *See* Chris Weller, *Lego is Slipping a Feminist Message into Its Newest Line of Characters*, BUS. INSIDERS (Jun. 29, 2015), http://www.businessinsider.com/legos-newest-characters-are-incredibly-important-for-young-girls-2015-6

19 *See* Julia Alexander, *Eight Hollywood Studios Threaten to if an Abortion Ban Becomes Law*, THE VERGE (JUN. 30, 2019), https://www.theverge.com/2019/5/29/18645156/disney-production-georgia-abortion-ban-bob-iger-netflix-avengers.

20 *See* Michal Barzuza, Quinn Curtis and David H. Webber, *Shareholder Value(s): Index Funds, ESG Activism and the New Millennial Corporate Governance*, 93 SOUTH CAL. L. REV. 101, 105, 121-24 (2020).

21 *See infra* text accompanying notes 148-150.

into a normatively desirable order. Both of these explanations, however, collide with the evidence about corporations' current CSR "offer." That offer, especially concerning divisive issues, presently reflects a virtually exclusive progressive orientation.[22] This inherently negates (i), as the internalization argument predicts increased, not reduced (or almost non-existent), moral pluralism. It also negates (ii), unless one believes that disregarding the moral preferences of half of the voting population is an efficient mechanism to compose a society's moral conflicts. Of course, nothing would change for our analysis if the CSR offer was homogenously conservative rather than progressive. Instead, the central research question here is why we observe morally unilateral CSR engagement.

The answer, we argue, comes from the combination of two factors: the complexities that the divisive nature of moral goods imports into their production calculus and the role played by asset price effects in that calculus. First, the defining feature of divisive moral goods is that the same moral good can produce either a positive or negative externality depending on the degree to which it matches one's moral identity (i.e., the set of moral preferences that is unique to each individual). This feature imports a unique production constraint in the production of such goods: "exclusivity," meaning that the production of moral good $x$, reflecting, say, a progressive moral identity (e.g., a pro-choice policy) excludes the ability to produce what we term the "contrarian" moral good $y$, reflecting a conservative identity (e.g., a pro-life policy). In response to this constraint, corporations will need to opt for either one good or the other, as producing both goods would destroy their respective values (For an evocative analogy, imagine what would happen if the Vatican Publishing House started to add pornography publications to its catalogue.)

Second, we argue that "moral portfolios" choices and asset price effects weigh heavily in CSR's production calculus. In the conventional account, one key economic concern with CSR engagement is that it may lead to forsake profits and hence a decline in share price, triggering arbitrage opportunities by non-sympathetic shareholders (i.e., who have no interest in the pursuit of moral actions).[23] This account, however, excludes the possibility that sympathetic investors might choose their portfolios based on moral preferences. Drawing on finance theory[24] and motivated by the rapid increase in sustainable

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[22] *See infra* notes 208-212 and accompanying text.

[23] *See, e.g.,* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005); Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247 (2017) (both examining how collective action problems encourage even prosocial shareholders to tender to hostile acquirers with antisocial goals).

[24] *See, e.g.,* Christian Gollier & Sebastian Pouget, The Washing Machine: Investment Strategies and Corporate Behavior with Socially Responsible Investors, No. 14-157 TSE Working paper (2014) (developing a model showing that investors can decrease the equilibrium cost of capital of responsible firms by altering their portfolio allocation towards the assets of these firms); Harrison Hong & Marcin Kacperczyk, *The Price of Sin: The Effect of Social Norms on Markets*, 93 J. FIN. ECON. 15 (2009) (showing empirically that "vice" assets enjoy a higher risk-adjusted returns than other assets).

investments, we consider that possibility.[25] Doing so shows that as long as sympathetic shareholders are willing to pay a premium for the shares of CSR corporations (i.e., distort their portfolios so to include *more* CSR shares than it would otherwise be optimal), CSR engagement may be compatible with share value maximization even if it is cash-flow reducing. In a stylized explanation, this is because the distortionary portfolio choices of sympathetic shareholders lead to increased demand for CSR shares. Similar to what happens in financial bubbles, this increased demand translates into a share price increase, helping to internalize the cost of moral goods. The attempt to capture these asset price effects will accordingly weigh heavily in corporations' CSR decisions. But then this means that CSR corporations will tend to produce the moral goods (e.g., $x$ rather than $y$) for which in the aggregate there is a larger demand, even though this demand may come from a minority of individuals under the preference aggregation mechanism in place in the corporation (i.e., the one-share, one-vote rule).

Now enter competitive markets. In, again, a simplified account,[26] it is intuitive to see how abstaining from CSR engagement would trigger a reduction in the share price of non-CSR corporations, as long as the effect arising from the portfolio readjustment of sympathetic investors is dominant. (This is an assumption that we show is reasonable for several motives, including the prediction that sustainable investments will soon take up more than half of global mutual fund investments).[27] Under this prediction, we can then expect an equilibrium of "conformist moralized markets." On the one hand, not engaging in (or disengaging from) CSR threatens corporations' competitiveness. On the other, catering to the capitalist majority is what enables corporations to capture a larger demand (while moral goods' exclusivity prevents corporations from also catering to minority morality demands).

Finally, this equilibrium prediction helps explain why we almost exclusively observe progressive CSR engagement—a circumstance that remains otherwise largely understudied. More fundamentally, the risk of corporate conformism suggests that the newly founded ability of corporations to bring together *homo economicus* and *homo moralis* may come at a high cost. In spite of long-standing scholarly concerns about the economic efficiency of CSR, this cost is, in fact, democratic. For the price to pay for this new corporate holism is the loss of pluralism that is triggered by what starts looking like a "(moral) tyranny of the (capitalist) majority."

This conclusion raises several crucial normative questions, which space constraints prevents us from fully addressing, but which we hope will be pursued in future research (the first question being what factors explain the association between the majoritarian capitalist demand and progressive identity). More pragmatically, in our policy analysis, we focus on what can be done to

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[25] *See infra* Part III.B.1.
[26] See infra Part III.B.2.
[27] *See* Alastair Marsh, *Almost 60% of Mutual Funds Will Be ESG by 2025, PwC Says* (Oct. 19, 2020) https://www.bloomberg.com/news/articles/2020-10-19/almost-60-of-mutual-fund-assets-will-be-esg-by-2025-pwc-says.

make CSR engagement compatible with pluralistic values. Our intuition is that restoring "market pluralism" would require a costly adaptation of the one-share, one-vote rule—which serves to efficiently aggregate economic preferences, but is the ultimate source of the loss of pluralism when it is employed to aggregate moral preferences. In particular, we envision two forms the adaptation of this rule could take. One proposal is to adopt a supermajority requirement over CSR decisions, to enhance their inclusiveness. The more radical, but perhaps also more consequential, proposal is to substitute the one-share, one-vote rule for CSR decisions with the one-person, one-vote rule, as the only mechanism that can safeguard an egalitarian aggregation of our moral preferences (and, indeed, the one that is adopted in political democracies).

The costs of this adaptation, as well as the implementation details (for example, where should one draw the line between CSR and non-CSR decisions?), are not negligible, however. This raises the question of whether we shouldn't just surrender to the idea that there is no solution to the Adam Smith's problem and accept that *homo economicus* and *homo moralis* belong to separate spheres. Yet, we might be too late to answer this question anyway, as it seems unlikely that we can go back to a model of "moral neutrality" of the corporation.[28] Finally, there are no easy answers when it comes to restoring market pluralism. But perhaps it is enough to begin a conversation about the questions we must ask.

This Article proceeds as follows. Part I examines where we stand in the CSR debate and attempts to understand why this debate has abstracted away from the issue of the divisive nature of moral goods. Part II (re)examines stakeholders' demand for moral actions and the corporations' supply of moral goods by taking into account the inherently divisive nature of moral goods. This analysis shows that while the morality demand is compatible with the system of preferences of *homo economicus*, the divisive nature of moral items uniquely characterizes the production calculus of moral goods and the related market clearing process. Part III is the core of our analysis. It first shows that under the asset price effects arising from moral portfolios, stakeholders' economic interest in the corporation is what ultimately matters for the production calculus of moral goods at the individual firm level. Second, it shows that when these effects are globally considered in the context of competitive markets, the moralization of capitalism becomes an endogenous market outcome, but so does corporate conformism. Part IV examines what can be done to restore the loss of pluralistic values that is triggered by corporate conformism, mainly focusing on identifying questions for future research.

## I. CORPORATIONS AND MORAL ACTIONS

A rapid search on Google Scholar reveals that the number of articles focusing on CSR issues in 2020 was over 20,000. And over 40 CSR conferences

[28]The prediction is, in fact, that CSR and ESG trends will continue to increase. *See e.g.,* Watchell, Lipton, Rosen & Katz Memorandum, ESG and Sustainability: Key Issues for 2021 (Jan. 27, 2021),https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.27332.21.pdf

and industry events took place in the United States alone last year.[29] Further, the University of Chicago Booth School of Business recently published an e-book collecting a series of 28 essays (from most prominent economists and corporate law scholars) that reexamine Milton Friedman's influential CSR article in its 50th anniversary.[30] The point is that the CSR debate is more alive than ever today.[31] In this Part, we examine where we stand in this debate, and introduce the novel analytical dimension our argument brings to the table.

In recent years we have witnessed the development of a new stage of understanding of the linkage between corporations and moral actions. In this new stage, corporate scholars have moved away from earlier "supply models" of CSR.[32] Those models revolved around the question of what the objective function of the corporation should be, with scholars divided between those defending shareholder value maximization as the corporation's sole function (i.e., the "Friedman Principle") and those advocating for a broader corporate purpose. But with the dramatic growth of CSR engagement, researchers have stopped asking *whether* corporations should behave morally; rather, they now ask *why* corporations do so. The majoritarian view, although presenting substantial nuances, is that we have transitioned to a "demand model" of CSR.[33] Under this model, growing stakeholder appetite for corporate morality explains the unrelenting expansion of sustainable corporate investments.

We share the demand approach of more recent studies and, in this Article, we aim to clarify some of the mechanisms at play in the new "market for corporate morality." To that end, we begin by addressing the somewhat sidelined question of what explains the changes that have occurred in the demand of stakeholders. After all, both corporations and moral preferences have been around for quite some time. So, why *now*? Next, we introduce an analytical dimension that has been largely overlooked in both recent and earlier CSR studies. This dimension concerns the nature of moral actions (as well as that of the moral goods corporations produce in response to the demand for corporate engagement in such actions). Surprisingly, the existing literature fails to consider the inherently divisive nature of most moral items,[34] instead working under the assumption that any moral conduct delivers universally justifiable benefits to all. This assumption, however, not only results in a descriptively

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29 *See, e.g.,* Texas Impact Alliance Blog, 47 Corporate Social Responsibility and Sustainability Conferences in 2020 (Jan. 2, 2020), https://www.texasimpactalliance.com/blog/top47.

30 *See* ProMarket, eBook: Milton Friedman 50 Years Later, A Reeavaluation (Nov. 17, 2020) [hereafter, ProMarket eBook), https://promarket.org/2020/11/17/ebook-milton-friedman-50-years-later/. Friedman famously published his CSR essay in 1970 in the New York Times Magazine. *See* Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, N.Y. TIMES (MAGAZINE), Sept. 13, 1970.

31 *See* Deborah Burand & Anne Tucker, *Legal Literature Review of Social Entrepreneurship and Impact Investing (2007-2017): Doing Good by Doing Business*, 11 WM. & MARY BUS. L. REV. 1 (2019-2020) (reviewing 260 legal scholarship articles written by over 150 authors about the fields of social enterprise, social finance, and impact investing in the 2007-2017 decade).

32 *See infra* Part I.A.

33 *See infra* Part I.B.

34 In this Article, we use the term "moral item" to refer to both moral actions and moral goods.

reductive account of CSR, but, as we shall see, it also vitiates the analysis of the normative implications of the market for corporate morality.

### *A. Where We Stand*

#### 1. Supply Models

As hinted to in this Article's introduction, the CSR debate can be seen as a variant of "das Adam Smith problem:" the problem of the relationship existing between *homo economicus* and *homo moralis*.[35] CSR critics move from the view that *homo economicus* and *homo moralis* occupy different social spheres. The former belongs to the economic sphere, in which humans maximize gains from material exchange and self-regarding behavior.[36] The latter occupies the sphere of personal exchange, which is the locus for sympathy and other-regarding conduct involving social or moral responsibility.[37] Under this dichotomic approach, the corporation, as an organization belonging to the market, clearly falls within the domain of *homo economicus*.[38] Hence, as famously put by Milton Friedman, the exclusive "social responsibility of business is to increase its profits."[39] Other-regarding conduct bringing about broad benefits should instead be left to the government (or non-profit organizations).[40]

In contrast, those defending the view that corporations have broader social obligations[41] move from the assumption that human beings have complex motivations, so that the sphere of sympathy and self-interest cannot be artificially separated.[42] Corporations should thus tend to both. However, in case of conflict, the preference of *homo moralis* are understood to trump those of *homo*

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[35] *See supra* note 5.
[36] *See* Vernon Smith, *The Two Faces of Adam Smith*, 65 SOUTH. ECON. J. 1, 3 (1998) (suggesting that Smith had one "behavioral axiom: the propensity to truck, barter, and exchange one thing for another.") *Id.* The relevance of different "loci" of exchange (i.e., the economic vs. the moral sphere) then "explains why the human nature appears to be simultaneously self-regarding or other-regarding."). *Id.*
[37] *See id.*
[38] *See, e.g.,* Ronen Shamir, *Corporate Social Responsibility: Toward a New Market Embedded Morality?* 9 THEOR. INQ. 371, 375 (2008) ("The invention of the economy [by Adam Smith] as a distinct sphere of human action, therefore, also proclaimed the autonomy of market relations from moral sentiments.").
[39] *See* Friedman, *supra* note 30.
[40] *See id.*
[41] The use of the term "social responsibility" to refer to the concept of incorporating stakeholders and their interests in how companies are run first emerged in the 1950s, when economist Howard Bowen's published his landmark book, "The Social Responsibilities of the Businessman." *See* Archie B. Carroll, *Corporate Social Responsibility*, 38 BUS. & SOC. 268, 269-70 (1999)(providing a detailed account of the history of the story of CSR) .
[42] *See, e.g.,* Ronald Coase, *Adam Smith's Views of Man,* 19 J. L. & ECON. 529, 533 (1976); Amartya Sen, *Economics. Business Principles, and Moral Sentiments*, 7 BUS. ETHICS 5 (1997) (challenging the view that moral sentiments "at least in economic matters, … have a very narrow reach (indeed, it is often presumed that such sentiments have no real influence on economic behavior)."); AMARTYA SEN, ON ETHICS AND ECONOMICS 1-28 (criticizing "the self-consciously" non-ethical character of modern economics.").

*economicus*, as "the law of justice" limits the pursuit of self-interest.[43] In more concrete terms, this means that the pursuit of moral conduct may require sacrificing profit-maximization and shareholder value.[44]

While conceptually antithetical, these views of CSR have two things in common. First, they both conceive of the preferences of *homo economicus* and *homo moralis* as largely irreconcilable.[45] Framed this way, CSR is a matter that involves a choice about the purpose of the corporation—that is, about which set of preferences should prevail over the other. Both these approaches, then, can be said to revolve around a "supply model" of CSR, although they provide opposite assessments of the optimal model. Either camp assumes that whether corporations should engage in CSR is a discretionary corporate choice. However, depending on whether one stands on the spectrum of earlier CSR positions (from Friedman-esque ones to progressive ones), the optimal choice takes the form of no CSR, profit-sacrificing CSR or anything in between.

Second, both the above approaches fail to explain the transformation we have witnessed in CSR practices in the past twenty years or so. Friedman-esque critiques of CSR seems increasingly outdated when confronted with the booming numbers of CSR investments. If "only people have responsibilities," as argued by Friedman,[46] what explains the increasing calls for corporate engagement in a broad range of moral actions? But CSR numbers also seem incompatible with the systematic sacrifice of shareholder value that is advocated by the most progressive CSR supporters, especially under the persistent shareholder primacy orientation of corporate law.[47] It is thus unsurprising that recent years have seen the development of a new approach to CSR. We turn to that approach next.

2. Demand Models

More recent approaches to CSR aim at identifying the reasons that can explain its steady growth. In particular, two positions have gained increasing popularity in the contemporary CSR literature: the "doing well by doing good" approach (also referred to as the "business case" for CSR) and "the maximize shareholder welfare not shareholder value" approach.

Under the former approach, pioneered by Harvard Business School Professor Michael Porter,[48] CSR serves as a source of competitive advantage by

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43 *Cf.* Mahoney, *supra* note 5, at 222.

44 Professor Einer Elhauge is perhaps the most famous defender of this view. *See* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005). For a more recent contribution, see Lund, *supra* note 8 (proposing the issuance of CSR bonds to incentivize profit-sacrificing CSR engagement).

45 *See* Kenneth E. Goodpaster & John B. Matthews, Jr, *Can A Corporation Have a Conscience*, HARV. BUS. REV. (1982), https://hbr.org/1982/01/can-a-corporation-have-a-conscience (criticizing the then dominant view of corporations that "[i]t is improper to expect organizational conduct to conform to the ordinary principles of morality.")

46 *See* Friedman, *supra* note 30.

47 *See, e.g,* Gadinis & Miazad, *supra* note 8, at 1409.

48 *See, e.g.,* Michael E. Porter & Mark R. Kramer, *The Competitive Advantage of Corporate Philanthropy*, HARV. BUS. REV. 58 (Dec. 2002) (arguing that "social and economic goals are not inherently

helping corporations to secure the goodwill of consumers, suppliers, employees and even regulators.[49] Note that under this conceptualization, CSR is fully compatible with the Friedman's principle. Yet, critics of the "business case" for CSR argue that it amounts to a mere slogan, or "mantra," as most CSR initiatives *absorb*, rather than increase, profits.[50] In response to this criticism, two variants of the "doing-well-by-doing good" approach have emerged. The first solves the issue of compatibility with shareholder value maximization along a temporal dimension, suggesting that while CSR initiatives might engender short-term costs, they tend to deliver long-term returns.[51] The second requalifies the business case for CSR as a risk-management tool, where risk is understood as arising from a wide variety of sources.[52] Importantly, these sources entail not just legally sanctioned risks but also "social risk," which arises from the violation of the social and/or moral values of a company's stakeholders.[53]

The "maximize shareholder welfare not shareholder value" approach calls, instead, for an expansion of the utility function of shareholders. As put by its leading proponents—the 2016 Nobel prize winner in economics, Oliver Hart, and Chicago Booth Professor Luigi Zingales—this approach revisits the Friedman Principle by arguing that shareholder welfare cannot be reduced to shareholder value.[54] For shareholders are ultimately ordinary people, who also care about ethical and social concerns and strive to internalize the negative externalities they are concerned with (for example, they may buy electric cars to reduce pollution).[55] Hence, there is no reason to think shareholders would not

conflicting but integrally connected."); Michael E. Porter et al., *Where ESG Fails*, INST. INV. (Oct. 16, 2019), https://www.institutionalinvestor.com/article/b1hm5ghqtxj9s7/Where-ESG-Fails (defending the idea of profit-driven social impact or "shared value").

49 The argument here is that behaving responsibly serves to "appease" regulators, thus reducing the risk of regulatory interventions. *See* David P. Baron, *Private Politics, Corporate Social Responsibility, and Integrated Strategy*, 10 J. ECON. & MANAGEMENT STRATEGY 7, 18 (2001).

50 *See, e.g.,* Roland Benabou & Jean Tirole, *Individual & Corporate Social Responsibility*, 77 ECONOMICA 1, 9.

51 *See id.*

52 In this context, the reference is more often to ESG than CSR. *See* Pollman, *supra* note 2, at 5, 7-8.

53 *See, e.g.,* Gadinis & Miazad, *supra* note 8, at 1411, 1424-39 (arguing that ESG serves shareholder interests at it remedies "gaps in boards' understanding of social risk by turning directly to potentially impacted third parties in order to source information about the consequences of company practices."); Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1 (2020) (arguing that increased institutional investors activism in socially responsible issues, such as climate change, is rationally motivated by their interest to internalize the negative externalities that may affect their diversified portfolios).

54 *See* Hart & Zingales, *supra* note 23, at 247; *see also* Eleonora Broccardo, Oliver Hart and Luigi Zingales, Exit vs. Voice, University of Chicago, Becker Friedman Institute for Economics Working Paper No. 2020-114, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3680815 (arguing that voice is a more effective strategy to promote shareholder welfare and socially responsible investments). The "utility maximization" view of CSR, however, is not entirely new. In his 1971 book, Business in Contemporary Society, Harold Johnson presents this approach as one of the established views of CSR, under which "the enterprise seeks multiple goals rather than only maximum profits." *See* HAROLD JOHNSON, BUSINESS IN CONTEMPORARY SOCIETY 59 (1971).

55 Hart & Zingales, *supra*, at 248.

want the companies they invest in to do the same, even if this might require giving up some expected returns.[56] This is especially likely to be the case when corporations are in the best position to mitigate externalities, such as when the production activity and the externality-engendering activity are not separable (think, for example, to pollution that is produced by the corporation itself).[57]

Notwithstanding their apparent differences, more recent approaches to CSR also have two things in common. First, they share a novel optimism about the ability of corporations to bring together *homo economicus* and *homo moralis*. The "doing well by doing good approach" poses that the preferences of the latter are not against, but rather consistent, with the preferences of the former. And the "maximize shareholder welfare not shareholder value" approach retrieves the argument of the complexity of human motivations and preferences but with greater hope that corporations can be utility-maximizing vehicles.[58] Restated, each approach moves beyond prior dichotomic characterizations, pointing to the rise of a new actor, the "*moralized homo economicus*."

Second, and relatedly, both approaches abandon a supply model of CSR, where the engagement in moral actions is an unconstrained choice of the corporation, to endorse instead a demand model, where this engagement responds to a demand of the corporations' stakeholders. As put more explicitly by Chicago Law School Professors Todd Henderson and Anup Malani, people now purchase corporate engagement in moral actions (what in this Article we call moral goods) as they do purchase other goods corporations produce.[59]

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[56] *Id.*

[57] *Id.* at 249.

[58] Utility here is defined as the sum of financial returns and non-financial benefits coming from the pursuit of moral actions.

[59] *See* M. Todd Henderson & Anup Malani, *Corporate Philanthropy and the Market for Altruism*, 571 COL. L. REV. 571, 575 (2009). Henderson & Malani's analysis of corporate philanthropy is, perhaps, the closest to our analysis of CSR. Like them, we start from the premise that CSR is supplied in response to a "morality demand" of the corporation's stakeholders and we perform an analysis of both the demand and supply side of the morality market. Several important differences, however, characterize our demand approach, both positively and normatively. As a positive matter, first, we conceive of moral goods as closer to private goods (as we claim that moral goods are excludable), while Henderson and Malani share the classic view of these goods as public goods. *See infra* text accompanying note 160. Second, and relatedly, we argue that the supply of moral goods is compatible with shareholder value maximization, while Henderson and Malani defend a broader shareholder welfare maximization test. *See infra* Part II.C.3. As a normative matter, they suggest that the market for altruism adds pluralism by fully internalizing our heterogeneous moral preferences, while we argue this market is conformist and then results in a loss of pluralistic values. *See infra* Part III.C. In 2007, Timothy Besley and Maitresh Ghatak were the first to propose a formal model of CSR demand. See Timothy Besley & Maitresh Ghatak, *Retailing Public Goods: The Economics of Corporate Social Responsibility*, 91 J. PUB. ECON. 1645 (2007). While their model presents several similarities with Henderson and Malani's account, Besley and Ghatak defend the idea that "CSR is consistent with profit-maximization in competitive markets. In equilibrium firms sell ethical brands and neutral brands, and consumers self-select according to their valuation of the public good." While this approach is closer to ours, Besley and Ghatak also fail to consider the divisiveness of moral goods and the positive and normative implications this feature has for CSR analysis. *See infra* Part II.C.2. Further, they also omit to consider moral portfolios and asset price effects, which, instead, play a crucial role in our analysis. *See infra* Part III.B.1.

However, the economics of the new demand model of CSR remain much disputed. Under the "doing well by doing good" approach the demand for CSR can be fully assimilated to the demand for other goods corporations produce and so can the market clearing of this demand, as we shall see in more detail in Part II. On this assumption, issues of economic efficiency affecting CSR decisions should be put to a market test, as it happens with any other corporate production decision. On the contrary under the "maximize shareholder welfare not shareholder value" approach, the CSR demand seems to be inherently different from the demand for other goods. This is largely due to the public good nature of moral goods and the broad social benefits these goods are assumed to deliver under this approach. Given the altruistic motivation behind the stakeholders' private contribution to these goods, satisfying the CSR demand thus requires relaxing economic efficiency and embracing the broader principle of shareholder welfare maximization.

### *B. Why Now?*

Although the debate on CSR is far from being resolved to a consensus view—especially along the economic dimension—the evolutionary trajectory of CSR studies point to a radical transformation. Gone are the days when the mainstream portrayed the corporation as an institution removed from, if not antithetical to, the individuals' moral sphere. Instead, today's corporations have become a means to satisfy our moral preferences, on top of our economic preferences. But what has prompted today's novel demand for corporate morality?

This is a complex question, which is unlikely to have just one answer. A possible explanation—favored by economists, including Nobel prizes Oliver Hart and Jean Tirole—is that society's increased demand for CSR is a response to "government failures" in producing public goods or correcting negative externalities.[60] It is unclear whether these failures are due to the mere inefficiency of the political process or a "combination of inefficiency, high transaction costs, poor information and high delivery costs."[61] In either case, the evidence that corporations do engage, and increasingly so, in CSR would imply that there is a large residual demand for public goods that is not cleared by the government or other organizations.[62] A different explanation—first appeared in market

[60] *See* Benabou & Tirole, *supra* note 50, at 2; Hart & Zingales, *supra* note 23, at 249.
[61] See Benabou & Tirole, *supra*, at 2.
[62] *See* Henderson & Malani, *supra* note 59, at 575 (arguing that while "nonprofits and the government already help others … people seek altruism from corporations … [because] corporations are sometimes better at delivering philanthropy.")

reports[63] and now elaborated in academic studies[64]—points to a cultural change (i.e., an evolutionary morality argument).[65] This change is led by Millennials and implemented through the stewardship of index funds, which have taken an active stance in promoting CSR engagement in hopes of winning "the soon-to-accumulate assets of the millennial generation, who place a significant premium on social issues in their economic lives."[66]

We will return to these explanations in the balance of this Article. Meanwhile, we wish to highlight two additional, but less explored, factors that we believe have played an enabling role in the rise of the morality demand. The first is the digital era, which has facilitated the acquisition of information by corporations about individuals' moral preferences,[67] as well as enhanced individuals' ability to monitor whether corporations deliver promised moral actions.[68]

The second factor is the change that occurred in the legal landscape as a result of the 2010 Supreme Court decision in *Citizens United v. Federal Election Commission*.[69] *Citizens United* established that laws barring corporations from making political expenditures (such as expenditures on advertisement supporting or opposing a candidate) were unconstitutional under the First Amendment.[70] More broadly, this decision is interpreted as having expanded the

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63 *See, e.g.,* Nielsen Report, *supra* note 3 (finding that 73% of global Millennials are willing to pay extra for sustainable offerings—up from 50% in 2014); Ryan Rudominer, *Corporate Social Responsibility Matters: Ignore Millennials at Your Peril*, HUFF. POST (Feb. 5, 2016), www.huffingtonpost.com/ryan-rudominer/corporate-social- responsi_9_b_9155670.html (citing a study by Horizon Media's Finger on the Pulse, which found that "81% of Millennials expect companies to make a public commitment to good corporate citizenship."); Cone, 2015 Cone Communication Millennial Study, https://www.conecomm.com/research-blog/2015-cone-communications-millennial-csr-study ("More than nine-in-10 Millennials would switch brands to one associated with a cause (91% vs. 85% U.S. average)").

64 *See* Barzuza et al., *supra* note 20; *see also* Teresa McGlone et al., *Corporate Social Responsibility and the Millenials*, 86 J. EDUC. BUS. 195 (2011) (arguing that CSR engagement may help corporations to retain the Millennial generation as employees).

65 Under this explanation, the demand for sustainable corporate policies marks the latest phase in our unrelenting march of moral progress, with Millennials taking the lead in this march. On the evolution of moral progress, *see generally* ALLEN BUCHANAN, OUR MORAL FATE – EVOLUTION AND THE ESCAPE FROM TRIBALISM vii-xx (2020).

66 *See* Barzuza et al., *supra* note 20, at 102.

67 *See, e.g.,* Gadinis & Miazad, *supra* note 8, at 1433 (arguing that today's corporations invest in formal and informal mechanism "to capture tidbits of data" about stakeholders' moral preferences that are relevant for the company's profile and reputation).

68 *See, e.g.,* Knowledge@Wharton, From Fringes to Mainstream: Companies Integrate CSR Initiatives into Everyday Business, (May 23, 2012), https://knowledge.wharton.upenn.edu/article/from-fringe-to-mainstream-companies-integrate-csr-initiatives-into-everyday-business/ ("In the Information Age, customers have more access to information … They're more educated. They're no longer hidden from how their food is produced or how their iPods are made. And, because of things like social media, like-minded people more easily find each other, have their say and effect change.") (quoting Robert Grosshandler, CEO of iGive.com).

69 130 S. Ct. 876 (2010).

70 Id. More specifically, *Citizens United* invalidated § 203 of the Bi-Partisan Campaign Reform

agency of corporations from the narrower domain of economic rights to that of socio-political rights.[71] In this broader interpretation, *Citizens United* has met widespread backlash for what was largely viewed as an improper expansion of corporate personhood[72] and the fear that this could lead to the marginalization of the voices of ordinary citizens.[73] A decade later, the evidence on CSR suggests an alternative interpretation of the long-term implications of that decision. By expanding the agency of corporations to socio-political rights, *Citizens United* initiated a process of corporate *responsibilization.*[74] For responsibility requires a space of autonomy where the motivation for action (or inaction) is not just a response to externally imposed rules or values; morality by fiat is a contradiction. By creating that space, *Citizens United* also made room for claims holding corporations responsible for the values they choose, contributing to the rise of the morality demand.

### C. *Where Are We Headed?*

Importantly (but nor commonly recognized), there is a shared assumption underlying all (both earlier and more recent) studies of CSR, as well as prevailing explanations for today's morality demand. This assumption is that the moral actions in which the corporation engages deliver benefits that are universally recognized, understood, and valued by all citizens/stakeholders. Friedman-esque critiques simply assumes that it is not up to the corporation to delivers these broad benefits, but rather to the government (or maybe charitable organizations).[75] Progressive approaches assume, instead, that *precisely* because CSR benefits are universal, the corporation has a duty to deliver them and

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Act of 2002, which bars corporations and unions from spending money from their general treasuries on "electioneering communication[s]," 2 U.S.C. § 441b (2006); Citizens United, 130 S. Ct. at 914–17. An electioneering communication is defined as "any broadcast, cable, or satellite communication" that "refers to a clearly identified candidate for Federal office" and is made within thirty days of a primary or sixty days of a general election. 2 U.S.C. § 434(f)(3)(A).

[71] *See, e.g.,* Amy J. Sepinwall, *Citizens United and the Ineluctable Question of Corporate Citizenship*, 44 CONN. L. REV. 575 (2012) (framing *Citizen United* as a decision about whether corporations are (like) ordinary people.)

[72] *See, e.g.,* Jamie Raskin, C*orporations Aren't People*, NPR (Sept. 10, 2009), http://www.npr.org/templates/story/story.php?storyId=112714052 ("A corporation is not, nor has it ever been, a constitutional person with voting rights . . . ."); Peter Rothberg, *The Story of "Citizens United" vs. the FEC*, THE NATION (Mar. 2, 2011, 5:52 PM), http://www.thenation.com/blog/158964/story-citizens-united-vs-fec ("Corporations are not people, they do not vote, and they should not be able to influence election outcomes.").

[73] Famously, Justice Stevens, in his dissent, remarked that the Court's decision "will undoubtedly cripple the ability of ordinary citizens, Congress, and the States to adopt even limited measures to protect against corporate domination of the electoral process. …" *Citizens United*, 130 S. Ct. at 977 (Stevens, J., dissenting).

[74] *Cf.* David G. Yosifon, *The Public Choice Problem in Corporate Law: Corporate Social Responsibility After Citizens United*, 89 N.C. L. REV. 1197 (2011) (arguing that by removing the insulation of the political process from corporate influence, *Citizens United* also necessarily removed the "division of labor" argument under which socially responsible activities should be left to the political process and profit-maximizing activities are the realm of corporations).

[75] *See* Friedman, *supra* note 30.

thereby increase social welfare.[76] More recent demand-driven approaches also assume no conflict in moral preferences among stakeholders; at best they concede that some individuals might be "neutral" toward the moral or social utility produced by CSR.[77]

Likewise, both the private production of public goods and the evolutionary morality arguments assume no conflicting moral preferences. This is most evident in the public good argument, where it is assumed to be intrinsic to the very nature of the good that everybody benefits from it.[78] Indeed, the problem with public goods is that even people who did not contribute to their production are able to benefit from the positive externality these goods engender, which creates a free rider problem. But even the evolutionary morality argument seems to largely rely on the same non-conflicted assumption with respect to our moral preferences, although it does not exclude that *some* Millenials and other generations might prefer a "more conventional approach to corporate governance" (i.e., an approach that focuses exclusively on shareholder value maximization).[79]

This assumption about individuals' moral preferences returns us to Adam Smith and the "Theory of Moral Sentiment."[80] For Smith, "man naturally desires, not only to be loved, but to be lovely; or to be that thing which is the natural and proper object of love."[81] The desire to be the *proper* object of love is a poetic and appropriately abstract description of morality. But the precise content of morality is contingent on both the individual and the social and environmental context in which she lives.[82] This implies that the boundaries of good morals naturally tend to be contested and that defining a proper moral code is often the endless, soul-gratifying work of each human and of humanity itself.

All of this would sound almost redundant, if it was not radically overlooked in the CSR literature. How is this possible? This question becomes even more puzzling when one considers the increased level of polarization of the American public[83] and the ink that is being spilled about today's growing and deeper partisan antipathy.

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[76] *See, e.g.,* Lund, *supra* note 8, manuscript at 1 (arguing that CSR is "in the service of social welfare" and advances the "interest of society.").

[77] *See* Besley & Gathak, *supra* note 59, at 1646.

[78] Public goods are nonrivalrous (one person's consumption does not preclude another's) and nonexcludable (one person cannot stop another from consuming the product). See Paul A. Samuelson, *The Pure Theory of Public Expenditure*, 36 REV. ECON. & STAT. 387, 387 (1954).

[79] *See* Barzuza et al., *supra* note 20, at 169. Barzuza et al. do briefly consider the objection that "not all shareholders in index funds share Millennial values (needless to say, not all Millennials share them either)." *See id.* Yet, they ultimately embrace the idea that the market can fully internalize our heterogenous moral preferences ("solve any excesses that result.") *See id.* As we shall see below, however, this assumption collides with the theory and practice of CSR.

[80] ADAM SMITH, THE THEORY OF MORAL SENTIMENTS (1759) (Ryan P. Hanley ed.).

[81] *Id.* at 136.

[82] That is, as we explain below, moral preferences are contingent on an individual's identity. *See infra* note 99 and accompanying text.

[83] *See supra* note 12.

We think there are two possible answers. First, the CSR literature has long kept issues associated to one's political or religious beliefs—what some refer to as "political CSR"[84]—artificially separated from seemingly (but not necessarily) less divisive ones. Consider, in the first category, issues such as abortion rights, immigration, same-sex marriage, race relations, and so on. In the second category, consider, instead, classic CSR themes, such as environmental concerns or fair trade. Yet, there is evidence that today's corporations are taking an increasingly active stance in many divisive issues[85] and, most importantly, that Americans are overwhelmingly supportive of corporate political engagement.[86] Further, as we will discuss in more detail in Part II, even seemingly non-divisive issues such as environmental concerns may turn out to be pretty divisive in practice.

Second, it could be that the divisive nature of moral preferences might have no substantial implications for the theory and practice of CSR. Two arguments can be advanced to support this conclusion. The first is that markets can fully internalize the heterogenous moral preferences of stakeholders so to satisfy the moral preferences of all. The second is that markets can provide a mechanism that is capable of efficiently aggregating these preferences into a normatively desirable moral order.[87]

The first argument relies on the foundational neoclassical idea that competitive markets allow for the greatest diversity in goals and resources.[88] Indeed, in a general competitive equilibrium, "[e]very desire of each consumer,

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84 *See supra* note 13.

85 See 2016 Global Strategy Report, *supra* note 14, at 2.

86 See Global Strategy Group, Doing Business in an Activist World 3 (2019) [hereafter, 2019 Global Strategy Report), https://www.globalstrategygroup.com/wp-content/uploads/2019/02/GSG-2019_Doing-Business-in-an-Activist-World_Business-and-Politics.pdf. ("Americans have an outsized appetite to take action on issues and drive change. They expect brands to do the same – and to engage with them as consumers and employees."

87 Alternatively, one could argue that what looks like a moral problem is, in fact, an epistemic problem. Under this approach, moral disagreement would be the rational outcome produced by the fact that different people hold different evidential or reasoning positions (i.e., have different information or epistemic standing). Reframed in economic terms, moral disagreement would be the result of either an asymmetric information or a bounded rationality problem. Following Hayek, it could then be that market contracting can accurately aggregate the dispersed knowledge of individuals to determine accurate moral positions, in the same way as it accurately determines prices. *See* Frederick A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519, 519-520 (1945). Philosophically, this view presupposes a conciliatory epistemic approach, under which given the available total evidence, individuals always reach the same moral conclusion. *Cf.* Richard Feldman, *Epistemological Puzzles About Disagreement* in S. HETHERINGTON (ED.) EPISTEMOLOGY(2006). Moral decisions, however, are not like tip calculations, a classic example from the literature on conciliationism. *See* David Christensen, *Epistemology of Disagreement: The Good News*, 116 PHIL. REV. 187, 193 (2007). Instead, on several moral issues there might be equally justifiable beliefs given the (same) available total evidence, as recognized under steadfast epistemological approaches. *See generally* Thomas Kelly, *The Epistemic Significance of Disagreement*, in T. SZABO GENDLER AND J.HAWTHORNE EDS. OXFORD STUDIES IN EPISTEMOLOGY 167-196 (2005). It follows that even though markets could efficiently aggregate all the information concerning a given moral issues, this would not eliminate the possibility of moral disagreement.

88 *See* John Geanakoplos, *Arrow-Debreu Model of General Equilibrium*, *in* 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS 119 (John Eatwell et al. eds., 1987).

no matter how whimsical, is met by the voluntary supply of some producer. And this is true for all markets and consumers simultaneously."[89] Even taking into account the incompleteness of actual markets,[90] under this argument moral disagreement would have only limited implications for CSR. Henderson and Malani seem to defend this line of reasoning when they say that: "different corporations can offer different types of altruism to different people."[91] The matter, however, becomes more complicated when one considers the possibility of not simply heterogenous moral preferences, but conflicting ones. Luigi Zingales touches *en passant* on the problem in his concluding essay in the ProMarket e-book on Friedman's CSR article.[92] Zingales observes that, for example, conservative investors may be against the production of an abortion pill even when it is profitable, while liberal investors may want to produce such a pill below cost.[93]

Under the argument that markets can fully internalize stakeholders' moral preferences, we should then observe that some corporations choose the first option (the no-abortion-pill policy) and others the second (the below-cost-abortion-pill policy). The practice of CSR, however, is not consistent with this conclusion. As we will discuss at length in Part III.C, this practice almost uniformly converges toward progressive policies. Conversely, the offer of conservative policies presently is virtually non-existent. This evidence suggests that something is missing in the above internalization argument, leaving open the question of whether, and how, the divisive nature of moral items matters for CSR analysis. Of course, the same conclusion would hold if we observed a convergence toward conservative rather than progressive positions. What matters here is the unilateral leaning of CSR engagement, not its "colors."

Likewise, the above evidence casts a doubt on the argument that markets can efficiently aggregate individual moral preferences. Indeed, it would be odd that catering only to the progressive identity, while disregarding conservative views, might provide an efficient mechanism to compose a society's moral conflicts (Again, our conclusion would be unchanged if the market only catered to the conservative identity). Zingales is optimistic on the matter, suggesting that as we have been able to design the institutions of political democracy to reconcile the differences, including of a moral nature, among a society's member, so can the institutions of shareholder democracy be adapted to a pluralistic end.[94] This might be a normatively accurate prediction. But it is not what we currently

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[89] *Id.*

[90] *See* William W. Bratton & Simone M. Sepe, *Corporate Law and the Myth of Efficient Market Control*, 105 CORNELL L. REV. 675, 703-704 (2020) (summarizing GET results on the impact of incomplete markets on equilibrium predictions).

[91] *See* Henderson & Malani, *supra* note 59, at 575. For example, they add, "those who like the environment can deal with Patagonia, which has pledged about one percent of profits to environmental causes, while those who are concerned about poverty in developing countries can engage with Google, which has made a similar pledge for this cause." *See id.*

[92] *See* Luigi Zingales, *Friedman's Legacy: From Doctrine to Theorem*, ProMarket eBook, *supra* note 30, at 133.

[93] *Id.* at 132.

[94] *Id.* at 133.

observe. As we shall discuss in Part IV, we hypothesize that the reason lies in the different aggregation mechanisms that are in place in the political and corporate arena: the one-person, one-vote rule vs. the one-share, one-vote rule. Under the one-share, one-vote rule, the "capitalist majority," which is tied to the shareholders' economic interest in the corporation,[95] also determines winning outcomes in the moral domain, even though that majority may be determined by a (possibly very small) minority of individuals and shareholders do not share a common objective function as they do in the economic domain.[96] For now, however, it is sufficient to point out that divisive moral issues cannot be assumed away from CSR analysis on the argument that markets can efficiently aggregate our conflicting moral preferences.

Finally, the progressive leaning of CSR policies also raises questions for our own explanations of the surge in the demand for corporate morality. Theoretically, the greater access to information of the Internet era should facilitate the internalization of all individuals' moral preferences. Why it is not so in practice? Further, the evidence that corporations exercise their post-*Citizens United* moral agency almost exclusively to advance progressive causes is puzzling when confronted with the prevailing prediction that *Citizens United* would have unleashed corporate wealth for political spending in favor of conservative policies.[97] What are we all missing in the analysis of the relationship between morality and CSR? Part II seeks to answer this question.

## II. WHITHER CORPORATE MORALITY

This Part reexamines the demand for moral actions and the supply of moral goods by corporations that engage in CSR ("CSR corporations") taking into account the inherently divisive nature of most moral goods. We begin in Section A by showing that the morality demand is compatible with the system of preferences of *homo economicus*. This exercise matters as it strengthens the suggestion of recent studies that the changes occurred in the CSR context have brought about a new actor, the *moralized homo economicus*.[98]

However, as we discuss in Section B, this does not imply that the market clearing of the demand of "classic" *homo economicus* and *moralized homo economicus* are fully assimilable, as the "doing well by doing good" approach and other

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[95] The capitalist majority also ties to consumers' purchasing powers and suppliers and workers' contractual power. *See supra* note 10. But under the asset price effects of moral portfolios, the weight of shareholders' economic interests in the corporation is likely to play a determinant role in determining the balance of the moral preferences of the capitalist majority. *See infra* Part III.B.1.

[96] *See infra* text accompanying notes 243-245.

[97] *See, e.g.,* Leo E. Strine Jr. & Nicholas Walter, *Conservative Collision Course: The Tension between Conservative Corporate Law Theory and Citizens United*, 100 CORNELL L. REV. 335, 335 (2015) (predicting that *Citizens United* would lead to engagement in political spending "solely to elect or defeat candidates who favor industry-friendly regulatory policies, even though human investors have far broader concerns, including a desire to be protected from externalities generated by corporate profit seeking.").

[98] *See supra* text accompanying note 58.

recent CSR studies seem to suggest. Instead, once one incorporates the possibility of moral disagreement, a fundamental difference emerges between the two (a difference that is equally ignored by the "maximize shareholder welfare not shareholder value" approach). The satisfaction of the demand of *homo economicus*, through the production of regular commodities, generally produces no effect on others. Individuals remain indifferent to the satisfaction of others' economic preferences as long as the others' consumption (and production) does not entail an externality. On the contrary, the satisfaction of the unique set of moral preferences of each *moralized homo economicus*—which we refer to as an individual's moral "identity"[99]—inherently tends to produce externalities. For the same moral action might be a "good" or a "bad" depending on the degree to which it is consistent or contrary to an individual's moral identity.

The question then is what the market clearing process looks like once one incorporates this distinctive feature of the morality demand into CSR analysis. Answering this question requires two steps. We take up the first in Section C, where we try to better understand the dynamics at play in the production of moral goods once one considers their often-divisive nature. The second step is the equilibrium analysis of the interaction between morality demand and moral goods production in competitive markets, to which we will turn in Part III.

### *A. The Demand for Moral Actions*

The theory of markets, as articulated under the first and second welfare theorems, assumes a system of individual preferences compatible with *homo economicus*.[100] That is, it assumes individuals who can order their preferences (respecting transitivity) and express their chosen order of preferences in a utility function (under the property of local non-satiation, i.e., more is better).[101] These individuals then act as utility maximizers.

Revisited under this assumption, the demand approach to CSR can be interpreted as holding that the morality demand satisfies the conditions under which a given demand is compatible with *homo economicus'* system of preferences. More technically, this approach must assume an integrability result where the fact that the morality demand shares the properties of demands generated under the *homo economicus*' utility function implies that this demand is generated by the same function.[102] It is worth briefly discussing what are these properties, as we

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[99] *See* Roland Benabou & Jean Tirole, *Identity, Morals and Taboos: Beliefs as Assets*, 126 Q. J. ECON. 805, 806 (2011) (modelling moral identity and similar concepts as beliefs about one's deep values). Note that linking one's moral preferences to one's moral identity does not mean admitting non-epistemically grounded beliefs. Rather, it means acknowledging that on several moral issues, there might be equally justifiable beliefs given the available total evidence. *See supra* note 87.
[100] *See generally* ANDREU MAS-COLELL, MICHAEL D. WHINSTON & JERRY R. GREEN, MICROECONOMIC THEORY 326-27 (1995).
[101] *See id.* at 42.
[102] *See id.* at 75 (explaining that if a demand is homogenous of degree zero, satisfies the Walras' law and has a substitution matrix, this is sufficient "for the existence of rational generating

will show that some of them have important implications for the analysis of CSR. Namely, such properties require that a demand: (i) be homogeneous of degree zero,[103] (ii) satisfies Walras' law,[104] and (iii) be subject to the substitution effect.[105]

The first property is pretty straightforward. It requires that the demand for any good stays the same if all prices and the individual's income are multiplied by any number.[106] This is a very innocuous assumption, which simply poses that there is no reason for one' morality demand to change if nothing really gets cheaper and the individual's income does not increase in real terms.

Second, Walras' law postulates that for any excess demand over supply for a single good, the invisible hand of markets operates so that there will be a corresponding excess supply over demand for at least one other good, allowing the market to reach equilibrium.[107] In the context of the morality demand, this implies that if there is excess demand for a given moral good, the price for that good will increase, while if there is excess supply, the price will decline, until the equilibrium is reached. This also seems a reasonable assumption as long as corporations operate in markets with some degree of competitiveness.[108]

Third, and most importantly for CSR analysis, there exists a substitution effect between the demand for moral goods and other commodities (or services),[109] implying that the morality demand is affected by changes in relevant prices. This does not just mean that if the price of engagement in a given moral action changes so does the overall morality demand. It also means that if there is a change in the price of a commodity (say the price of commodity $x$ increases), this change reduces the consumption of $x$ and, therefore, could redirect individuals "to buy" more corporate engagement in moral actions. Put more simply, the substitution effect implies that the demand for moral actions (and so the willingness to pay for moral goods) admits tradeoffs once one considers that individuals' utility function is constrained by their budget. To offer just one trivial example, we all buy costly smartphones while children are starving in Third World countries. Admittedly, the notion that people make such moral tradeoffs is a materialistic assumption. But thinking of morality in absolute (i.e., binary) terms, seems an unrealistic assumption, which would likely make most of us "immoral."

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preferences."). *See also id.* at 76. ("As long as consumer demand satisfies these properties, there is *some* rational preference relation that could have generated that demand.").

103 *See id.* 23, 27, 75.

104 *See id.* 23, 75.

105 *See id.* 24, 76.

106 For example, if I have income of 10 to buy two apples at the price of $2 and two bananas at the price of $3 and both my income and the prices of apples and bananas double, I will continue to buy two apples and two bananas.

107 *See* MAS-COLELL, *supra* note 100, at 584.

108 As we shall see below, the equilibrium analysis of the morality market reveals that, in fact, the Walras law is only satisfied for one side of the market, that associated with progressive demand. *See infra* note 215 and accompanying text.

109 In more technical term, this implies that a Slutsky (i.e., semidefinite and symmetric) matrix exists for morality demand. *See* MAS-COLELL, *supra* note 100, at 34-35.

Under these properties, one can revisit morality demand as coming from economic agents with a preference for the consumption of moral actions—that is, *moralized homo economicus*. But this does not mean that the market clearing of this demand is fully assimilable to that of classic *homo economicus*. As we shall see next, this conclusion only holds under the assumption of heterogenous moral preferences (or heterogeneity "within moral identities.") But it is displaced once one incorporates the possibility of conflicting moral preferences (or heterogeneity "across moral identities"), with crucial implications for the production of moral goods.

### B. *Market Clearing and Moral Disagreement*

Under the orthodox Walrasian model,[110] the process of economic allocations relies on the artifact of the Walrasian auctioneer to aggregate individual preferences so to make plans compatible[111] (where the collection of plans over goods and prices that clears markets is the set of compatible plans).[112] However, when we move to the more realistic representation of markets as incomplete—and hence affected by a familiar list of market failures—neither efficiency nor compatibility are ensured.[113] Viewed through this lens, Friedman-esque critiques of CSR revolve around the common idea that markets alone cannot satisfy our moral preferences because of a public good problem. Under this problem, the anticipation of free-riding undermines the incentives to produce the good in the first place, wreaking havoc on the Walrasian process of economic allocation.

The demand approach to CSR challenges this conclusion, suggesting that the market has to some extent self-corrected the public good problem. If morality demand is compatible with the system of preferences of *homo economicus*, individuals must be willing to pay for the satisfaction of those preferences (as they are willing to do for other preferences). This, combined with other advantages resulting from the corporate production of moral goods,[114] mitigates

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110 *See* LÉON WALRAS, ÉLÉMENTS D'ECONOMIE POLITIQUE PURE: OU, THÉORIE MATHÉMATIQUE DE LA RICHESSE SOCIALE (Corbaz ed., 1874). (reproduced mathematically in Kenneth J. Arrow and Gérard Debreu, *Existence of an Equilibrium for a Competitive Economy*, 22 ECONOMETRICA 265 (1954)).

111 In non-technical terms, after the Walrasian auctioneer's announces a set of prices for all available commodities, each individual chooses how much of each commodity she would pay for when considering all the commodities and the associated prices and her budget and executes a virtual set of trades on the basis of their hypothetical plans under those prices. The auctioneer observes all the agents' responses to each announced set of prices and then determines whether the combination of those trades would leave any positive or negative excess demand. If it does, he tries a different set of prices and again the agents respond with virtual trades. And this goes on until the auctioneer finds the set of prices, which are such that when people execute their plans, there is zero excess demand. That is the equilibrium price. *See* Thomas Christiano & Simone M. Sepe, Agency and Markets 9, (unpublished manuscript) (on file with authors).

112 In this sense, complete markets are said to satisfy even our most whimsical desires. *See supra* note 89 and accompanying text.

113 *See* Bratton & Sepe, *supra* note 90, at 703-704.

114 *See infra* text accompanying note 133.

the public good problem (or eliminates it altogether).[115] The result is that the allocation process comes to more closely resemble the abstract Walrasian process. Under this prediction, morality demand is cleared through the same market mechanisms that operate for the clearing of the demand for all available commodities. That is, plans compatibility—here taking the form of moral pluralism—is reinstated through competition and specialized production.[116]

But this prediction rest on a restrictive assumption about moral actions: that while we have heterogenous moral preferences, each moral action delivers universally justifiable benefits to all. This assumption abstracts away from the possibility of moral disagreement and the evidence that what represents a universally justifiable benefit is, in fact, tied to one's "moral identity," defined as the set of unique moral preferences of each individual. When one incorporates these facts, a crucial difference emerges about the market clearing of the demand of "classic" *homo economicus* and *moralized homo economicus*.

The satisfaction of the former demand, through the production of regular commodities, generally produces no effect on other actors. If you want, say, a pair of red shoes, I will be indifferent to whether your demand is satisfied. Conversely, the satisfaction of the demand of *moralized homo economicus* inherently entails the production of externalities: for the same moral action might be a "good" or a "bad" depending on whether and to what degree that action matches an individual's identity. This does not exclude that a moral action might match the identity of many individuals. For example, it seems reasonable to assume that virtually all individuals belonging to the *moralized homo economicus* class believe that fighting poverty is a "good." However, when it comes to specifying the beneficiaries of this action, individuals might have not just different but conflicting preferences, depending on how close or distant their moral identities are.

That what constitutes a moral action is inherently tied to one moral identity has important structural implications. When preferences are heterogenous within (similar) moral identities, the above prediction on the clearing of the morality demand is likely to hold, meaning that CSR engagement is likely to ameliorate the public good problem and hence enhance plans compatibility. But when preferences are heterogenous across moral identities—so that the same moral action is a good for some and a bad for those with a contrarian identity—we are back to a world of market failures (i.e., externalities) and incompatible plans.

Now, it is difficult to draw the line between one set and the other of heterogenous moral preferences, because this requires a value judgement on people's moral identity. We believe, however, that a good indication comes from the political division between conservative and progressive, which we consider

115 For the "doing well by doing good" approach, there no longer is a public good problem as moral goods are exactly like other goods the corporation produces. *See supra* text accompanying note 50.

116 To the point, recall Henderson and Malani's example about Patagonia and Google, with each corporation competing for the morality demand and specializing in the production of different moral goods. *See supra* note 91.

as the paradigmatic case of contrarian identities. The specific subject matter also plays a significant role in this determination. Indeed, when we extend the domain of CSR to issues associated to one's political or religious beliefs, it becomes easier to see that those issues might prove highly divisive and that the satisfaction of the morality demand might generate (more) externalities.[117]

Further complicating the matter, there is the issue of moral tradeoffs. Recall that under the substitution effect, one's morality demand admits tradeoffs given the individual's budget constraint.[118] Because of this circumstance, even the satisfaction of the demand for theoretically less divisive moral actions might end up creating externalities. To offer an example, consider environmental concerns, which have now become a key area of interest in CSR practices worldwide.[119] While we can assume that we all have an epistemic reason to share such concerns, one's propensity to care for the environment might well change if caring means closing down the factory where she works.[120]

The question then is what the market clearing process is going to look like once one incorporates these issues into the analysis of the market for corporate morality. Answering this question requires two steps. The first is the study of the supply side of this market: that is, understanding the dynamics at play in the production of moral goods by corporations. We turn to this in the following section. The second is the equilibrium analysis of the interaction between morality demand and moral goods production in competitive markets, which will be the focus of Part III.

Recall, however, that the observation of current CSR engagement provides a clear indication on the end result of the morality market's allocation process. This result is the convergence of CSR "supply" toward progressive positions, with the virtual exclusion of any conservative offer, at least as coming from large corporations. This outcome, as we saw, runs contrary to the idea that the morality market can fully internalize moral disagreement (and the same would hold if we observed a unilateral convergence toward a conservative CSR supply).[121] But such an outcome also seems difficult to reconcile with the view that this market can efficiently aggregate our divergent moral preferences, especially across moral identities.[122] This conclusion is further strengthened when one considers the evidence that half of the voting population identifies with conservative views and thus, under our analysis, is likely to suffer from negative externalities under the current CSR offer. What explains this outcome, then? This is the ultimate question we will try to answer in Part III.

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[117] To the point, recall Zingales' example about the production of an abortion pill. *See supra* text accompanying notes 92-93.

[118] *See supra* Part II.A.

[119] *See, e.g.,* Gadinis & Miazad, *supra* note 8, at 1414.

[120] This implies that individuals might have different justifiable beliefs on the optimal level of a firm's environmental policy. Simplistically, given a certain objective level of environmental concern, individuals might disagree on whether a "high policy" with "high job cuts" or a "middle policy" with "middle job cuts" is optimal. If an individual is directly at risk of a job cut, it will be more likely that she might prefer the middle policy to the high policy.

[121] *See supra* Part I.C.

[122] *See supra* Part I.C.

*C. Moral Good Production*

Faced with increased demand for engagement in moral actions, corporations have responded by expanding their production set. Nowadays, they no longer produce just physical commodities or issue commercial or financial claims. They also produce what we call "moral goods," which give contractual stakeholders who are willing "to pay" for such goods a claim to the corporation's engagement in moral actions. This engagement can take several forms, including donating money to, or otherwise supporting, nonprofits engaged in the delivery of moral services, the direct pursuit of moral actions or participating to the public discourse around such actions.

At first sight, one could be tempted to conclude that the demand for engagement in moral actions "is like anything else that individuals desire: … [it] generates production by suppliers in a market."[123] But is it?

As we saw in Part A.II, studies falling under the "doing well by doing good" approach defend a perfect assimilation between the supply of regular commodities (and other corporate claims) and moral goods and, with it, the compatibility between CSR and shareholder value maximization. These studies, however, do not go into the details of the moral goods' production calculus. They simply point to a willingness to pay of various categories of stakeholders. But they do not discuss the nature of such goods (de facto ignoring the prevailing public good classification of CSR engagement), or articulate their costs or, still, explain how exactly these costs are internalized by stakeholders. Unsurprisingly, this lack of further elaboration of the details of the "model" is a main reason this approach is often regarded with skepticism in the literature.[124]

The "maximize shareholder welfare not shareholder value" approach sees instead the supply of moral goods as different from the supply of other goods, mainly due to their public good nature. This is because, first, "the lines between who does the producing and who does the consuming may be blurred" in the supply of these goods.[125] Indeed, while only consumers consume regular commodities like, say, toothpaste, *all* stakeholders receive a utility from the production of moral goods as public goods.[126] Second, the supply of moral goods may involve the sacrifice of corporate profits, unlike the production of other (private) goods. Under this recharacterization, the question of the normative desirability of CSR thus shifts to whether corporations have any comparative advantage over both non-profits and the government as producers of public goods.[127]

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[123] *See* Henderson & Malani, *supra* note 59, at 585.

[124] *See supra* text accompanying note 50.

[125] *See* Henderson & Malani, *supra* note 59, at 589.

[126] *See id.* at 574.

[127] *See*, e.g., Hart & Zingales, *supra* note 23, at 249 (arguing that corporations enjoy a comparative advantage (i) in the case of non-separable activities, where profit and damage are inextricably connected for technological reasons, (ii) in tailoring public goods to specific needs, and (iii) when political change is hard to achieve); Henderson & Malani, *supra* note 59, at 590-603 (identifying five comparative advantages of corporations over governments and non-profit organization as

Neither of these approaches considers the divisive nature of moral goods. Doing so raises several questions. Is the public good characterization of moral goods still descriptively accurate when one takes into account this feature? If not, are we returned to an equation between the supply of moral goods and other corporate goods or are there other distinctive features that characterize the production of moral goods? More broadly, does the divisive nature of moral goods matter for the normative desirability of CSR and, if so, how?

In order to tackle these issues, it is useful to begin with a stylized illustration of the production mechanisms of moral goods for less divisive moral actions. We will then move to examine how the production calculus changes when a moral good is divisive and how this change is reflected into the cost structure of moral goods and affects their normative desirability.

1. Non-Divisive Moral Goods

To keep things simple, let us first consider a less divisive item such as fair-trade. More tangibly, consider Starbucks' fair-trade policy, which has become a classic CSR example.[128] In transacting with Starbuck, its contractual stakeholders (financial investors, consumers, employees, suppliers, and so on) buy two goods. As with any other corporate transaction, they acquire a claim to a specific corporate performance—the delivery of a physical commodity in the case of consumers (e.g., coffee), a claim to the company's equity in the case of shareholders, a claim to receive a wage in the case of employees, and so on. But Starbucks stakeholders also acquire a claim (i.e., the intangible moral good) to the company's engagement in a specific moral action: fair trade.[129]

Under these transactional features, we have three parties: the corporation $C$, the "sympathetic" stakeholder $S$, and the beneficiary $B$ (i.e., the Third World farmers) of the moral action $X$ (i.e., fair trade) bought through the moral good $x$ (i.e., the fair-trade policy attached to the corporation's non-moral goods). These parties intervene in two relationships. The first is the "underlying moral relationship" between $S$ and $B$, which belongs to the personal sphere of the individual (the *homo moralis* dimension). Within this relationship, $S$ believes that action $X$ benefitting $B$ (e.g., fair trade) is a universally justifiable moral action. Next, there is the "derivative moral relationship," which is, instead, a market relationship (belonging to the *homo economicus* dimension) between $S$ and $C$. Within this additional relationship, $S$ buys from the corporation an intangible moral good $x$ that gives her the right (an "entitlement") to the corporation's

producers of public goods: (i) economies of scope, (ii) ability to bundle public goods with private goods; (iii) ability to tailor public good production to individual needs; (iv) lower agency costs; and (v) network effects).

[128] *See, e.g.,* Benabou & Tirole, *supra* note 50, at 10-11; Henderson & Malani, *supra*, at 575, 591.

[129] For the sake of simplicity, we assume here that stakeholders only buy engagement in one moral action at the time in transacting with the corporation. In practice, depending on the range of CSR activities of a corporation, stakeholders will typically buy corporate engagement in multiple moral actions.

engagement in $X$ to the benefit of $B$.[130] The bundling of the intangible moral good with the other commodities the corporation produces or claims it issues is the technology that ties these two relationships together,[131] in response to the demand of *moralized homo economicus*.

Under this representation, it is quite easy to see why, economically, $C$'s fair trade policy is described as a public good. Under the standard account of moral goods as non-divisive, $S$'s utility arises from the satisfaction of her altruistic interest: that is, what matters to $S$ is that $B$ benefits from improved working conditions. But since $X$ is assumed to be supported by broad consensus, $S$ will not care where the benefit to $B$ comes from, while it is also reasonable for $S$ to expect that other people may have a similar altruistic interest in pursuing $X$. This is the source of the free rider problem.[132] On this view, then, the corporate production of moral goods is normatively desirable as it helps reduce that problem: bundling allows exploiting the economies of scope between public and private goods, either lowering the price of the public good or making the private good more attractive.[133]

2. Divisive Moral Goods

Consider now the production of divisive moral goods. In spite of the lack of attention they have received in the CSR scholarship, the data show both that the demand for corporate engagement on politically divisive matters is on the rise[134] and that corporations are more and more willing to satisfy this demand.[135] Target's move to gender-neutral store signage,[136] Wells Fargo's commitment to the LGBT community at large,[137] Amazon's decision to ban the sale of Confederate flag merchandise,[138] LEGO's addition of more female "minifigures" to its catalogue[139] or, still, Netflix and Disney's threat to stop filming in states supporting restrictive abortion laws[140] are just a few recent examples.

Likewise, investors have become increasingly willing to demand engagement on potentially divisive issues. Last year, for example, the ESG[141]

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[130] An interesting research question, which space constraints prevent us from pursuing in this Article, is whether stakeholders' entitlement to corporate engagement in moral action $X$ is legally enforceable. Thus, for example, if it turned out that Starbucks was selling "regular" rather than fair-trade coffee, would its stakeholders have a CSR claim against the corporation? Our intuition is that they should, similar to what happens with the breach of contract in the sale of other commodities the corporation produces.
[131] *See* Henderson & Malani, *supra* note 59, at 593-96 (examining bundling mechanisms).
[132] *Id.* at 586.
[133] *Id.* at 594.
[134] *See* 2019 Global Strategy Report, *supra* note 86.
[135] *See* 2016 Global Strategy Report, *supra* note 14.
[136] *See supra* note 15.
[137] *See supra* note 16.
[138] *See supra* note 17.
[139] *See supra* note 18.
[140] *See supra* note 19.
[141] *See supra* note 2.

division of Black Rock, the world's largest asset management firm, was involved in over 3000 thousand engagements worldwide.[142] Among Blackrock's top ESG priorities were gender and race issues both at the board level and employee level,[143] in addition to the transition to a low-carbon emission economy.[144] More generally, Barzuza, Curtis and Webber report that index funds have grown increasingly vocal, at times even confrontational, in their engagement in salient social issues.[145] They also highlight that diversity issues have taken the lion's share of the funds' "social" activism,[146] with the Fearless Girl campaign by State Street epitomizing the lenghts to which index funds are now willing to go in engaging in these issues.[147]

Further, bear in mind that matters of moral identity are subtle, and entail tradeoffs when individuals are subject to budget constraints.[148] Viewed through this lens, all moral goods can potentially morph into being divisiveness. Consider, for example, General Motor (GM)'s proposal last year to close a plant producing gasoline cars in Michigan and open one producing electric cars further south.[149] While the environmental concerns behind this decisions are theoretically less divisive than other moral actions, this decision must have been, in fact, rather divisive for the GM's Michigan workers and the local community, even assuming they shared environmental concerns. The same goes for workers in the coal industry faced with Blackrock's recent announcement that it will divest its active funds from coal stocks as a tangible sign of commitment to a low-carbon economy.[150]

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142 The Deal, Corporate Governance 2020: Balancing ESG, Sustainability and Growth, Keynote Interview with Ray Cameron, Head of Investment Stewardship, Blackrock, Inc. https://www.thedeal.com/solutions/corporate-governance-2020-event-video-library/ (last visited Jan. 28, 2021).

143 *Id.*

144 *Id.*

145 *See* Barzuza et al., *supra* note 20, at 105.

146 *Id.* at 122-24.

147 *Id.* at 122. Now, one could argue that gender diversity *should* not be a divisive issue. We agree. The data, however, attest to the contrary, with the division following well-known partisan lines. According to a recent report from the Pew Research Center, while 69% of Democrats believe that more needs to do be done to promote gender equality, more than half among Republicans think things are just about right and no further gender policies should be put into place. *See* Juliana Menace Horowitz et al., *Wide Partisan Gaps in U.S. Over How Far the country Has Come on Gender Equality*, Pew Research Center (Oct. 18, 2017), https://www.pewsocialtrends.org/2017/10/18/wide-partisan-gaps-in-u-s-over-how-far-the-country-has-come-on-gender-equality. While this might not look like a huge divide if one thinks of this in binary terms (i.e., gender policy vs. no gender policy), it becomes relevant if gender policy is, in fact, "graded" (i.e., more or less gender policy initiatives), as it is in actuality.

148 *See supra* Part II.A.

149 *See* Steven N. Kaplan, *The Enduring Wisdom of Milton Friedman*, in ProMarket eBook, *supra* note 30, at 5-6 (mentioning the GM's example). While Kaplan also mentions tradeoffs, he has in mind the economic tradeoffs arising for managers in choosing between shareholder and stakeholder interests. On the contrary, we have in mind the individual moral tradeoffs implied by CSR decisions.

150 *See* Bill McKibben, Citing Climate Change, *Blackrock Will Start Moving Away from Fossil Fuels*, THE NEW YORKER (Jan. 16, 2020), https://www.newyorker.com/news/daily-comment/citing-climate-change-blackrock-will-start-moving-away-from-fossil-fuels.

When engagement in a given moral action is divisive, rather than being supported by broad social consensus as conventionally assumed, the underlying production mechanisms change in several respects. First, depending on an individual's moral identity, the same moral good $x$ (e.g., a policy promoting gender equality)[151] will deliver a positive utility $u(x) > 0$ to stakeholders with matching identity $I_x$ (e.g., believing that we have not yet achieved gender equality),[152] *but* a disutility $d(x) > 0$ to stakeholders with a contrarian identity $I_y$ (e.g., believing that we have already achieved gender equality).[153] "Contrarian stakeholders" would, instead, receive a utility $u(y) > 0$ if the corporation produced moral good $y$ (e.g., did not engage in any gender equality policy). Of course, the more divisive a given moral good is (think of abortion issues or gun control) the greater the disutility conveyed to contrarian stakeholders.

Second, when the morality demand is reconceptualized as an effect of individuals' often conflicting moral identities, then the consumption of many moral goods seems unlikely to be affected by the free-riding problem that is typical of public goods. Indeed, under this reconceptualization, moral goods become a means that offer satisfaction along two primary dimensions, which only partially overlap with their common altruistic assumption. First, they satisfy the individual's need for self-identification as a moral agent (where altruism is just one of the characterizing aspects of the self). That is, they are a means that allow people to retain a sense of who they are in the Hegelian sense.[154] Second, moral goods also satisfy the *social* aspect of one's irreducible interest in self-definition.[155] This aspect passes for our adhesion to some human groupings to affirm our identity vis-à-vis others, i.e., a form of virtue signaling. Neither of these needs can be delegated to others. It follows that very little, if any, room for free riding remains under this different understanding of moral goods. Assuming otherwise would be like saying that going to Sunday mass does not matter as long as others go—something no good Catholic would ever agree with.

To put this in stylized terms, the utility stakeholder *S* with identity $I_x$ derives from moral good $x$ is not just that arising from the benefit delivered to $B$ through moral action $X$, as suggested in the public good account of CSR.[156] Instead, $u(x)$ primarily arises from the value of $x$ as a means of self-identification and virtue signaling. Thus, people buy coffee at Starbucks (and they are willing to pay a higher price for it, as we shall see in more detail in Part III) not just because of the benefit that is delivered to Third World farmers.

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151 *See supra* text accompanying notes 145-147 (explaining that gender diversity has become a core CSR issue).

152 *See supra* note 147 (reporting on data on polarized views about the need for gender policy).

153 *See supra* note 147 (reporting on data on polarized views about the need for gender policy).

154 *See* G.A. COHEN, KARL MARX'S THEORY OF HISTORY – A DEFENSE 346 (1978) (contrasting Marxist philosophical anthropology, in which "the ruling interest and difficulty of men was relating to the *world*," with the Hegelian philosophical anthropology, in which the focus is on "the subject's relationship to itself").

155 *See id.* at 347 (referring to "the social manifestations of the interest in self identification").

156 *See supra* text accompanying notes 132-133.

Instead, they do so because buying fair-trade coffee both fosters their sense of self-identification as socially responsible consumers and signals to others that they belong to this human grouping rather than that of *non*-socially responsible consumers. Similarly, one shops at Whole Food because this is a means to affirm one's identity as an environment-friendly consumer and take a stand against those who are not.[157]

But then: that others' engagement might deliver the same benefit to $B$ only matters to a limited extent for the satisfaction of the individual's utility, because if the individual does not personally engage, she is deprived of the benefits of self-identification and virtue signaling. In fact, when the individual fails to engage, she might run an even greater risk if the moral good is highly divisive. In this case, she risks that someone with a contrarian identity $I_y$ might appropriate $u(y)$ (i.e., the self-identification and virtue signaling benefits arising from the production of moral good $y$ rather than $x$), with the result that the individual $I_x$ will now bear a disutility $d(y) > 0$.[158]

Third, when moral goods are divisive, they entail a production constraint that does not generally affect the production of other corporate commodities: exclusivity. The same corporation may very well satisfy the demand for commodities with diverse, even opposite, physical characteristics. For example, a corporation may produce both "regular" food and gluten-free food. Likewise, auto companies produce both "regular" and hybrid cars. But when a moral good is highly divisive, the production of moral good $x$ (consider, for example, the endorsement of a pro-choice abortion policy—a stance that more and more corporations are now openly taking)[159] will prevent the corporation from producing the contrarian moral good $y$ (i.e., the endorsement of a pro-life abortion policy). This is because producing $y$ would mean "destroying" $x$ (and vice versa if the corporation chooses to produce $y$ in the first place).

Finally, moral goods' exclusivity feature imports a companion feature, as these goods tend to be consumed in conjunction with other goods reflecting the same moral identity. In this sense, moral goods are complementary rather than substitute goods. In economics, substitute goods are those presenting consumers with alternative choices (e.g., oil and butter). Complementary goods, instead, are consumed in conjunction the one with the other (e.g., right and left shoes). To return to the abortion policy example, if a company is engaged in a pro-choice abortion policy, the same company might expectedly supply its stakeholders with engagement in policies supporting embryonic stem cell

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157 This, of course, does not exclude that people may buy coffee at Starbucks or food and other things at Whole Food also for other reasons (e.g., they think these corporations' products are of a better quality), but the same goes under the public good conception of moral goods.

158 Given the production calculus of moral goods, for this risk to materialize a majority of individual needs to demand the contrarian good. *See infra* Part II.C.3.. But theoretically not-engaging in CSR at the individual level makes it easier that such a contrarian majority may materialize.

159 *See, e.g.,* Jess McHugh, *More Companies Are Openly Supporting Abortion Rights. That Might Be Controversial, But It's Also Good Business*, FORTUNE (Nov. 8, 2019), https://fortune.com/2019/11/08/companies-that-openly-support-abortion-access/.

research, but not in opposite policies against this research. More broadly, if we pose that the pro-choice policy $x$ is representative of a more general progressive position, this means that once the corporation has chosen $x$, then it will likely produce only moral goods that are compatible with that position (i.e., $x_1$, $x_2$ , $x_3$, etc). By extension, this means that the production of $x$ does not just exclude $y$ (i.e., a pro-life policy), but also $y_1$, $y_2$ , $y_3$, i.e., any moral good associated with an opposite conservative position.

3. Production Calculus

Once the divisive nature of moral goods is taken into account, these goods start to resemble more private goods than public goods. Indeed, to the extent that these goods are a means to appropriate the benefits of self-identification and virtue signaling, only by paying for the moral good can individuals secure those benefits. In this sense, moral goods are excludable, unlike public goods.[160]

a. Moral Goods and Shareholder Value

The above conclusion challenges the view that the supply of moral goods, as public goods, needs to satisfy a broader shareholder welfare test. With public goods comes free-riding and, hence, internalization issues. These issues undermine the shareholder value test that defines the production calculus of the corporation as the essential institution of a private enterprise system. (For individuals can appropriate the benefits of the good, once it is produced, even if they do not contribute to it). Under the assumption that moral goods deliver broad social benefits, relaxing the shareholder value test then becomes necessary to pursue those benefits. But when the free riding problem is removed, we see no reason why the stakeholders' demand for moral goods cannot be fully internalized. Under this different conclusion, corporations are held to produce moral goods *because*, not in spite of, shareholder value maximization.

A possible objection here is that not all stakeholders are "sympathetic," i.e., have the traits of *moralized homo economicus*. And when the existence of non-sympathetic stakeholders is taken into account, the production of moral goods would encounter all kinds of complications. In the first place, CSR engagement exposes corporations to non-sympathetic hostile acquirers who can shift the direction of the company and monetize forsaken profits for themselves.[161] Restated, the argument here is that the cost of CSR dampens the company's share price, thus providing an arbitrage opportunity for non-sympathetic investors. Under this argument, even a sympathetic shareholder will tender to a non-sympathetic bidder because the former anticipates that other

160 It is unclear whether moral goods, conceived as a means toward self-identification and virtue signaling, are also rivalrous. To the extent they are not (or only low rivalrous), moral goods would fall under the category of "club goods," which are indeed excludable, but nonrivalrous. The seminal contribution on club goods is James M. Buchanan, *An Economic Theory of Clubs*, 32 ECONOMICA 1 (1965).

161 *See* sources quoted *supra* at note 23.

shareholders will tender. Therefore, if the sympathetic shareholder did not tender, she would lose out on the takeover premium.

We will discuss CSR's internalization mechanisms, including by financial stakeholders, in detail in Part III. But it is worth pointing out here that the above argument seems to conceive of CSR "transactions" as operating in a vacuum rather than the market. Indeed, this argument rules out both (i) the effect on the share price of the demand of non-financial stakeholders such as consumers, and (ii) the idea that sympathetic investors might choose their portfolios based on moral preferences. Under this different understanding of CSR transactions, it is not clear to us why CSR engagement would dampen share prices and create arbitrage opportunities. This prediction also seems inconsistent with current CSR trends, under which pro-social investing has reached an astonishing $40 trillions worldwide and about 70 percent of global consumers declare themselves to be willing to spend more for sustainable products.[162] Further, even admitting the possibility of arbitrage opportunities, the additional argument that even sympathetic investors would tender either assumes that these investors are not very sympathetic after all, or that free-riding problems distorts their incentives. In both cases, we find the underlying assumption descriptively inaccurate.

Yet, the similar nature of moral goods and other corporate goods does not mean that these goods share the same production calculus, as suggested by "the doing well by doing good" approach. For the moral goods' production calculus must take into account their divisive features, which import both a different cost structure and different internalization mechanisms. We will address the cost structure below. In Part III, we will then discuss CSR's internalization mechanisms, as well as the normative implications of our approach.

b. <u>Cost Structure</u>

Once one considers their divisive nature, moral goods entail three different sets of costs. Like any other corporate good, all moral goods entail an *exogenous* cost, which is the technological cost of producing the good. This is the out-of-pocket cost of supplying corporate engagement in favor of specific moral actions. In the case of less divisive moral actions like environmental concerns, consider, for example, the cost of researching fuel-efficient engines or the cost of new technology to reduce carbon dioxide emissions.[163] For more divisive matters, consider, for example, the cost of advertisement finalized to convey the corporation's stance on LGBT issues (e.g., Wells Fargo)[164] or racial issues (e.g., the famous Nike's Kaepernik ad).[165]

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[162] *See supra* notes 2 and 3.

[163] *See, e.g.,* Henderson & Malani, *supra* note 59, at 637 ("Countless high-profile companies have committed to lower emissions of carbon dioxide at the cost of several billion dollars …").

[164] *See supra* note 16.

[165] Jia Wertz, *Taking Risk Can Benefit Your Brand – Nike's Kaepernick Campaign is a Perfect Example*, FORBES (Sept. 30, 2018), https://www.forbes.com/sites/jiawertz/2018/09/30/taking-risks-can-benefit-your-brand-nikes-kaepernick-campaign-is-a-perfect-example/?sh=7928867145aa (reporting that Nike profited from the Kaepernik's controversial campaign).

More divisive moral goods, however, also entail two additional sets of *endogenous* costs, that is, costs that are intrinsic to the nature of the good (and do not, instead, affect other goods the corporation produces). First, they entail the opportunity cost that arises from the feature of exclusivity. As we saw above, under this feature the production of moral goods reflecting a divisive moral stance (e.g., a campaign in favor of a pro-choice abortion policy) excludes the possibility of producing moral goods reflecting the contrarian stance (e.g., a campaign in favor of a pro-life abortion policy). Note that under the companion feature of complementarity, this opportunity cost also involves the cost of excluding all the moral goods that are complements to that contrarian stance (e.g., a campaign for a policy against embryonic stem cell research, etc.). Second, and relatedly, moral goods entail the cost arising from the disutility generated on stakeholders with a "contrarian" identity (for whom these goods are, in fact, "bads.") In response to this disutility, contrarian stakeholders may engage in costly retaliatory actions, for example boycotting the corporation.[166] Of course, the more divisive the good is, the higher the expected disutility cost will be.

## III. THE MARKET FOR MORALITY: AN EQUILIBRIUM ANALYSIS

Part II has discussed the implications of the divisive nature of moral goods for their production. In this Part, we continue our analysis of the corporate morality market by moving to examine the interaction between morality demand and moral goods production in competitive markets.

We begin with a discussion of the different internalization mechanisms that channel stakeholders' willingness to pay for moral goods. In Section A, we examine the mechanism operating for non-financial stakeholders, including consumers, workers, suppliers and any other stakeholder with a non-financial contractual claim in the corporation. This mechanism involves an increase in stakeholders' reservation price for the non-moral claims that are bundled with the moral goods the corporation produces, where the production calculus is positive when this increase internalizes the costs of producing the moral good.[167]

In Section B, we then move to the analysis of the internalization mechanisms operating for financial stakeholders, including shareholders. This analysis is the most revealing. It first shows that asset price effects play a determinative role in the overall production calculus of moral goods. These effects arise from the willingness of sympathetic investors to hold moral portfolios and pay a premium for the shares of CSR corporations. Most importantly, we show that under these effects, on the one hand, CSR may be compatible with shareholder value maximization even if it reduces cash flows.

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166 *See, e.g.,* Broccardo et al., *supra* note 54, (manuscript at 1) (reporting evidence that "38% of Americans are currently boycotting at least one company, up from 26% only a year ago").

167 This may happen in full or in part when one also considers the internalization mechanism operating for the financial stakeholders.

On the other, when asset price effects are globally considered in the context of competitive markets, there is no profitable deviation at the equilibrium for corporations as producers of moral goods. This is because non-engaging (or disengaging) from CSR would make corporations less competitive. Under this assumption, the moralization of capitalism thus becomes an endogenous market outcome.

On the whole this sounds like as though it could result in the best of all possible worlds. But, as we explain in section C, moralized markets risk undermining a central democratic value: pluralism. This risk arises because the morality market clears by producing almost exclusively the moral goods that conform to the moral preferences of the capitalist majority. On the one hand, what we call "corporate conformism" allows corporations to appropriate a larger morality demand (and, in particular, the positive asset price effects of moral portfolios). On the other, once corporations have catered to the majoritarian capitalist demand, the production constraints arising from the unique features of moral goods prevents them from satisfying minority morality demands—finally providing a plausible explanation for why we only observe progressive CSR engagement.

### *A. Non-Financial Stakeholders*

What are the internalization mechanisms that channel stakeholders' morality demand into the production of moral goods? In the case of non-financial stakeholders, the internalization mechanism involves a positive effect on the stakeholders' willingness to pay for the corporation's non-moral claims (i.e., including regular commodities)—an effect that moves the stakeholders' reservation price for those claims upward.[168] The increase in the reservation price for non-moral claims is the price the stakeholders pay for the moral good. Correspondingly, when the divisive good creates a negative externality for contrarian stakeholders, this will impose an endogenous cost on the corporation by shifting the stakeholders' reservation price for the corporation's non-moral claims downward.

For illustrative purpose let's stick to the case of Starbuck's engagement in fair trade. In the case of consumers, they will be willing to pay a higher price for a cup of Starbucks coffee relative to coffee of the same quality they can buy from coffee companies that do not engage in fair trade (which can be interpreted as the consumers' reservation price). This price increase reflects the cost to consumers of buying the moral good. As to suppliers (excluding the coffee producers, of course), they will similarly be willing to charge lower supply prices, or anyway offer better contractual terms, in return for Starbucks' fair-trade

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[168] The bundling of the moral good with the corporation's non-moral claim is typically the channel through which this internalization mechanism operates. *See supra* text accompanying note 131. Bundling, however, is not strictly necessary. Consider, for example, Amazon's decision to ban the sale of Confederate flag merchandise. *See* supra note 17. While there is obviously no bundling here, Amazon's choice can still be expected to have determined a positive effect on the stakeholders' willingness to pay for other Amazon products, moving the stakeholders' reservation price for these products upward.

engagement. And, likewise, Starbucks employees will be willing to accept lower wages.

Now, the risk of using illustrations is that they tend to lean toward oversimplification. In the Starbucks case, for example, we describe how the internalization mechanism *can* operate for different non-financial stakeholders. But this does not mean that this mechanism needs to apply to *all* Starbucks non-financial stakeholders (especially in the case of suppliers and workers). Still, the evidence that Starbucks does engage in fair-trade suggests that the revenues generated through the sale of this moral good are sufficient (or significantly help) to internalize Starbucks' cost to sustain a fair-trade policy.[169]

This analysis sheds light on the operationalization of the business case for CSR. As we saw, a main criticism raised against the "doing well by doing good" approach is that it is unclear how this approach can be reconciled with the fact that CSR increases a corporation's costs.[170] More technically, it is unclear how this approach can be squared with the neoclassical teaching that cost minimization is the dual problem of profit maximization in the achievement of efficient production technology[171] (i.e., technology that situates production at the transformation frontier).[172] Indeed, under the "doing well by doing good" approach, profits are maximized without costs being reduced, which is economically puzzling. This puzzle, however, disappears when "doing good" means producing moral goods. For these goods expand the corporation's production set (adding moral claims to non-moral ones), moving its transformation frontier. In English, moral goods introduce a technological innovation that preserves the neoclassical assumption of duality between profit maximization and cost minimization.

Under this innovation, "doing well by doing good" is no longer just an empty slogan;" instead, it captures the evidence that CSR engagement is compatible with shareholder value maximization. This remains true even when one considers financial, rather non-financial, stakeholders as parties with a taste for moral claims. As we shall see next, however, the dynamics of compatibility between CSR and shareholder value maximization are complexified by asset price effects in the case of financial stakeholders.

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169 In actuality, one can arguably expect Starbucks' engagement in fair-trade to also be commercially viable, rather than just involving the mere passing through of profit sacrifice at the stakeholders' demand. For example, one can assume that partnering with fair-trade farmers might produce signaling benefits as to the quality of Starbucks' coffee (i.e., add "brand" value). However, the fact that CSR production is compatible with better products and increased commercial, in addition to moral, value to customers might complexify the production calculus of Starbucks' CSR engagement but does not change our baseline analysis.
170 *See supra* note 50 and accompanying text.
171 *See* MAS-COLELL, *supra* note 100, at 139 ("cost minimization is a necessary condition for profit maximization.")
172 Here the term technology is used in its economic meaning as "the set of all production vectors that constitute feasible plans for the firm." *See id.*, at 128. Maximizing profits under the technological constraint is equivalent to minimizing cost under the constraint of a production objective.

### *B. Financial Stakeholders*

#### 1. Moral Portfolios and Asset Price Effects

Drawing on recent finance literature,[173] we argue that for financial investors (i.e., shareholders but also bondholders) the internalization mechanism does not just involve the passing through of profit sacrifice at the stakeholders' demand, but rather a distortion of portfolio choices. The starting point to understand this mechanism is the portfolio theory under which investors diversify their portfolios by weighing assets based on expected risks and returns.[174]

In a stylized (and thus necessary simplified) representation, one can accordingly pose that all investors will include in their portfolio *some* CSR assets for diversification purposes. Sympathetic investors with a taste for moral actions, however, can be expected to alter their allocations so to include *more* CSR assets in their portfolios relative to the equilibrium portfolio choices of non-sympathetic investors who are not interested in moral actions.[175] We call this a "moral portfolio" choice. This choice produces an asset price effect, as it drives an increase in the demand of CSR assets relative to the demand that would obtain if all investors only based their portfolio choices on fundamental values (i.e., excluding the value of the entitlement produced by moral goods but factoring in the costs of producing such goods). Similar to what happens with financial bubbles, the increased demand for CSR assets then drives an increase in the global asset value of CSR corporations. Finally, this asset increase is reflected in share prices, helping to internalize the costs of moral goods.

This analysis sheds further light on the operationalization of the shareholder value maximization principle in CSR corporations. Under the business case for CSR, this principle revolves around classic profit maximization. In our analysis, this account accurately captures the internalization mechanism operating for the morality demand of non-financial stakeholders.[176] However, it fails to consider the asset price effects arising from the moral portfolio choices of financial stakeholders. These effects are similarly overlooked by scholars defending a shareholder welfare maximization test for CSR corporations. As we saw, under this approach the utility shareholders derive from being entitled to corporate morality remains separated from the price mechanism that inform corporations' decisions in competitive markets (in

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[173] *See* sources cited *supra* at note 24.

[174] See STEPHEN F. LEROY & JAN WERNER, PRINCIPLES OF FINANCIAL ECONOMICS 214 (2001) ("When security returns have a factor structure, diversification can be used to reduce idiosyncratic risk in portfolios (that is, the risk in portfolio payoffs that reflects idiosyncratic risk in securities' payoffs). Of course, with a finite number of securities, diversification cannot entirely eliminate idiosyncratic risk, but with an infinite number complete diversification is possible.") On portfolio diversification and factor pricing, see Stephen A. Ross, *The Arbitrage Theory of Capital Asset Pricing*. 13 J. ECON. THEORY 341 (1976). Note that our illustration could also be adapted to other asset pricing theories and the intuition we derive from it would remain the same. *See* Bratton & Sepe, *supra* note 90, at 714-20 (examining different asset pricing models).

[175] *See* Gollier & Pouget, *supra* note 24, (manuscript at 2).

[176] *See supra* Part III.A.

part because that mechanism is seen as being distorted by a public good problem).[177]

In particular, both these approaches fail to consider that moral portfolios and related asset price effects expand the boundaries of shareholder value maximization for CSR corporations, giving these corporations a further degree of freedom in obliging to this principle. This additional degree of freedom arises from the discretion to pursue cash-flow reducing CSR engagement as long as asset price effects more than compensate for the cash flow reduction.[178] Restated, as long as sympathetic investors are willing to pay a premium for holding the shares of CSR corporations, CSR engagement may be compatible with shareholder value maximization even when it is cash-flow reducing.[179] To consider a salient example, think to the American disinvestment campaign from South Africa (or anti-apartheid campaign) of the 1980s.[180] Although that campaign almost certainly triggered revenues losses[181] for the participating corporations, this had little effect on stock prices.[182] While several reasons may explain this outcome,[183] the anti-apartheid campaign is at least evocative of the impact of asset price effects on CSR decisions. Given the numbers of today's ESG investments, it is only more likely that asset price effects may play a large role in these decisions.

For added clarity, let us introduce an example that clarifies these dynamics.[184] This example is also an opportunity to reexamine the above objection that when one considers both the existence of sympathetic and non-sympathetic investors, CSR is incompatible with shareholder value maximization and creates arbitrage opportunities.[185] To further enrich our setting, let us also consider contrarian investors, who are not just indifferent to CSR but suffer a disutility from the production of moral goods that do not match their moral identity. Note that these investors will include less, rather than more, CSR assets in their diversified portfolio.

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177 *See supra* Part III.C.3.

178 Correspondingly, it also means that profit maximization might not be enough for the moral goods' production calculus to be positive if the underlying moral action creates negative asset price effects.

179 *See* Gollier & Pouget, *supra* note 24, (manuscript at 2).

180 *See* Craig Forcese, *Globalizing Decency: Responsible Engagement in an Era of Economic Integration*, 5 YALE H. R. & DEV. L.J. 1 (2002) (defending the efficacy of the American disinvestment campaign from South Africa). *But see* Paul Lansing, *The Divestment of United States Companies in South Africa and Apartheid*, 60 NEB. L. REV. 304 (1981) (offering a skeptical view of the anti-apartheid campaign as a means to advance human rights reform).

181 *See Disinvestment in South Africa; Does America Have a Stake in Apartheid?*, N.Y. TIMES (Apr. 14, 1985), https://www.nytimes.com/1985/04/14/weekinreview/disinvestment-in-south-africa-does-america-have-a-stake-in-apartheid.html (detailing the value of American investments in apartheid-era South Africa).

182 *See* Siew Hong Teoh et al., *The Effect of Socially Activist Investment Policies on the Financial Markets: Evidence from the South African Boycott*, 72 J. BUS. 35, 37-38 (1999).

183 *See id.* (considering several of these factors).

184 This illustration draws on the formal model elaborated by Gollier and Pouget in their work on responsible investors and asset price effects. *See* Gollier & Pouget, *supra* note 24.

185 *See supra* text accompanying notes 161-162.

To capture this transactional environment, consider a setting where a firm, $A$-Corp., wants to sell its shares to public investors. The investor population is normalized to 1 and distributed as follows (i) $\alpha$ investors have identity $I_x$ and receive utility $u(x) > 0$ per period when the corporation produces a moral good $x$ with attached a moral action $X$; (ii) $\beta$ investors have contrarian identity $I_y$, meaning that $\beta$ suffers a disutility $d(x) > 0$ per period when the corporation produces the moral good $x$;[186] and (iii) $\gamma$ investors are non-sympathetic, meaning that when a moral good of either kind $x$ or $y$ is produced, they remain indifferent and bear neither an utility or disutility (or, equivalently, they enjoy an externality equal to $0$). The investor population (which corresponds to the number of shares) is exhausted by these three categories, so that $\alpha + \beta + \gamma = 1$.

$A$-Corp. has to decide whether to produce the moral good $x$. The production of $x$ has a cost equal to $c > 0$ per share. When $A$-Corp. does not produce $x$, it generates per share net profits equal to $\pi > 0$ for each period (e.g., year), while per share profits are reduced to $\pi - c$ when it produces $x$. To make this illustration meaningful, we further assume that all the investors have some degree of risk aversion, meaning that they prefer to diversify their financial holdings into a portfolio.[187] However, we do not include the risk (i.e., variance)[188] terms in this illustration as we only aim to convey the basic intuition.[189] Finally, we assume that investors have rational expectations on prices.

The investor per-period payoff when the moral good $x$ is not produced is the same for everyone, i.e., $\pi$. When, instead, $A$-Corp. produces $x$ the investors' utility is: $\pi - c + u(x)$ for the $\alpha$ investors; $\pi - c - d(x)$ for the $\beta$ investors; and $\pi - c$ for the $\gamma$ investors.[190] This means that the production of

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186 Correspondingly, $\beta$ receive utility $u_y > 0$ when the corporation produces a moral good $y$ with attached a moral action $Y$. Restated, $\alpha$ and $\beta$ have competitive identities such that: $I_x$: $u(x) > 0, d(y) > 0$ and $I_y$: $u(y) > 0, d(x) > 0$.

187 For simplicity we also assume that the risk-free rate is normalized to zero.

188 Note that this is an oversimplification (although it imports no loss of generality for our argument), as the very reason investors diversify is variance (otherwise they would just include assets with the highest expected returns in their portfolios). *See* GABRIELLE DEMANGE & GUY LAROQUE, FINANCE AND THE ECONOMICS OF UNCERTAINTY 95 (2006) ("An investor ranks portfolios on the basis of the expectations and variances of their payoffs. The ranking is increasing in expectation and decreasing in variance.")

189 Formally this can be represented by the investor utility function $U(Z) = -e^{-AZ}$ where $A > 0$ represents the constant absolute risk aversion parameter and $Z$ the return, which may include the positive (negative) externality from the consumption of the moral good. In addition, like in Gollier and Pouget, we assume that the investors solve the same one-risk-free-one-risky portfolio problem in which it is known that the Arrow-Pratt approximation for the certainty equivalent final wealth is exact. *See* Gollier & Pouget, *supra* note 24, at 5. This means that all the investors select a portfolio that maximizes the certainty equivalent final wealth.

190 In this stylized illustration we make two innocuous assumptions: (A1) $\pi > c$ meaning that the cost of producing a moral good cannot be so high as to entirely absorb the per period profit. Otherwise, there would be a clear violation of directors' fiduciary duties; (A2) $\pi - c - d(x)$ can be negative. In such a case, $\beta$ investors would either not invest at all in $A$-Corp. or even short

$x$ always reduces $A$-Corp.'s net cash flows (i.e., from $\pi$ to $\pi - c$) and creates a conditional utility (i.e., $u(x)$, $d(x)$, and $0$ depending on the kind of investors).

Given their different identities, the investors will then choose diverse portfolios, taking into account the utility/disutility that $A$-Corp. creates in producing the moral good $x$. This means that each investor category will compose their portfolios including different proportions of $A$-Corp.'s securities.[191] In the jargon of portfolio theory, $\alpha$ investors will be willing to accept *more* variance (risk) for the same return when $A$-Corp. produces $x$. On the contrary, $\beta$ investors will be willing to accept *less* variance (risk) for the same return when $A$-Corp. produces $x$. Finally, $\gamma$ investors will continue to base their portfolio choices only on $A$-Corp.'s fundamentals (but factoring in the cost $c$ of producing $x$). Hence, $\gamma$ investors will also be willing to accept less variance (risk) for the same return.

Under these assumptions, and further posing that investors capitalize their per-period expected payoffs at the same rate *r*, [192] and the market clearing condition holds at the equilibrium, [193] the shareholder value of $A$-Corp. when it produces $x$ is $V_x = [(\pi - c) + \alpha u(x) - \beta d(x)]/r$.[194] When, instead, $A$-Corp. does not produce $x$, the shareholder value is $V = \pi/r$.[195] Therefore, since $\alpha$ investors are willing to provide more liquidity to $A$-Corp. when it produces the moral good $x$ (for the same return on their investment), while $\beta$ and $\gamma$ investors are willing to provide less liquidity, producing $x$ maximizes shareholder value when $\alpha u(x) > c + \beta d(x)$ holds. This means that the production of the moral good $x$ will *increase* the asset value of $A$-Corp. when the utility $u(x)$ arising from $x$ weighted for the proportion of investors who enjoy that utility ($\alpha$) is higher than the reduction of cash flows ($c$) *plus* the disutility ($d(x)$) arising from $x$ for the contrarian investors ($\beta$) weighted for the proportion of contrarian investors.

This conclusion runs contrary to the prediction that CSR engagement necessarily leads to a share price decline and creates arbitrage opportunities in complex transactional environments including sympathetic investors, non-sympathetic investors and (we add) contrarian investors. Accordingly, it dispels concerns that CSR might be incompatible with economic efficiency. However, it raises a novel, democratic, concern. Indeed, given the cost of production of

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sell its stock. However, the value of the stock can never go below zero because of limited liability.

191 What matters in a portfolio are the weight of the securities that determine the final composition of the portfolio. *See* DEMANGE & LAROQUE, *supra* note 188, at 97. ("The return of a portfolio is the linear combination of the returns of the component securities weighted by their respective shares in the portfolio composition.").

192 If we assume that A-Corp. only lasts one period, there is no need for capitalizing at rate *r*. *See* Gollier & Pouget, *supra* note 24, at 6. The implications of our illustration remain unchanged under this different assumption.

193 *See id.* (for more details on the solution of the market clearing condition at the equilibrium).

194 With the risk (variance) term, the above formula would be $V_x = [(\pi - c) + \alpha u(x) - \beta d(x) - A\sigma^2]/r$, where $A$ is the coefficient of absolute risk aversion and $\sigma^2$ is the variance.

195 With the risk (variance) term, the above formula would be $V = \frac{\pi}{r} - A\sigma^2$.

moral goods, corporations will produce those moral goods that generate more utility than disutility (i.e., satisfy the $\alpha u(x) > c + \beta d(x)$ condition above). It follows that these goods will tend to conform to the moral preferences of the capitalist majority, as determined, under the one-share, one-vote rule, by the shareholders' economic interest in the corporation. This raises the risk that only the moral preferences of the wealthiest may be catered for, even though they represent just a minority of individuals.

As we shall see in the ensuing discussion, this risk becomes compelling when one incorporates CSR dynamics in competitive markets. Outside of these dynamics, "corporate conformism" can still be regarded as a Schumpeterian choice of management,[196] which makes CSR compatible with shareholder value maximization, but that managers can trade off with other welfare maximizing production decisions. But once the dynamics of competitive markets are taken into account, corporate conformism turn into a constraint, as there no longer is a profitable deviation from CSR engagement.

2. Moralized Markets

The prior Section has examined the weight of moral portfolios and asset price for the moral goods' production calculus in CSR corporations. However, we have not yet considered the impact of sympathetic investors on corporations that do *not* engage in CSR and how this plays out at the equilibrium.

In, again, a stylized representation, the equilibrium prediction is that moral portfolio choices will determine a corresponding reduction in the demand for the assets of non-CSR corporations, with a negative impact on share value. Put differently, one can expect a cross-subsidization result under which the shareholders of non-CSR corporations subsidize the costs of moral action engagement by CSR corporations. Anticipating this outcome, at the equilibrium, all corporations will have incentives to engage in CSR. This will neutralize negative asset price effects, with the result that the shareholders of each CSR corporation will ultimately bear CSR costs. However, under these circumstances, a decision not to engage in CSR would be even more costly to shareholders, as this would trigger back negative asset price effects for non-engaged corporations.

A variation on the above example is helpful to clarify this equilibrium prediction.[197] Suppose there are only two companies in the economy: $A$-Corp., which issues stock $a$, and $B$-Corp., which issues stock $b$. Stocks $a$ and $b$ are

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[196] Famously, in Schumpeter's early theory on "creative destruction," entrepreneurs are the source of change and innovation, who continuously search for and create new economic opportunities. *See* Joseph A. Schumpeter, THE THEORY OF ECONOMIC DEVELOPMENT: AN INQUIRY INTO PROFITS, CAPITAL, CREDIT, INTEREST, AND THE BUSINESS CYCLE (1934). Thus, Schumpeterian managers can innovate in the moral dimensions as well as several others, being able to trade off costs and benefits.

[197] By equilibrium prediction, we mean that this is the equilibrium to which the market for corporate morality tends, rather than the present market equilibrium However, the rapid rise in ESG investments as well as predictions for future CSR engagement suggests that the morality market is increasingly moving toward this predicted equilibrium.

traded, respectively, at price $p_a$ and $p_b$ and have the same return and variance as the two corporations have the same fundamentals $\pi$. For expositional simplicity, also assume that there are only sympathetic and non-sympathetic investors, and that each investor has the same wealth to allocate to the purchase of her portfolio.[198] The portfolio of the sympathetic investors can then be represented as $(\omega_a \times a, \omega_b \times b)$, where $\omega_a$ is the weight of $A$-Corp. shares in the sympathetic portfolio and $\omega_b$ is the weight of $B$-Corp. shares. Correspondingly, the portfolio of the non-sympathetic investors can be represented as $(\lambda_a \times a, \lambda_b \times b)$, where $\lambda_a$ is the weight of $A$-Corp. shares in the non-sympathetic portfolio and $\lambda_b$ is the weight of $B$-Corp. shares. Under standard portfolio theory assumptions, the optimal portfolio diversification strategy for both classes of investors is thus $\omega_a = \omega_b = \lambda_a = \lambda_b = 1/2$.[199]

Assume now that $A$-Corp. decides to produce moral good $x$, for which it has to bear cost $c$.[200] The sympathetic investors will then reoptimize their portfolio by holding more $a$ stock, i.e., $\omega_a > \omega_b$. Conversely, the non-sympathetic investors, who only look at the fundamentals and hence the cost of $c$, will readjust their portfolio to $\lambda_a < \lambda_b$. Now, let us assume that the asset price effect arising from the portfolio readjustment of the non-sympathetic investors is dominated by that of the sympathetic investors. Under this assumption, the increased demand for $a$ by the sympathetic investors will determine an increase in $p_a$, such that $\Delta\, p_a > 0$,[201] where the production of the moral good will be fully internalized as long as the share price increase is such that it offsets the profit reduction $A$-Corp.'s shareholders bear for $x$.[202]

We are aware the above assumption is not a weak one. Three reasons, however, make this assumption reasonable. First, assuming that the asset price effect arising from the portfolio readjustment of sympathetic investors is dominant reflects the steadily increasing trend of CSR investments and is consistent with recent evidence that these investments will soon take up more than half of global mutual fund investments.[203] Second, even if one were skeptical about this equilibrium assumption, the same outcome (i.e., the increase in $p_a$) holds under a Keynesian view of markets where prices are influenced by

198 In this illustration we continue to assume that investors have some degree of risk aversion, but we do not include the risk terms in the illustration as this would over-complexify the analysis. *See supra* note 188.

199 This is a degenerate case that we use for the sake of simplification. If all returns are independent and have the same variance than the optimal composition is to include the securities in the portfolio with the same proportion. *See* DEMANGE & LAROQUE, *supra* note 188, at 98. But "in the general case in which expected returns differ across securities, it is necessary to arbitrate between the expectation and the variance of the return." *Id.* at 99.

200 To this extent, the exclusion of contrarian investors reflects the assumption that in producing moral good $x$, $A$-Corp. has already determined that this good generates more utility than disutility.

201 That $\Delta\, p_a > 0$ implies that the $\alpha u(x) > c + \beta d(x)$ holds. *See supra* text accompanying notes 194-195.

202 That is, $\Delta\, p_a \geq c/n$ holds, where $n$ is the number of shareholders.

203 *See* Marsh, *supra* note 27.

herd behavior.[204] Indeed, herding behavior may induce investors to react to aggregate market demand rather than to their own information.[205] As a result, asset price effects may reflect not just market actors' average expectations about fundamental values, but these actors' beliefs about other market actors' beliefs (that is, higher-order beliefs).[206] In our applied context, this means that if the non-sympathetic investors believe that the portfolio readjustment by the sympathetic investors will have a positive asset price effect, they could decide *not* to readjust their portfolio or even readjust it in the same way as the sympathetic investors, with the result that $p_a$ will increase. Third, if one were to discard both of these arguments, this would mean that arbitrage opportunities exist, so that we should observe overperforming long-stock portfolios holding long positions in non-CSR corporations and short-position in CSR corporations. Yet, this counterfactual evidence is conspicuously absent.

With this clarification in mind, we can then move to examine what happens to the value of $B$-Corp (i.e., $p_b$). Because of analogous asset price effects, the distortion in the portfolio choice of the sympathetic investors will lead to a decreased aggregate demand for $b$, reducing $p_b$. Therefore, the ultimate result of the production of moral good $x$ by $A$-Corp. is $p_a > p_b$. This is the cross-subsidization effect, under which non-CSR corporations finance the production of moral goods by CSR corporations. Anticipating this effect, however, $B$-Corp. will rationally engage in CSR, which, in turn, will lead the sympathetic investors to reoptimize their portfolios once again, i.e., returning to the standard diversification strategy of $\omega_a = \omega_b = \lambda_a = \lambda_b = 1/2$. As a result, prices will equalize again at the original value $p_a = p_b$ (as $p_a$ decreases and goes back to its original value and $p_b$ increases and similarly goes back to its original value).

Importantly, note that here $p_a = p_b$ no longer reflects $\pi$, but rather $\pi - c$, due to the cost of CSR engagement to both $A$-Corp. and $B$-Corp. shareholders. The question then is whether this outcome violates the principle of shareholder value maximization. Under the assumption of competitive markets, the answer is negative.[207] For CSR disengagement would reignite negative asset price effects, triggering an even larger reduction in share value.

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204 See JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY 156 (1936). The speculative-market hypothesis has been later formalized by Michael Harrison and David Kreps, see J. Michael Harrison & David M. Kreps, *Speculative Investor Behavior in a Stock Market with Heterogeneous Expectations*, 92 Q.J. ECON. 323 (1978), and more recently by José Scheinkman and Wei Xiong, see José A. Scheinkman & Wei Xiong, *Overconfidence and Speculative Bubbles*, 111 J. POL. ECON. 1183 (2003). For a treatment of the Keynesian view of markets tailored to a legal audience, see K.J Martijn Cremers & Simone M. Sepe, *The Empowered Value of Staggered Boards*, 68 Stan. L. Rev. 67, 113-14 (2016).

205 *See* Keynes, *supra*, at 156.

206 See, e.g., Philippe Bacchetta & Eric Van Wincoop, *Higher Order Expectations in Asset Pricing*, 40 J. MONEY, CREDIT & BANKING 837, 838-39 (2008); and Bruno Biais & Peter Bossaerts, *Asset Prices and Trading Volume in a Beauty Contest*, 65 REV. ECON. STUD. 307, 307-09 (1998).

207 CSR disengagement would be sustainable only if $A$-Corp. and $B$-Corp. could enter into a colluding behavior, but this violates the assumption of competitive markets.

That is, at the equilibrium, no profitable deviation from CSR engagement exists for either $A$-Corp. or $B$-Corp.

This equilibrium prediction points to a radical normative implication: a demand for corporate morality, combined with the dynamics of competitive markets, moves in the direction of a global moral constraint for capitalism. That is, a competitive capitalist system is forced to internalize the cost of moral actions when these actions are demand-driven. On the one hand, the stakeholder morality demand cannot be left unsupplied under the rule of shareholder value maximization. On the other, once a market for corporate morality is introduced and corporations begin to supply moral goods, the moralization of capitalism becomes an endogenous outcome in competitive markets, one that is binding for all market participants.

If there was only one morality, this could be the best of all possible worlds. But in a world of heterogenous and often conflicting moral preferences, moralized markets tend to be conformist and trigger a loss of pluralistic values, as we shall see next.

### *C. Corporate Conformism*

In our equilibrium analysis, we have considered a general demand for morality, distinguishing between corporations that engage in CSR and those which do not. The question, however, is what kind of CSR engagement we actually see. Restated, what moral goods do corporations produce?

Contrary to the optimistic view that moralized markets foster pluralism,[208] we have already observed that most moral goods tend to reflect (or cater to) a progressive moral identity. The bulk of CSR engagement concentrates around the "usual suspects": climate change, human rights, and labor rights—that is, seemingly less divisive items.[209] Still, under the tradeoffs affecting our moral choices, one can arguably expect that, on average, engagement in these issues may appeal more to progressives than conservatives. But it is with more divisive issues, that the progressive orientation of CSR engagement really becomes evident. For example, while several corporations have taken an open stance against restrictions in state abortion laws,[210] we observe no CSR engagement on the pro-life front. Similarly, several corporations have called for gun control reforms or enforced restrictive gun policies in the conduct of their business,[211] while no corporation has openly taken a pro-gun stance. We could

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[208] *See supra* text accompanying notes 88-93.

[209] *See* Gadinis & Miazad, *supra* note 8, at 1414.

[210] *See supra* note 159.

[211] *See, e.g.,* Recoil, Here a List of Companies that Support Gun Control (Sept. 12, 2019), https://www.recoilweb.com/heres-a-list-of-companies-that-support-gun-control-152884.html (listing 145 among public and private companies supporting gun control and restrictions). Anti-gun policies received special impetus after the tragedy at Parkland High School in Florida in 2018. In particular, Walmart famously decided to switch to a more restrictive gun policy following the Parkland tragedy. *See* Walmart, Walmart Statement on Firearms Policy (Feb. 28, 2018), https://corporate.walmart.com/newsroom/2018/02/28/walmart-statement-on-firearms-policy. Investors have also been active in calling for restrictions on gun policies. *See,*

offer several other examples concerning the divisive issues in which today's corporation engage, from immigration to LGBT issues or same-sex marriage or, still, police body cameras.[212] The bottom line would not change, however. Corporations seem to only produce progressive moral goods.

In explaining this outcome, we proceed by backward induction, incorporating the complexities arising from the nature of the modern public corporation and the specific features of moral goods. Today's corporations are (or aspire to be) global institutions that operate at a very large scale and cater to an equally large, often global, consumption base. Striving to capture the majoritarian demand is thus an intrinsic element of their business model. On top of satisfying these demands, different corporations will then specialize in the production of different goods for which there are niches of minority demands.

As we saw in Section III.B.1, corporations also reproduce this business model in the morality market, supplying the goods that appeal to the capitalist majority. Unlike non-moral goods, however, no minority demand can be satisfied in this market once corporations have catered to the majoritarian demand, due to the unique features of moral goods. Recall the core trait of exclusivity, which imparts a production constraint preventing corporations from simultaneously producing a given moral good and what we have defined as the contrarian moral good (see the pro-life example).[213] This constraint is then broadened under the complementary nature of moral goods, which prevents corporations that have chosen a certain moral goods from producing all moral goods that are complement to the contrarian moral good (see the embryonic stem-cell research example).[214] It follows that if the majoritarian demand is progressive—as the evidence suggests—corporations become unable to attend to contrarian conservative demands. Instead, they become locked into satisfying progressive demands only.[215]

We can then finally answer the question about the market clearing for moral goods. At aggregate level, the market for corporate morality is likely to clear by producing exclusively the moral goods that are consistent with the majoritarian capitalist demand. For "corporate conformism" is what enables corporations to appropriate a larger demand and remain competitive in moralized markets. This conclusion exposes the democratic loss of moralized

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*e.g.,* Blackrock, Press Release (Mar. 2, 2018), BlackRock's Approach to Companies that Manufacture and Distribute Civilian Firearms, https://www.blackrock.com/corporate/newsroom/press-releases/article/corporate-one/press-releases/blackrock-approach-to-companies-manufacturing-distributing-firearms (committing to both offer Blackrock's clients a choice of products excluding firearms manufactures and/or retailers and to engage with firearms manufacturers and retailers for safer gun policies).

212 See 2016 Global Strategy Report, *supra* note 14.

213 *See supra* Part II.C.2.

214 *See supra* Part II.C.2.

215 This outcome suggests that the Walras' law is only satisfied for one side (i.e., the progressive side) of the morality market. *See supra* text accompanying notes 107-108. This means that any excess demand over supply for a single *progressive* moral good is likely to trigger a corresponding excess supply over demand for at least one other *progressive* good. But the same does not hold for conservative goods, as the market for morality largely fails to produce such goods.

markets. This loss does not arise from the risk that corporations might behave in an a-moral, if not altogether immoral, way, as some (ironically, mostly in the progressive camp) argue.[216] Rather, corporations may have come to suffer from exactly the opposite problem, an excess of morality under what starts to resemble a "tyranny of the capitalist majority," which may very well be individually a minority.

This, of course, does not mean there might not be exceptions.[217] After all, there are mutual funds that specialize in ethical investing based on conservative values ranging from excluding companies that support abortion or have any involvement with the pornography industry.[218] More importantly, in non-publicly listed corporations, the urgency to cater to the majoritarian demand might be compensated by the willingness of the controlling shareholder to internalize the cost of minority demands for contrarian moral goods. These corporations, which often operate at a more local or regional level, may also cater to a local consumer or worker base that supports the demand of conservative moral goods, turning the production calculus for these goods to

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[216] Reconsider, here, for example, the post-*Citizens United* concerns, when many scholars worried that vesting corporations with socio-political rights would have, at best, disproportionately advanced conservative values and, at worst, led to the immoral marginalization of ordinary citizens. *See supra* notes 72-73, 97 and accompanying text.

[217] A notable exception is, for example, Papa John. This exception, however, might be more apparent than real. In 2017, Papa John's CEO, founder and major shareholder, John Schnatter, criticized the National Football League (of which Papa John was the most recognized sponsor) for showing "poor leadership" in dealing with football players who kneeled during the national anthem as a form of political protest. *See* Cindy Boren & Des Bieler, *Papa John's Owner Blames Sagging Sales on NFL Anthem Protests and League Leadership*, WASH. POST (Nov. 1, 2017), https://www.washingtonpost.com/news/early-lead/wp/2017/11/01/papa-johns-owner-blames-sagging-sales-on-nfl-anthem-protests-and-league-leadership/. These remarks caused such a controversy that eventually Schnatter announced he would step down of his role as the company's CEO. *See* Thomas Moore, *Timeline of a Crisis: Papa John's Deletes Founder From Marketing*, PR WEEK (July 13, 2018), https://www.prweek.com/article/1487792/timeline-crisis-papa-johns-deletes-founder-marketing. Then, in July 2018, Forbes reported that Schnatter used a racial slur on a conference call in May. *Id.* The result was that the company's sales dropped 7.1 percent for the year, while fourth quarter income dropped from $22.8 million the prior year to $4.6 million. *See* Grace Schneider, *Papa John's Sales Dropped Again, This Time By 8.1 percent Last Quarter*, LOUISVILLE COURIER JOURNAL (Feb. 26, 2019), https://www.courier-journal.com/story/money/companies/2019/02/26/papa-johns-lost-72-million-adjusted-net-income-2018/2993974002/. Papa John's events support our intuition about the impact of asset pricing effects on the supply of moral goods and the conformist constraint the attempt to capture such effects imports in CSR decision. It is also telling that while it is uncertain whether the behavior of Schnatter can count as CSR engagement (as such a behavior was more of an idiosyncratic reflection of the controlling shareholder's preferences than a management decision), the company's response after the July 2108 scandal certainly was. Unsurprisingly, that response went in the opposite direction of attempting to cater to the majoritarian progressive demand. Indeed, in March 2019, Papa John's new CEO, Steven Ritchie, announced the launch of a TV and digital marketing campaign to "show Papa John's leaning into the story of our products and ingredients and doing it in a way that is relevant to Millennial and Gen Z customers." *See* Danny Klein, *Papa John's Faces an Uphill Battle in 2019*, QSR MAG. (Feb. 2019), https://www.qsrmagazine.com/pizza/papa-john-s-faces-uphill-battle-2019.

[218] *See* Jeff Cox, *For this Fund, Abortion and Porn Out, Profits In*, CBNC (Nov. 12, 2013), https://www.cnbc.com/2013/11/11/for-this-fund-abortion-and-porn-out-profits-in.html.

positive. Chick-fil-A, Carl's Jr., and Hobby Lobby all provide examples of major private corporations that engage in conservative (or even ultra-conservative) CSR.[219]

None of these corporation is listed, however. This points to a further cost of moralized markets, one that carries a purely economic component. This is the cost private companies bear, under our equilibrium prediction, if they decide to go public. Under the current majoritarian demand, these companies would most likely have to give up their conservative identity in order to be able to raise large amounts of capital in the financial markets. Doing otherwise would require them to fully internalize both the cost of alienating progressive investors and negative asset price effects[220]—a cost that could undermine the benefits of going public. Under this analysis, Truett Cathy, the founder of Chick-fil-A, might thus have had a sound economic reason to contractually bind the company to stay private.[221]

## IV. POLICY IMPLICATIONS

Part III has argued that moralized markets inherently tend to be conformist, which may provide an explanation for why we presently observe almost exclusively progressive CSR engagement. This explanation, however, falls short of accounting for the causes that led to a progressive majoritarian demand. This is an overly complex question, which goes beyond the purpose of this Article. (And, again, the question would be equally compelling if the CSR supply was oriented toward conservative rather than progressive values.) One can hypothesize, for example, explanations based on wealth effects (could conservatives, *on average*, have less available income to spend on the purchase of moral goods rather than goods satisfying more primary needs?) or cultural effects (could conservatives trust the market less than other private organizations to carry out their moral values?). An independent research effort is required to test these and other potential explanations, both theoretically and empirically. On our part, we content ourselves with showing that this is a crucial question to ask, hoping that future research will take up that effort.

On this premise, in this Part we embrace a more pragmatic approach, attempting to understand what can be done to remedy the loss that market conformism imports for the fundamental democratic value of pluralism. We first reexamine, in Section A, recent proposals that defend the view that subsidizing CSR, through an extension of the benefits granted to non-profit organizations, would be normatively desirable. The problem, we argue, is under which metric. We do not doubt that expanded subsidization would help

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219 *See, e.g.,* Lauren Kelly, Five Radical Right-Wing Food Companies, SALON (Jul. 24, 2012), https://www.salon.com/2012/07/24/right_wingers_food_companies_salpart/.
https://marketrealist.com/p/is-chick-fil-a-publicly-traded/

220 Papa John's story offers an idea of the magnitude of these costs. *See supra* note 217.

221 *See* Kate Taylor, *Why Chick-fil-A Will Never Go Public*, BUS. INSIDER (Jan. 28, 2016), https://www.businessinsider.com/chick-fil-a-will-never-go-public-2016-1

optimize the production of moral goods, increasing the economic efficiency of CSR. This, however, would likely come at an even higher loss on the pluralism front.

In Section B, we then move to the core of our policy analysis, attempting to understand whether CSR engagement can be made compatible with pluralistic values. As noted above, Luigi Zingales recently observed that we have been able to design pluralistic institutions for contemporary democracies.[222] Thus, why shouldn't we be able to do the same for shareholder democracy? Our intuition is that we can but doing so requires a costly adaptation of the preference aggregation mechanism in place in the corporate context: the one-share, one-vote rule. This adaption is necessary because the one-share, one-vote rule serves to efficiently aggregates economic preferences,[223] but it is the ultimate source of the loss of pluralism when it is employed to aggregate moral preferences.

In particular, we envision two forms the adaptation of the one-share, one-vote rule could take to mitigate CSR's democratic disfunction. One proposal is to include a supermajority requirement combined with an expanded shareholder franchise over CSR decisions, so to mitigate the risk of a "tyranny of the (capitalist) majority." The more radical, but perhaps also more consequential, proposal is to both expand the shareholder franchise over CSR decisions and substitute the one-share, one-vote rule with the one-person, one-vote principle, as the only mechanism that can safeguard an egalitarian aggregation of our moral preferences (and, indeed, the one that is adopted in political democracies).

The costs of this adaptation, as well as the details (for example, where should one draw the line between CSR and non-CSR engagement?), are not negligible, however. This raises the question of whether we shouldn't just admit that Milton Friedman was right all along: the moral sphere and the economic sphere should be separated. This is another tough question, one that is further complicated by the fact that we are, anyway, unlikely to go back to a model of "moral neutrality" of the corporation.[224] Finally, there are no easy answers when it comes to restoring market pluralism. But this should not discourage us from asking the right questions to pursue that end.

### *A. Subsidizing CSR?*

In Part I, when we first introduced the issue of the divisive nature of our moral preferences, we argued that if the market could fully internalize these preferences, it would not matter much that they are often conflictual. We also argued that part of the most recent CSR literature embracing a demand approach assumes precisely this: that markets allow for the greatest diversity in moral

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[222] *See* Luigi Zingales, *supra* note 92, at 133.
[223] This does not mean that the efficiency of this rule for economic outcomes cannot be improved. *See, e.g.,* Eric Posner & E. Glen Weyl, *Quadratic Voting as Efficient Corporate Governance*, 81 U. CHI. L. REV. 251 (2014) (defending the idea that Quadratic Voting is a superior form of corporate voting).
[224] *See* Watchell, Lipton, Rosen & Katz Memorandum, *supra* note 28.

preferences.[225] On this assumption, it is then unsurprising that these studies' common normative goal is to increase CSR efficiency. In particular, under the view that corporations may be more efficient than other organizations in producing public goods, some scholars advocate an extension to for-profit corporations of the tax benefits granted to non-profit organizations.[226]

This proposal relies on the argument that a disparate subsidy treatment could undermine corporations' comparative advantage in producing public goods,[227] with a net efficiency loss. Eliminating the "coupling" between tax benefits and the non-profit corporate form would thus "encourage a vast increase in the production of community-benefits goods and services by for-profit firms." [228] Further, under the assumption that "the profit incentive explains why for-profit firms are managed more efficiently than nonprofit firm,"[229] "decoupling" would also improve the efficiency of the non-profit production of public goods.[230]

We discussed above why we think that moral goods are more similar to private than public goods.[231] This position, however, does not exclude the idea that moral goods produce positive externalities toward third parties.[232] Therefore, these goods can still be regarded as producing the community-benefits and services that justify the call for expanded subsidization. To this extent, we share the view that decoupling would increase the economic efficiency of CSR engagement. But efficiency here is only one of the terms of the analysis. The other, which emerges when one takes into account the divisiveness of moral goods, is pluralism. Therefore, the normative desirability of expanded subsidization needs to be evaluated against the implications of this proposal for pluralistic values.

Let's consider, first, the implications of expanded subsidization for publicly listed corporations. Under the conclusion that moralized markets tend to be conformist, our intuition is that increased efficiency in the production of

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225 *See supra* text accompanying notes 88-93.

226 *See* Henderson & Malani, *supra* note 59, at 605-11; Anup Malani & Eric A. Posner, *The Case for Profit Charities*, 93 VA. L. REV. 2017 (2007). At state level, non-profits receive tax benefits, such as an exemption from sales and property taxes, if they comply with the state law definition of a "community-benefit" organization. *See, e.g.*, Alaska Stat. § 29.45.030 (2006) (extending tax exemption to properties used for nonprofit religious, charitable, cemetery, hospital, or educational purposes); Fla. Stat. Ann. § 196.012 (West 2007) (defining an exempt use of property for purposes of property tax computation as any predominant or exclusive utilization of said property for, inter alia, charitable purposes). If the firm also meets a substantially similar community-benefit criterion under Section 501(c)(3) of the federal tax code, it will also obtain important federal tax benefits. These include an exemption from the corporate income tax and, more importantly, the ability of donors to deduct their donations from the taxable income. See I.R.C. § 170 (2000).

227 *See supra* note 127 and accompanying text.

228 Malani & Posner, *supra* note 226, at 2022.

229 *Id.*

230 *Id.*

231 *See supra* Part II.C.3..

232 This would be the benefit $B$ in our notation above. *See supra* Part II.C.1.

moral goods would likely trigger an even greater risk of "tyranny of the (capitalist) majority." Put differently, under the current progressive orientation of CSR engagement, a proposal to extend subsidization to CSR corporations would further reinforce this orientation. This is because under the constraints arising from the features of exclusivity and complementarity of moral goods, the increased production of moral goods enabled by expanded subsidization would translate into an *exclusive* increase in the production of progressive moral goods.

Could this effect be different for non-listed corporations? After all, the availability of subsidies could help ease the financial burden of controlling shareholders that decide to bear the costs of endorsing a contrarian, conservative CSR. This is possible, but we are not sure that this effect could more than compensate the added pluralist loss a broader subsidization policy would produce in listed corporations.

The implications for non-profit corporations are even more difficult to gauge. On the one hand, we agree that for-profit incentives would result in better managed non-profit organizations and hence enhance the efficiency of their social and moral engagement. On the other hand, however, those incentives could also import conformist features into non-profit engagement, inducing non-profit organizations to also "chase" the majoritarian demand. We do not know whether that demand would be more likely to be progressive or conservative, but regardless of the nature of this demand, this would import another democratic loss. If that demand turned out to be progressive, the problems we described for CSR corporations would be further exacerbated. If it turned out to be conservative, current polarization issues would likely become even more severe. The bottom line is that proposals for expanded subsidization bear substantial hidden costs once one incorporates pluralism in addition to efficiency as a relevant term of analysis.

### B. *Restoring Pluralism*

The prior discussion has highlighted that improving CSR efficiency will not remedy the pluralism loss triggered by corporate conformism (in fact, it risks making the problem more severe). The ultimate question then is whether CSR engagement can be made compatible with pluralistic values. Answering this question requires an inquiry into the current institutional design of shareholder democracy, beginning with its basic pillar: the one-share, one-vote rule.

#### 1. CSR and the One Share, One Vote Rule

Like any other democracy, the shareholder democracy operates through a voting system. Shareholders, as corporate "citizens," have the right to elect (and remove)[233] their representatives, the directors. They also have the right to vote to approve major corporate transactions, including charter amendments,

[233] Commonly removal must be for cause. *See* Campbell v. Loew's, Inc., 134 A.2d 859 (Del. Ch. 1957) (establishing that a director is entitled to due process rights in removal for cause). Some states, however, provide for the shareholder's right to remove directors without cause. *See, e.g.*, Del. Code Ann. tit. 8, § 141(k) (2001) (allowing removal with or without cause).

mergers and acquisitions, and sales of assets.[234] Most importantly for the purpose of this discussion, Rule 14a-8 of federal proxy rules (i.e., the *town meeting rule*) vests shareholders with the right to include certain proposals in the company's proxy materials, including proposals about CSR.[235]

However, unlike in political democracies, where the voting rule is the egalitarian one-person, one-vote, the (general) voting rule in shareholder democracy is the one-vote, one-share rule.[236] This rule has now become so familiar to make it seem timeless and natural. Until the end of the nineteenth century, however, many U.S. corporations adopted the one-person, one-vote rule or otherwise had restrictions in place to limit the voting power of larger shareholders.[237] These restrictions are still in place in several countries around the world.[238] Mostly, they find justification in the egalitarian concerns raised by the departure of the one-share, one-vote rule from the principle of equal suffrage.[239]

In response to these concerns, scholars of corporate voting point to incentive reasons to justify the one share, one vote rule.[240] First, apportioning voting power among the shareholders proportionally to their corporate investment gives more voice to those with "more skin in the game" and, thus, the best incentives to devote time and effort to the corporate affairs.[241] Second, and relatedly, the one share, one vote rule enables the commodification of the

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234 More generally, all corporate actions that are large, investment-like, and potentially self-interested are candidates for shareholder approval or other constraints on unfettered board decision-making. *See* Edward Rock et al., *Significant Corporate Actions*, *in* THE ANATOMY OF CORPORATE LAW 132 (Kraakman et al., eds. 2004).

235 *See* Securities Exchange Act of 1934, 17 C.F.R. § 240.14(a)-8 (2010). Rule 14(a)-8 permits shareholders to include their own proposals in the corporation's proxy statement prepared by managers. Hence, as compared to ordinary proxy solicitations by shareholders (regulated under Rule 14(a)-7), the town meeting rule both reduces the costs shareholders must bear for proxy solicitations and allows them to promote certain corporate actions without the need that managers make a solicitation on the same matter. *See, e.g.,* ROBERT CLARK, CORPORATE LAW 372 (1986).

236 *See* Alan D. Miller, *Voting in Corporations*, THEOR. ECON. (forthcoming), manuscript available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2970143 (noting the exceptions to the general one-share-one-vote rule). For example, "[t]oday, many corporations issue multiple classes of voting stock to allow the founders to sell their shares without losing control of the corporation or to provide extra voting power to long-term investors." *See id.* (manuscript at 2-3).

237 *See* Colleen A. Dunlavy, *Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights*, 63 WASH. & LEE. L. REV. 1347, 1356 (2006); David. L. Ratner, 56 CORNELL L. REV. 1, 5-8 (1970).

238 *See* Ratner, *supra*, at 12-15.

239 *Id.* Still in many European countries, where restrictions to the one share, one vote rule used to be in place, the practice has increasingly converged towards the American standard. *See, e.g.,* Guido Ferrarini, One Share--One Vote: A European Rule? 22 (European Corporate Governance Inst., Law Working Paper No. 58/2006, 2006), available at http://ssrn.com/abstract-878664.

240 *See* Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30 HOFSTRA L. REV. 445, 472-77 (2008).

241 *See id.* at 475 (arguing that "one share, one vote" is a "logical consequence" of the theory of shareholder primacy.")

corporation itself (rather than just corporate shares), making it much easier to transfer control than other voting rules.[242] The one-share, one-vote rule is thus necessary to operationalize the market for corporate control and its disciplining effect.

Engaging in the debate on the efficiency of corporate voting remains outside the scope of this Article. Still, with the benefits of hindsight, it seems to us that the one-share, one-vote rule has served U.S. corporations well in the domain of economic rights and decisions for over two centuries. Today's corporations, however, are increasingly engaged in the moral, rather than just the economic, domain. As we have explained, in the post-*Citizens United* era, corporations have gained moral agency (in addition to economic agency), cater to *moralized homo economicus*, and produce a vast array of moral goods. The one-share, one-vote rule has been automatically carried over to this entirely different domain. Paired with the divisive nature of moral actions and moral goods, this poses a problem. Indeed, in the economic domain, shareholders can be assumed to share a common objective function (i.e., share value maximization).[243] Under this assumption, voting rights are unequally distributed, but in the pursuit of an egalitarian outcome, as all shareholders are expected to (proportionally) benefit from the enhanced economic efficiency brought about by the one-vote, one-share rule.[244] That assumption, however, no longer holds in the moral domain, where the one share, one vote rule imports no shared benefits for the capitalist minority. Instead, this rule translates into an "householder (or census) franchise,"[245] under which only the moral preferences of the wealthiest matter.

Here, however, we anticipate an objection: after all, CSR engagement is a managerial decision. So how does the one share, one vote rule "enter" into such decisions? There are two basic channels. The first, as we saw above, is through the managerial anticipation that the failure to satisfy shareholders' morality demand means suffering negative asset price effects, while the economic magnitude of this loss increases with the percentage of shares shareholders own.[246] In this sense, we can say that the one-share, one-vote rule

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242 *See* Dunlavy, *supra* note 237, at 1356, 1363.

243 This conclusion does not go without qualifiers. *See* Bratton & Sepe, *supra* note 90, at 707-11 (discussing conditions under which shareholders may not share the same objective function). But in the economic domain, the one share, one vote rule provides a correction to those qualifiers. *See* Peter M. DeMarzo, *Majority Voting and Corporate Control: The Rule of the Dominant Shareholder*, 60 REV. ECON. STUD. 713, 719 (1993) (showing that a dominant blockholder with a financial incentive to move the firm to a production plan that maximizes value can build a majority coalition and solve shareholder disagreement on the firm's objective function).

244 *Cf.* Jill E. Fisch & Simone M. Sepe, *Shareholder Collaboration*, 98 TEX. L. REV. 863, 903 (2018) (arguing that all shareholders are likely to benefit from shareholder "collaboration" with corporate management as "the equity contract provides a premium to all shareholders … (proportionally to their equity stake), leveling the bargaining power of all interested parties in the distribution of the gains arising from deliberation.").

245 The householder (or census) franchise was introduced in England by the Reform Act of 1832, which granted voting rights to all householders who paid a yearly rental of 10 pounds or more. *See* UK Parliament, The Reform Act 1832, https://www.parliament.uk/about/living-heritage/evolutionofparliament/houseofcommons/reformacts/overview/reformact1832.

246 *See supra* Part III.B.

informs the relative weight of shareholders in influencing managerial decisions about CSR. But there is also another channel, which is independent from asset price effects, through which the one-share, one-vote rule matters for managerial decisions on CSR. This additional channel operates through the managerial anticipation of retaliatory actions that the shareholders can exercise either through their voting powers (i.e., removal) or by divesting their investment in the corporation.[247] Importantly, under this second channel, there is an even higher risk that the moral preferences of a minority of shareholders may become dominant, as long as the former can concentrate their holdings in the corporation so to represent a majority of shares.

2. Rethinking Shareholder Democracy?

The prior section showed that the use of the one share, one vote rule to aggregate moral, rather than just economic, preferences, serves as the ultimate source of corporate conformism and the loss of pluralism that conformism triggers. Therefore, we argue that restoring pluralism in the morality market requires a modification of the one share, one vote rule for CSR decisions, while this rule should continue to be the default for shareholder voting on any non-CSR decisions.

This intervention alone, however, would likely have only limited efficacy. For any CSR decision that is excluded from the application of Rule 14-a-8 would continue to fall within managerial discretion and then be indirectly shaped by the logic of the one share, one vote rule. Indeed, while CSR shareholder proposals have now come to surpass corporate governance proposals (the other most common type of 14a-8 proposals),[248] management can exclude shareholder-requested matters from the corporation's proxy solicitation material if they relate to "ordinary business operations."[249] In order not to run afoul of the ordinary business exclusion, the Securities Exchange Commission (SEC) thus requires that CSR shareholder proposals focus on "significant policy issues," but the exact contours of the public policy exceptions remain murky and heavily litigated.[250] Because of these and other restrictions, some corporate scholars argue that proxy access rules on CSR empower managers at the expense of shareholders,[251] advocating that shareholders should have the right "to vote on the broad outlines of corporate policy." [252]

We agree with this conclusion, although for different normative reasons. Unlike other recent proposals for an expanded shareholder franchise on CSR, we deviate from the assumption that shareholders have largely identical (or at least non-conflicting) moral preferences. As a result, our proposal is not

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[247] *See* Broccardo et al., *supra* note 54, (manuscript at 3) (analyzing investors' exit strategies).
[248] *See* Subodh Mishra, *An Overview of U.S. Shareholder Proposal Filings*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 28, 2018), https://corpgov.law.harvard.edu/2018/02/28/an-overview-of-u-s-shareholder-proposal-filings/.
[249] *See* Securities Exchange Act of 1934, 17 C.F.R. § 240.14(a)-8 (2010).
[250] *See* Hart & Zingales, *supra* note 23, at 258.
[251] *See id.* at 270; *see also* Broccardo et al., *supra* note 54, (manuscript at 37-38).
[252] *See* Hart & Zingales, *supra*, at 270.

concerned with addressing the divergent preferences of managers and shareholders, i.e., *vertical* relations of power.[253] Instead, we see the expansion of the shareholder CSR franchise primarily as a means to redress the *horizontal* power relations among shareholders in the moral domain.[254] As we explained above, we see no need for a corresponding corrective action in the economic domain, as economically shareholders can be assumed to share a common objective function. This calls for a reform intervention that can separate the exercise of shareholder power in one domain and the other. An expansion of the shareholder franchise on CSR under a modified voting rule would serve this purpose, ensuring that any CSR decision, rather than just the limited subset of decisions that fall under Rule 14-a-8, be subject to the "CSR voting rule."

Specifically, we envision two forms the adaptation of the one-share, one-vote rule could take in CSR matters. The first draws on the classic argument in the political science literature that supermajority rules can provide protection to minorities by enhancing the inclusiveness of collective decisions.[255] However, in the context at hand, a supermajority rule would come with a slight twist. This is because the minority needing protection here is that of individuals with less invested wealth in the corporation (i.e., the capitalist minority), which may well represent a larger number of people (i.e., a democratic majority). On this assumption, a supermajority rule would make it less likely that CSR engagement might just reflect the moral preferences of the wealthiest few, by attributing a sort of veto power to the capitalist minority. Under this veto power, engagement in highly divisive moral actions would be less likely to gather sufficient support than engagement in less divisive moral actions. This would likely redirect social activism for the most divisive moral actions outside the corporation and the market, mitigating the risk of corporate conformism and therefore the pluralism loss that arises under it.

The adoption of a supermajority rule, however, would not help channel the voice of the capitalist minority. Under a strictly consequentialist argument, then, restoring market pluralism would require a more radical modification of the one-share, one-vote rule: this rule should be turned into the democratic one-person, one-vote rule. In his 1970 article on the history of voting rules in U.S. corporation, David Ratner offers an illustration that exemplifies how this different rule would change the relations of power among shareholders.[256] While we do not envision an overall replacement of the one share, one vote rule,[257] Ratner's illustration is worth considering.

Inspired by one of the earliest examples of CSR engagement—a 1970 CSR campaign that aimed to make General Motors ("GM") "responsible to the

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[253] *See* Dunlavy, *supra* note 237, at 1365-68.
[254] *See id.*, at
[255] *See*, *e.g.*, MELISSA SCHWARTZBERG, COUNTING THE MANY: THE ORIGINS AND LIMITS OF SUPERMAJORITY RULE (2014) (examining, and criticizing, classic arguments in favor of modern supermajority rules in political democracies).
[256] *See* Ratner, *supra* note 237.
[257] Ratner also have in mind a stakeholder model of the corporation, while we do not depart from the classic shareholder model.

community as a whole"[258]—Ratner considers the different conditions that a similar campaign needs to satisfy in order to be successful under the one-share, one-vote and the one-person, one-vote rule, respectively.[259] At the time GM had 285 million shares outstanding with a market value of about twenty billion dollars.[260] Under the one share, one-vote rule, acquiring a thirty-percent interest in GM (an equity participation large enough to give its owner sufficient influence over managerial decisions) would have costed about six billion dollars. For most individuals, or even group of individuals, Ratner duly notes, this is "totally beyond their capabilities, if not their imagination."[261] In particular, if the then 750,000 employees of GM had wanted to have a say in this campaign, an investment of more than $13,000 per capita would have been required.[262] But: if each GM shareholders only had one vote, and with back then about 1,400,000 GM shareholders,[263] an investment of 65 dollars (the then price of a GM share) per employee[264] would have been sufficient to give the GM employees more than one-third of the votes.[265]

Ratner's illustration is useful for two purposes. First, it provides a tangible idea of the different threshold investment required to have voice in CSR matters under one rule and the other. Because the one-person, one-vote rule largely disentangles an individual's ability to exert CSR voice from her wealth, this rule would likely promote a broader range of positions on moral matters. Second, and relatedly, the disentangling between shareholder wealth and CSR voice would make the shareholder category inherently more inclusive. That is, in CSR matters, to use the words of another historian of corporate voting, Colleen Dunlavy, shareholders would cease to be "fundamentally different from the human beings who stand behind the fiction [of shareholding]," and would begin to more closely resemble real citizens.[266]

Yet, redesigning shareholder democracy to foster market pluralism would not come cheap, which raises yet other questions about what the right policy response is. We ask those questions below, in our last Section. Answering those questions, however, will require a collective scholarly effort and engagement. Our hope is that this study will be successful in motivating that endeavor.

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258 *See* Ratner, *supra* note 237, at 29 (describing the GM campaign).
259 *See id.* at 33-35.
260 *See id.* at 34.
261 *See id.*
262 *See id.*
263 *See id.*
264 *See id.*
265 Of course, "assuming that other interested groups did not start buying GM shares to pursue their own interests." *See id.*
266 *See* Dunlavy, *supra* note 237, at 1350 (quoting Daniel Greenwood on the use of the term "fictional shareholders," see Daniel J.H. Greenwood, *Fictional Shareholders: For Whom are Corporate Managers Trustees, Revisited*, 69 S. CAL. L. REV. 1021, 1025 (1996)).

3. Market Pluralism and Its Costs

Our proposal for a combined expansion of the shareholder franchise on CSR and a modification of the one share, one vote rule for CSR decisions would entail significant costs and need to overcome a variety of impediments. First, there is the issue of how corporations—and, in case of litigation, courts—should distinguish between CSR and non-CSR decisions. As we saw above, what constitutes "a significant policy issue," rather than an ordinary business matter, is already heavily litigated. [267] Most likely, litigation would increase if the domain of significant policy issues was expanded, as our proposal requires. Further, it could be argued that potentially any decision a corporation takes has moral or social implications, which would make the contours of CSR and non-CSR decisions even more blurred. There is also the question of whether the distinction between these decisions should be regulated or rather left to the discretion of corporations (subject to shareholders' right to dispute such decisions). On the one hand, a regulatory approach could add the clarity of a bright line; on the other, it could quickly turn into a "one-size-fits-all-approach" that would fail to take into account specific situations. More radically, it is unclear whether a proposal to expand the shareholder franchise and—even more so—to modify the one-share, one-vote rule for CSR matters would be politically feasible, especially in light of the persisting, almost paternalistic, view among regulators that CSR engagement jeopardizes shareholder value maximization.[268]

Second, assuming that these impediments could be overcome, there are the direct costs associated with voting. While in a wired word the bureaucratic cost of administering proxy votes is often described as trivial,[269] this cost would exponentially increase under our proposed expansion of the shareholder franchise on CSR, as any CSR decision would be put to a shareholder vote. Further, while managers routinely engage on CSR issues these days,[270] this engagement would also exponentially increase under an expanded CSR shareholder franchise, and so would its costs—including the opportunity cost of distracting managers from non-CSR, ordinary business matters.

Third, there is the complex issue of index funds' voting. Under our more radical proposal to turn the one-share, one-vote rule into a one-person, one-vote rule for CSR matters, each index fund would only get one vote. Yet, index funds represent hundreds of millions of investors. How is this compatible with democratic egalitarian values? We think the answer is that index funds investors with an interest in CSR matters could individually redirect a fraction of their

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[267] *See supra* note 248-250 and accompanying text.

[268] As the latest example confirming this view, consider the proposal by the Trump administration's US Department of Labor that private pension fund managers need to focus only on maximizing financial returns, ignoring any ESG factors. U.S. Department of Labor, News Release, U.S. Department of Labor Proposes New Investment Duties Rule, https://www.dol.gov/newsroom/releases/ebsa/ebsa20200623 (last visited Jan. 12, 2020).

[269] *See* Hart & Zingales, *supra* note 23, at 271.

[270] *See* Fisch & Sepe, *supra* note 244, at 881-892 (offering a taxonomy of the new "shareholder collaboration" model).

equity investments to these matters. This, however, would entail additional costs for the retail investors (from opportunity to search costs). Perhaps more worryingly, this proposal would encounter the disfavor of index funds, especially under the hypothesis of Barzuza et al. that the latter view their ability to capture Millennials' CSR interests as a major source of future revenues.[271]

Overall, these costs and impediments raise a fundamental question: are moralized markets worth the effort? Put differently, given the costs of redressing the pluralism loss these markets trigger, why do we not just surrender to the Friedman-esque view that markets are designed to just cater to our economic sphere, while other institutions should deal with our moral sphere? If the problem is that these other institutions—government and non-profit organizations—are affected by several inefficiencies, why do we not focus on addressing these inefficiencies, while holding corporations to "moral neutrality"?

These are questions that have no clear-cut answer. First, it could be that these inefficiencies cannot be fixed or, if so, that the cost of doing so exceed the cost of fixing corporate conformism. Second, there might be cases in which only corporations can address certain moral or social issues or, anyway, do this more efficiently. For example, as aptly pointed out by Hart and Zingales, there are instances where the corporation's production activity is not separable from its damage-generating activity.[272] In these cases, the corporation is the party best suited to mitigate that damage. Still, in practice, it seems unlikely that the CSR tide can be reversed to restore corporations' moral neutrality.

In spite of all these difficulties and uncertainties, these are the questions we must begin to ask. For we are all already bearing high CSR-related costs. These costs are different than is conventionally understood, however. Rather the real cost, the real fallout is a critical democratic loss.

## CONCLUSION

This Article has shown that two elements are missing from contemporary scholarly analyses of CSR. The first is the divisive nature of moral actions and moral goods, as a reflection of individuals' heterogenous and often conflicting moral preferences. The second are the distortions that arise when the one-share, one-vote rule, which serves to efficiently determine winning majorities in the economic domain, is imported *tout-court* in the moral domain. When these elements are fully considered, the real cost of CSR is democratic not economic. For moralized markets tend to devolve into conformity and only cater to the moral preferences of the capitalist majority, thereby triggering a loss of pluralistic values. This might provide an explanation to why the current offer of CSR has an almost exclusive progressive connotation—a circumstance that has so far been largely overlooked in the CSR literature.

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[271] *See* Barzuza et al., *supra* note 20, at 143.
[272] *See supra* note 57 and accompanying text.

This conclusion raises several policy questions. Pragmatically, we have focused on attempting to understand what can be done to restore pluralism in the market for corporate morality. This exercise reveals that there are no easy answers, but, perhaps, just more questions. Can the one-share, one- vote rule be effectively adapted to promote a pluralist offer of moral goods by corporations? Are the costs of this adaptation bearable? Otherwise, shall we try to restore a system of moral neutrality of the corporation? Is that even feasible?

Many other questions remain unanswered. For example, how does one explain the *raison d'etre* of corporations that engage in conservative production, such as gun manufacturers and cigarette companies? Does CSR engagement fully captures a corporation's moral identity? Further, as index funds and other institutional investors are the real driving force behind rising CSR trends, could our analysis just point to a problem of excessive politicization at the institutional investor level? Can effective board leadership be a response to this supposed problem?

We are sure there are yet many more questions to ask. Hopefully, that will be the task of future CSR research.

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