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Does Enlightened Shareholder Value Add Value?

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May 2022

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Abstract

Unlike shareholder value maximization (SV), which merely calls on corporate leaders to maximize shareholder value, enlightened shareholder value (ESV) combines this prescription with guidance to consider stakeholder interests in the pursuit of long-term shareholder value maximization. ESV is being increasingly embraced by many actors: it was adopted by the U.K. Companies Act, is being considered for inclusion in the Restatement of Corporate Governance Law, and is broadly supported by both corporate leaders and institutional investors. This article examines whether replacing SV with ESV can be expected to benefit stakeholders or society. We begin by arguing that the appeal of ESV and the enthusiasm for it among supporters is grounded in a misperception about how frequent "win-win situations" are. In reality, corporate leaders often face significant trade-offs between share-holder and stakeholder interests, and such situations are exactly those for which the specification of corporate purpose is important. Furthermore, we explain that, under certain standard assumptions, SV and ESV are always operationally equivalent and prescribe exactly the same corporate choices. We then relax these assumptions and consider arguments that using ESV is beneficial in order to (i) counter the tendency of corporate leaders to be excessively focused on short-term effects, (ii) educate corporate leaders to give appropriate weight to stakeholder effects, (iii) provide cover to corporate leaders who wish to serve stakeholders, and/or (iv) protect capitalism from a backlash and deflect pressures to adopt stakeholder-protecting regulation. We show that each of these arguments is flawed. We conclude that, at best, replacing SV with ESV would create neither value nor harm. However, to the extent that ESV would give the false impression that corporate leaders can be relied on to protect stakeholders, the switch from SV to ESV would be detrimental for stakeholders and could impede or delay reforms that could truly protect them.

Keywords: Corporate purpose, corporate social responsibility, stakeholders, stakeholder governance, stakeholder capitalism, stakeholderism, corporate constituencies, enlightened shareholder value, corporate governance, short-termism.
JEL Classifications: D21, G32, G34, G38, K2

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DOES ENLIGHTENED SHAREHOLDER VALUE ADD VALUE?

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ABSTRACT

Unlike shareholder value maximization (SV), which merely calls on corporate leaders to maximize shareholder value, enlightened shareholder value (ESV) combines this prescription with guidance to consider stakeholder interests in the pursuit of long-term shareholder value maximization. ESV is being increasingly embraced by many actors: it was adopted by the U.K. Companies Act, is being considered for inclusion in the *Restatement of Corporate Governance Law*, and is broadly supported by both corporate leaders and institutional investors. This article examines whether replacing SV with ESV can be expected to benefit stakeholders or society.

We begin by arguing that the appeal of ESV and the enthusiasm for it among supporters is grounded in a misperception about how frequent "win-win situations" are. In reality, corporate leaders often face significant trade-offs between shareholder and stakeholder interests, and such situations are exactly those for which the specification of corporate purpose is important.

Furthermore, we explain that, under certain standard assumptions, SV and ESV are always operationally equivalent and prescribe exactly the same corporate choices. We then relax these assumptions and consider arguments that using ESV is beneficial in order to (i) counter the tendency of corporate leaders to be excessively focused on short-term effects, (ii) educate corporate leaders to give appropriate weight to stakeholder effects, (iii) provide cover to corporate leaders who wish to serve stakeholders, and/or (iv) protect capitalism from a backlash and deflect pressures to adopt stakeholder-protecting regulation. We show that each of these arguments is flawed.

We conclude that, at best, replacing SV with ESV would create neither value nor harm. However, to the extent that ESV would give the false impression that corporate leaders can be relied on to protect stakeholders, the switch from SV to ESV would be detrimental for stakeholders and could impede or delay reforms that could truly protect them.

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I. INTRODUCTION

There are growing concerns about the effects that corporations have on "stakeholders," including employees, suppliers, customers, local communities, and the environment. In the words of one prominent economist, "[t]he world is on fire" and "if we don't reimagine capitalism, we will all be significantly poorer."[1] Another eminent commentator notes that the traditional model of corporate governance has resulted in "wage stagnation, growing inequality, climate change that threatens humanity, repeated bailouts by the many of the few, consumer exploitation, and increased insecurity, social division, and racial and economic inequality."[2] There is therefore a great deal of support, which we share, for developing rules and arrangements that would produce a capitalism that works for all stakeholders.

Even those who agree on the importance of this goal, however, differ substantially in their views on how to advance it. In this article, we focus on one influential and widely supported approach, the view that corporations should replace their traditional purpose of shareholder value maximization (SV) with a standard commonly referred to as "enlightened shareholder value" (ESV). We show that, at best, this approach would fail to deliver any material benefits to stakeholders or society. At worst, however, ESV would fuel confusion and misperceptions about what corporate leaders actually do, and would generate illusory expectations that could impede more promising solutions to social problems.

Part II discusses the ESV approach and the increasing support it has been receiving from academics, corporate leaders, and institutional investors. Unlike the "pluralistic" version of stakeholderism, which considers stakeholder welfare as an end in itself, ESV directs corporate leaders to take into account stakeholder concerns only as a means to the maximization of shareholder value.

Part III discusses the common misperception that seems to lie at the core of the support for ESV. This misperception, which we call the "win-win" illusion, misconceives the scope and frequency of win-win situations in which the same corporate actions benefit both shareholders and stakeholders.

We show that the win-win illusion is explicitly embraced by some prominent ESV manifestos, such as the 2019 statement of the Business Roundtable

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[1] REBECCA HENDERSON, REIMAGINING CAPITALISM IN A WORLD OF FIRE 8, 11 (2020).

[2] Leo E. Strine, Jr., *Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy. A Reply to Professor Rock*, 76 BUS. LAW. 397, 399 (2021).

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on corporate purpose, but it is unsubstantiated. Contrary to the perceptions of many ESV supporters, trade-offs between shareholder interests and stakeholder interests are ubiquitous, and corporate leaders routinely face difficult choices among options with very different effects for shareholders and stakeholders. This recognition, we argue, shows that even if ESV were successful in increasing the focus of corporate leaders on the relevance of stakeholder issues for shareholder value, trade-offs would remain pervasive and would severely limit the potential effects of ESV on societal problems.

Part IV examines the question whether SV and ESV are operationally equivalent, that is, whether corporate leaders operating under an ESV standard would make different decisions than corporate leaders operating under the traditional SV standard. The question is critical because supporters of SV, including Milton Friedman in a famous essay, acknowledge that treating stakeholders well may be good for shareholder value. Therefore, since SV already requires corporate leaders to make stakeholder-friendly decisions if these decisions are indeed shareholder value-maximizing, it is important to understand what a switch from SV to ESV is expected to add to the traditional framework. To this end, Part IV identifies four assumptions under which ESV and SV are operationally equivalent and direct corporate leaders to take the same corporate action.

Part V relaxes in turn each of the four assumptions discussed in Part IV and examines whether doing so justifies the case for switching from SV to ESV. First, we discuss whether ESV is an effective strategy to address the problem of short-termism, which allegedly affects today's capitalism. We show that, even if concerns about short-termism were valid, support for ESV would not follow.

Second, we discuss whether an ESV standard might be an effective way to focus corporate leaders' attention on the relevance of stakeholder factors for long-term shareholder value. We argue, however, that there is no evidence that corporate leaders are generally well informed about profitable business strategies but poorly informed about the specific relevance of stakeholder welfare for long-term value.

Third, we discuss whether ESV could provide legal cover or moral support for corporate leaders to make stakeholder-friendly decisions. We show, however, that under SV, thanks to the business judgment rule, corporate leaders already have sufficient legal cover to make stakeholder-friendly decisions and justify them on the grounds that they would contribute to long-term value maximization.

Fourth and finally, we discuss whether ESV could be a way for corporate leaders to improve the image of their companies, and of capitalism in general, and to deflect pressures for regulatory interventions on business. To those

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interested in stakeholder protection, however, this should be a reason for opposing ESV, not for supporting it. Indeed, if ESV provided rhetorical and political cover to corporate leaders without producing any benefits for stakeholders, stakeholders would be better off under SV.

We conclude in Part VI that replacing SV with ESV should not be expected to produce benefits for either shareholders or society and should thus not be appealing to anyone who is concerned about corporate effects on stakeholders. Adopting ESV could at best be just inconsequential, but it could also be counterproductive by introducing illusory expectations that would impede stakeholder-favoring reforms.

II. TOWARD ENLIGHTENED SHAREHOLDER VALUE?

A. Moving from SV to ESV

Under the traditional SV approach, the purpose of a corporation is the maximization of shareholder value (SV).[3] Under this view, corporate leaders should aim at creating the most value for shareholders, and corporate governance should be preoccupied with preventing corporate leaders from deviating from that goal and pursuing their own self-interest.

Some of those who seek to reform this traditional conception in order to make capitalism more inclusive advocate making the welfare of stakeholders an element of corporate purpose—in other words, as an end in itself.[4] According to this view, the welfare of each group of stakeholders is relevant and

[3] In 1997, the Business Roundtable's "Statement on Corporate Governance" expressed a commitment to SV, stating that "the paramount duty of management and of boards of directors is to the corporation's stockholders." BUS. ROUNDTABLE, STATEMENT ON CORPORATE GOVERNANCE 3 (1997), http://www.ralphgomory.com/wp-content/uploads/2018/05/Business-Roundtable-1997.pdf; *see also* JEAN TIROLE, THEORY OF CORPORATE FINANCE 56 (2006) ("economists, and for that matter much of the legal framework, have always asserted, on the grounds that prices reflect the scarcity of resources, that management should aim at maximizing shareholder wealth"); Edward B. Rock, *For Whom Is the Corporation Managed in 2020? The Debate over Corporate Purpose*, 76 BUS. LAW. 363, 368 (2021) ("In the traditional view… corporate managers face a constrained optimization problem: maximize the value of the company subject to side constraints imposed by regulation (and possibly social and ethical norms).").

[4] *See, e.g.*, COLIN MAYER, PROSPERITY 39 (2018) (arguing that the purpose of business should not be to make profits for shareholders but to "produc[e] profitable solutions to problems of people and planet").

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valuable independently of its effect on the welfare of shareholders.[5] This approach can be called "pluralistic," because it provides directors with a plurality of independent constituencies and requires them to weigh and balance a plurality of autonomous ends.[6]

An important application of the pluralistic approach can be found in the so-called constituency statutes adopted by many U.S. states in the late 1980s and early 1990s.[7] These statutes authorize directors to consider the interests of stakeholders without limiting the relevance of these interests to their effect on shareholders. Some statutes even explicitly specify that the rule does not require that any particular interests be given priority over others.[8]

By contrast, the "enlightened shareholder value" approach (ESV) considers stakeholder interests "instrumentally," as means for advancing the goal of long-term shareholder value maximization.[9] Under this view, corporate leaders should take into account the interests of stakeholders to the extent, and only to the extent, that doing so would serve the goal of long-term shareholder value maximization.

Compared to the traditional formulation of corporate purpose, ESV explicitly focuses on the treatment of stakeholders as a way to achieve long-term shareholder value maximization. Thus, the support for moving from SV to ESV seems to be grounded in the belief (correct, in our view) that the effect of stakeholder treatment on long-term value often represents a factor that is important to take into account in corporate decision-making. Corporations and their long-term success inevitably depend on the cooperation and contributions of stakeholders. For example, corporations depend on employees for human capital, on local and national taxpayers for institutional infrastructure, on customers for revenues, on small and large independent firms and their

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[5] *See, e.g.*, Colin Mayer, *The Governance of Corporate Purpose* (Eur. Corporate Gov. Inst. Working Paper No. 609/2021, 2021), https://ssrn.com/abstract=3928613 ("a purpose of producing profitable solutions and not profiting from producing problems extends accountability to a wider body of beneficiaries than just shareholders").

[6] *See* Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 114 (2020) (defining "pluralistic stakeholders" in the sense discussed in this article).

[7] For a detailed discussion of the constituency statutes and their approach, see Lucian A. Bebchuk, Kobi Kastiel & Roberto Tallarita, *For Whom Corporate Leaders Bargain*, 94 S. CAL. L. REV. 1467, 1485–95 (2021).

[8] *See, e.g.*, ARIZ. REV. STAT. § 10-830 (LexisNexis 2020); N.Y. BUS. CORP. LAW § 717 (Consol. 2020); 15 PA. CONS. STAT. ANN. § 1715 (LexisNexis 2020).

[9] For articles supporting ESV, see, for example, Virginia Harper Ho, *"Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 J. CORP. L. 59 (2010).

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employees for raw materials, intermediate products, and services, and so forth. Furthermore, firms cannot operate and make profit without a certain degree of social and political recognition and acceptance, which is sometimes termed a "social license."[10]

As a result, maximizing long-term value for shareholders requires paying close attention to how a company affects stakeholders, which in turn influences how stakeholders may respond. For example, a company's treatment of employees would likely affect its ability to attract, retain, and motivate its labor force; a company's treatment of customers would likely affect its ability to produce revenues; and a company's treatment of local communities or the environment would likely affect its reputation, political support, and peaceful coexistence within the community. The move from SV to ESV is supposed to highlight the importance and significance of taking these factors into account and to ensure that corporate leaders actually do so.

A prominent example of legal rules implementing the ESV approach is the 2006 United Kingdom Companies Act.[11] Before the enactment of this statute, U.K. company law essentially embraced SV.[12] By contrast, the new statute contains a non-exhaustive list of factors that corporate directors should consider in seeking to enhance shareholder value, including "the interests of the company's employees," "the need to foster the company's business relationships with suppliers, customers and others," and "the impact of the company's operations on the community and the environment." Importantly, directors are called to consider such factors in order "to promote the success of

[10] For a discussion of the relevance of social license for corporations, see generally Hillary A. Sale, *The Corporate Purpose of Social License*, 94 S. CAL. L. REV. 785 (2021).

[11] Companies Act 2006, c. 46, § 172(1) (UK).

[12] John Loughrey, Andrew Keay & Luca Cerioni, *Legal Practitioners, Enlightened Shareholder Value, and the Shaping of Corporate Governance*, 8 J. CORP. L. STUD. 79, 83 (2008) (stating that, according to the Company Law Review Steering Group, the committee charged with studying and proposing a framework to reform company law, the then current law "reflected the fact that companies are managed for the benefit of the shareholders").

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the company for the benefit of its [shareholders]." In other words, consideration of these factors is a means to the end of shareholder welfare.[13] Furthermore, adding an ESV standard is now under consideration for the new *Restatement of Corporate Governance Law.*[14]

Prominent economists have forcefully presented the case for ESV. Rebecca Henderson, for example, devotes a whole chapter of her compelling defense of stakeholder capitalism to examples of companies that improved their bottom line by granting better terms and conditions to small suppliers, turning to renewable sources of energy, or cutting emissions.[15] For Henderson, "the embrace of shared value"—that is, "doing the right thing while simultaneously reducing risk, cutting costs, and increasing demand"—is a "powerful way to create economic return."[16]

In another important book-length endorsement of the ESV version of stakeholder capitalism, Alex Edmans reviews a substantial body of empirical evidence showing a positive correlation between social performance and financial performance.[17] And he argues that companies should focus on growing the whole "pie" (that is, the entire value they create for both shareholders and stakeholders), rather than exclusively on increasing profits.[18]

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[13] *See* CO. L. REV. STEERING GRP., DEVELOPING THE FRAMEWORK 14 (2000) (explaining that the directors' duty to take into account stakeholder interests should not be viewed as an independent goal). For an analysis of the UK statutory provision of "enlightened shareholder value," see Andrew Keay, *Section 172(1) of the Companies Act 2006: An Interpretation and Assessment*, 28 CO. LAW. 106, 106–110 (2007).

[14] Restatement of the Law, Corporate Governance § 2.01(a)(1) (Am. L. Inst. Council Draft No. 1, Sept. 7, 2021).

[15] Henderson, *supra* note 1, at 49–83.

[16] *Id.* at 36, 59.

[17] ALEX EDMANS, GROW THE PIE: HOW GREAT COMPANIES DELIVER BOTH PURPOSE AND PROFIT 105–106, 112 (rev. ed. 2022) (discussing such work, including his own empirical studies).

[18] *See, e.g.*, *id.* at 21–22 ("The pie includes the value an enterprise gives to its *colleagues* . . . the long-term value *customers* enjoy over and above the price they pay . . . the value to *suppliers* from a stable source of revenue . . . the value provided to the *environment* . . . the value enjoyed by *communities* . . . the value given to the *government* through *tax* revenues. A company thus serves not only investors, but also colleagues, customers, suppliers, the environment, communities, and the government.").

For early recognitions of this view by prominent economics and management scholars, see, for example, Robert E. Freeman., Jeffrey S. Harrison & Andrew C. Wicks, MANAGING FOR STAKEHOLDERS: SURVIVAL, REPUTATION, AND SUCCESS 4

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ESV has also been receiving significant support from legal scholars.[19] A common theme to the views expressed in their works is that serving stakeholders is ultimately good for long-term shareholder value. Finally, and most importantly for practice, might be the broad and growing support that has been expressed from business leaders to which we now turn.

B. Support from Business Leaders

1. Corporate Leaders

In the last few years, a large number of corporate leaders have expressed their strong support for stakeholder-oriented corporate purpose. In 2019, more than 180 CEOs signed the Business Roundtable's statement in which

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(2007) ("[t]here is a very pragmatic reason to adopt a ''managing for stakeholders'' view: it is what any successful business really does . . . . So, even if the ideologues who insist that the only legitimate purpose of a business is to maximize shareholder value or maximize profits, the only way to do that is to create great products and services that customers want to buy. Even in these narrowly defined businesses, managers must pay attention to supplier and employee relationships . . . .").

[19] *See, e.g.*, Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401, 1410 (2020) ("[w]e argue that ESG serves shareholders' interests . . . because it helps companies identify and manage social risks to their business"); Andrew Keay, *The Enlightened Shareholder Value and Corporate Governance*, 76 MOD. L. REV. 940 (2013); Harper Ho, *supra* note 9 at 80–81 (claiming that investors view attention to stakeholder interests as "key to long-term financial gain," and arguing that ESG metrics capture long-term risks that traditional accounting metrics fail to capture); Cynthia A. Williams & John M. Conley, *An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct*, 38 CORNELL INT'L L.J. 493, 515–17 (2005) (discussing a proposal of statutory formulation of ESV).

In addition to scholars that expressed explicit support for switching to ESV, there are scholars who have paid close attention to ESV and discussed the growing support for it by corporations and investors. For such works, see, for example, Dorothy S. Lund, *Enlightened Shareholder Value, Stakeholderism, and Managerial Accountability*, in RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD 91 (Elizabeth Pollman & Robert B. Thompson eds., 2022); John Loughrey, Andrew Keay & Luca Cerioni, *Legal Practitioners, Enlightened Shareholder Value, and the Shaping of Corporate Governance*, 8 J. CORP. L. STUD. 79, 85 (2008).

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they pledged to "deliver value to all . . . stakeholders."[20] A few months later, the World Economic Forum issued its Davos Manifesto, which argued that the "purpose of a company is to engage all its stakeholders in shared and sustained value creation."[21] And many individual CEOs have been voicing their commitment to stakeholders.[22]

While some corporate leaders interpret their support for stakeholder capitalism as an endorsement of the pluralistic approach, which considers stakeholder welfare as an independent end, it seems that most of these statements, manifestos, and pledges reflect an ESV approach. Indeed, these declarations are generally careful to avoid expressing any willingness to ever sacrifice shareholder value for stakeholder benefits.

The Business Roundtable, for example, denies that delivering value to stakeholders could prove detrimental to shareholders. Indeed, the Business Roundtable makes it clear that its statement is not a "repudiation of shareholder interests,"[23] and that protecting stakeholders is the right way to build a successful business for shareholders.[24] Moreover, when giving examples of how companies will meet their commitments toward stakeholders, the Business Roundtable does not include any case that suggests that directors would ever put the interests of stakeholders above those of shareholders.[25]

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[20] *Statement on the Purpose of a Corporation*, BUS. ROUNDTABLE (Aug. 19, 2019), https://opportunity.businessroundtable.org/ourcommitment.

[21] *Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution*, WORLD ECON. F. (Dec. 2, 2019), https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution.

[22] For such expressions of support by CEOs, see, for example, Ajay Banga, *Mastercard CEO: How to Make the Digital Economy Work for Everyone*, FORTUNE.COM, Aug. 23, 2019, https://fortune.com/2019/08/23/g7-meeting-mastercard-business-roundtable; *Business Roundtable Redefines the Purpose of a Corporation to Promote "An Economy That Serves All Americans,"* BUS. ROUNDTABLE (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans (quoting Jamie Dimon).

[23] Bus. Roundtable, *Redefined Purpose of a Corporation: Welcoming the Debate*, MEDIUM (Aug. 25, 2019), https://medium.com/@BizRoundtable/redefined-purpose-of-a-corporation-welcoming-the-debate-8f03176f7ad8.

[24] *Id.* ("for corporations to be successful . . . , they need to consider the interests and meet the fair expectations of a wide range of stakeholders in addition to shareholders, including customers, employees and the communities in which they operate").

[25] *Id*.

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Indeed, a recent study by two of us examined the corporate governance guidelines of the signatories of the Business Roundtable's statement, and it found that, whereas almost none of the signatories explicitly express a willingness to trade-off shareholder value and stakeholder benefits, many of them embrace an ESV approach.[26] For example, General Motors' guidelines state that "shareholders' long-term interests will be advanced by responsibly addressing the concerns of other stakeholders essential to the Company's success, including customers, employees, dealers, suppliers, government officials and the public at large."[27] Similarly, Walmart's guidelines advise directors to show their "awareness that the Company's long-term success depends upon its strong relationship with its customers, associates, suppliers and the communities, including the global community, in which it operates."[28]

Indeed, the Davos Manifesto grounds its defense of stakeholder capitalism in the view that such an approach would "strengthen the long-term prosperity of a company."[29] Op-eds and commentary collected on the World Economic Forum's website clarify that the theory underlying the Davos Manifesto is that "[i]n most companies, strategies to achieve financial success for shareholders will include addressing environmental, social and governance (ESG) matters."[30] Indeed, the founder and executive chairman of the World Economic Forum has defined "stakeholder capitalism" as "a form of capitalism in which companies seek long-term value creation by taking into account the needs of all their stakeholders, and society at large."[31]

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[26] *See generally* Lucian A. Bebchuk & Roberto Tallarita, *Will Corporations Deliver Value to All Stakeholders?,* 75 VAND. L. REV. (forthcoming 2022), https://ssrn.com/abstract=3899421. In particular, the study found that about 20 percent of the signatory companies have corporate governance guidelines that express support for an ESV approach.

[27] *General Motors Company Board of Directors Corporate Governance Guidelines*, GEN. MOTORS CO. 2 (Aug. 8, 2017), https://pcg.law.harvard.edu/data/BRTPurposeArchive/GM1.pdf.

[28] *Walmart Inc. Corporate Governance Guidelines,* WALMART INC. 3 (Feb. 6, 2020), https://pcg.law.harvard.edu/data/BRTPurposeArchive/Walmart1.pdf.

[29] *Davos Manifesto 2020*, *supra* note 21.

[30] Milton Cheng, Beatriz Pessoa de Araujo & Julia Hayhoe, *Questions Directors Need to Ask in the Age of Stakeholder Capitalism*, WORLD ECON. F. (Jan. 8, 2020), https://www.weforum.org/agenda/2020/01/what-is-the-role-of-directors-in-the-age-of-stakeholder-capitalism.

[31] Klaus Schwab & Peter Vanham, *What Is Stakeholder Capitalism?*, WORLD ECON. F. (Jan. 22, 2021), https://www.weforum.org/agenda/2021/01/klaus-schwab-on-what-is-stakeholder-capitalism-history-relevance.

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Thus, it seems clear that the driving theory behind the massive support expressed by business leaders for stakeholder capitalism is the ESV approach. Pledges by corporate leaders largely avoid the expression of any willingness to ever trade-off shareholder value against stakeholder welfare, and they generally express explicitly or implicitly the view that attention to stakeholder concerns is a strategy to increase shareholder value.

2. Institutional Investors

An ESV approach is also shared by the many institutional investors that have voiced support for stakeholder capitalism, ESG stewardship, and inclusive corporate purpose. The three largest asset managers BlackRock, State Street, and Vanguard, known as the "Big Three," have urged CEOs to "serve [their] full set of stakeholders,"[32] to manage systemic risks and promote racial, ethnic, and gender diversity,[33] and to tackle climate change.[34] On a closer examination, however, the Big Three and many other large institutional investors have carefully avoided any endorsement of a pluralistic conception of stakeholder capitalism, and they often explicitly stress that they care about stakeholder concerns because and to the extent that these concerns matter for shareholder value.

BlackRock CEO Larry Fink, for example, has observed that "a company must create value for and be valued by its full range of stakeholders in order to deliver long-term value for its shareholders,"[35] and that "[s]takeholder capitalism is all about delivering long-term, durable returns for shareholders."[36] Fink's ESV view is well summarized by his observation that BlackRock's conviction is that "companies perform better when they are deliberate about their role in society and act in the interests of their employees, customers, communities, and their shareholders."[37]

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[32] Larry Fink, *2021 Letter to CEOs*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 30, 2021), https://corpgov.law.harvard.edu/2021/01/30/letter-to-ceos.

[33] Cyrus Taraporevala, *CEO's Letter on Our 2021 Proxy Voting Agenda*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 18, 2022), https://corpgov.law.harvard.edu/2022/01/18/ceos-letter-on-ssga-2022-proxy-voting-agenda.

[34] John Galloway, *Vanguard Insights on Evaluating Say on Climate Proposals*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 14, 2021), https://corpgov.law.harvard.edu/2021/06/14/vanguard-insights-on-evaluating-say-on-climate-proposals.

[35] Larry Fink, *2022 Letter to CEOs: The Power of Capitalism*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter (last visited Mar. 19, 2022).

[36] *Id.*

[37] *Id*.

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Similarly, State Street CEO Cyrus Taraporevala has pointed out that "addressing material ESG issues is good business practice and essential to a company's long-term financial performance—a matter of value, not values."[38] Therefore, the reason why State Street supports addressing ESG risks and stakeholder concerns is because doing so delivers better returns to shareholders. As Taraporevala has made clear, his firm "approach[es] these issues from the perspective of long-term investment value, not from a political or social agenda."[39]

Finally, Vanguard has repeatedly stressed that it approaches ESG issues "from a fiduciary perspective,"[40] meaning that it considers such issues due to their effect on the financial returns for its clients. In this spirit, Vanguard has argued, for example, that "[c]limate change represents a profound, material, and fundamental risk to companies and their shareholders' long-term success,"[41] and that it will keep ESG issues "at the forefront in order to deliver value to Vanguard investors."[42]

Even public pension funds such as CalPERS and CalSTRS, which have been traditionally active on social responsibility issues, seem to endorse the ESV version of stakeholder capitalism. CalPERS has made it clear that it "views climate change, and associated risks and opportunities, as an investment issue,"[43] and that "by advocating for climate risk reporting, [CalPERS] can better protect our investments that help pay the pensions promised to our members."[44] Similarly, CalSTRS has stated that ESG issues "can affect the

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[38] Cyrus Taraporevala, *CEO Letter to Board Members Concerning 2020 Proxy Voting Agenda*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 3, 2020), https://corpgov.law.harvard.edu/2020/02/03/ceo-letter-to-board-members-concerning-2020-proxy-voting-agenda.

[39] Cyrus Taraporevala*, 2019 Proxy Letter—Aligning Corporate Culture with Long-Term Strategy*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 15, 2019), https://corpgov.law.harvard.edu/2019/01/15/2019-proxy-letter-aligning-corporate-culture-with-long-term-strategy.

[40] *Climate Change Investment Stewardship Insights 2021*, VANGUARD, https://global.vanguard.com/documents/voting-insights-climate-proposals-2021.pdf (last visited Mar. 19, 2022).

[41] *Id*.

[42] *2020 Investment Stewardship Annual Report*, VANGUARD, https://global.vanguard.com/documents/2020-investment-stewardship-annual-report.pdf (last visited Mar. 19, 2022).

[43] *Why Climate Risk Reporting Is Important*, CALPERS, https://news.calpers.ca.gov/why-climate-risk-reporting-is-important (last visited Mar. 19, 2022).

[44] *Id*.

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performance of [its] investments,"[45] and that "unsustainable practices that hurt long-term profits are risks to the system's investment,"[46] with no mention of the possibility that some unsustainable practices may be profitable for investors.

Further evidence that large asset managers' environmental and social stewardship is grounded in the ESV view is that many environmental and social activists engaging companies on social responsibility issues frame their case as a business case because they want to cater to the ESV narrative embraced by institutional investors.[47] Many of these activists have an institutional mandate to advance environmental or social goals,[48] and they routinely file shareholder proposals (on their behalf or on behalf of other shareholders) with an explicit prosocial motivation.[49] A significant fraction of these proposals, however, present justifications that focus on the financial benefits of the proposed environmental or social action. For example, many proposals on climate change stress the "regulatory risk" of upcoming environmental restrictions that would dramatically change the value of the company's assets and therefore recommend that the company pivot to greener projects in order to protect shareholder value against such a risk.[50] And several proposals pushing for board or workforce diversity similarly praise the positive effects of diversity on financial performance and shareholder value.[51]

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[45] *Corporate Governance Principles 2021*, CalSTRS, https://www.calstrs.com/sites/main/files/file-attachments/corporate_governance_principles_1.pdf (last visited Mar. 19, 2022).

[46] *Id*.

[47] *See generally* Roberto Tallarita, *Stockholder Politics*, 73 HASTINGS L. J. (forthcoming 2022), https://ssrn.com/abstract=3798101 (manuscript at 33–37).

[48] *See id.* at 49–59 (reporting empirical evidence on the activities of the most active sponsors of environmental and social shareholder proposals, many of which engage in policy activism, lobbying, and other forms of advocacy).

[49] See id.

[50] For an example of an ESV-driven proposal on decarbonization, see the proposal presented in 2018 by Arjuna Capital to ExxonMobil, which requested a report on "how the Company could adapt its business model to align with a decarbonizing economy," and stressed at length that "[m]ajor oil companies face unprecedented disruption to their business model driven by global imperatives to limit global warming to well below 2 degrees Celsius." ExxonMobil, Inc., S.E.C. No Action Letter Request, 2018 WL 721678, at *7 (Mar. 23, 2018).

[51] For an example of an ESV-driven proposal on employee diversity, see the proposal presented in 2017 by the Benedictine Sisters of Boerne, Texas, to Home Depot, which requested a diversity report and justified the request based on, among other things, the fact that "companies with good [equal opportunity employment]

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III. THE WIN-WIN ILLUSION

Supporters of replacing SV with ESV seem to believe not only that doing so would make a difference, which we question below, but that the difference made would be substantial. Under this view, if corporate leaders were to take into account how long-term shareholder value is affected by the treatment of stakeholders, which ESV seeks to ensure, capitalism would work markedly better for all stakeholders. For this reason, ESV supporters such as Rebecca Henderson claim that this approach would entail an "architectural innovation" of how businesses are run, which would enable "reimagining capitalism."[52]

Likewise, the Business Roundtable describes its statement, as do many of those commenting on this statement, as an historic milestone.[53] This view, we argue, seems to be grounded in a misperception about the scope and frequency of "win-win situations" in which certain business choices would benefit both shareholders and stakeholders. This view fails to recognize, however, that corporate leaders often face real and significant trade-offs between shareholder and stakeholder interests.

The Business Roundtable, for example, explicitly denies that long-term shareholder value and stakeholder interests may ever be in conflict, by stating that "[w]hile . . . different stakeholders may have competing interests in the short term, . . . the interests of all stakeholders are inseparable in the long term."[54] This view, however, is unwarranted. In fact, potential trade-offs between shareholders and stakeholders are ubiquitous. Even if a company took all the available opportunities to improve shareholder value by improving stakeholder welfare, there would still be many opportunities to improve stakeholder welfare further, but at the expense of shareholders. Companies

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records have a competitive advantage in recruiting/retaining employees," and "[a] diverse work force is more likely to anticipate and respond effectively to consumer demand." The Home Depot, 2017 Proxy Statement (Form 14A), at 28 (Apr. 3, 2017).

[52] Henderson, *supra* note 1, at 71–72.

[53] *See, e.g.*, Afdhel Aziz, *The Power of Purpose: How Conscious Capitalism Is Helping Shape the New Paradigm for Business*, FORBES (Sept. 5, 2019, 11:05 AM), https://www.forbes.com/sites/afdhelaziz/2019/09/05/the-power-of-purpose-how-conscious-capitalism-is-helping-shape-the-new-paradigm-for-business/#3560595679eb (defining the Business Roundtable's statement as a "revolutionary . . . moment in business"); David Benoit, *Top CEOs See a Duty Beyond Shareholders*, WALL ST. J., Aug. 20, 2019, at A1 (referring to the statement as to a "major philosophical shift.").

[54] Bus. Roundtable, *Redefined Purpose of a Corporation, supra* note 23.

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find themselves in these situations all the time. Indeed, some of the most serious societal problems underlying the current debates on corporate purpose involve situations that do not offer win-win choices—but rather present clear and substantial trade-offs between shareholders and stakeholders. Consider the following five hypotheticals.

Climate Change: Consider an oil and gas company that has already taken into account the effects of its carbon emissions on its own sustainability and reputation. Suppose that the company's long-term profit maximization would be served by generating over the next ten years massive profits from a project that would produce socially excessive carbon emissions. The decision whether to invest in this project would involve a tradeoff between shareholder interests and society's interest in reducing climate risks.

Market Power: Consider a company with already significant market power that could take advantage of existing opportunities and, within what the law permits, increase its market power even more. Expanding and using its market power would involve a tradeoff between the interests of shareholders and those of customers.

Offshoring: Suppose that a company could operate its plants more profitably by moving all its manufacturing facilities abroad to a country with substantially lower labor costs. And suppose further that the extra long-term profits would far exceed any reputational and moral costs to long-term profits that result from such an offshore move. In this case, choosing whether to move the operations offshore would involve a trade-off between the interests of shareholders and the interests of current employees and local communities.

Labor Share: Consider next a company that operates in the U.S. Rust Belt and employs a large number of blue-collar employees. Suppose that the company's assets, given all the competitive constraints, are expected to generate over time a stream of profits that would be sufficient to fund all the anticipated investments and still leave a significant stream of annual free cash flow. Deciding how to allocate the free cash flows between dividends to shareholders and extra compensation to employees (beyond what would be needed just to retain them given the limited options available in their communities) would involve a tradeoff between the interests of shareholders and those of employees.

Tax Avoidance: Finally, consider a company that is informed by its advisers that it could adopt structures and arrangements that would enable it to substantially reduce its tax liabilities, in full compliance with the law. Deciding whether and to what extent to take advantage of this opportunity would involve a tradeoff between the interests of shareholders and the interests of taxpayers and society.

The "win-win illusion" might be in part based on empirical studies documenting a statistically significant association between employee satisfaction

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and shareholder return,[55] as well as between social responsibility scores and company valuation.[56] These studies, however, at most show that some shareholder-friendly actions can increase shareholder value for some firms, but they do not imply a pervasive lack of substantial trade-offs or that all potential stakeholder-friendly options would generally be good for shareholders.

As Alex Edmans concedes in his thoughtful review of the empirical literature on this issue, the fact that there is a positive correlation between social and financial performance in some industries or in some countries does not mean that the same correlation exists in all industries or in all countries. Most importantly, these correlations do not imply that "increasing social performance without limits always increases financial performance."[57] The empirical evidence is thus fully consistent with the ubiquitous presence of trade-offs.

In the next two Parts we will discuss whether a move from SV to ESV would make any practical difference, and we will consider several factors that could enable ESV to produce an improvement in the extent to which corporate leaders incorporate stakeholder concerns into the maximization of long-term shareholder value. However, the discussion in this Part indicates that even if ESV were successful in increasing the focus of corporate leaders on the relevance of stakeholder issues for shareholder value, trade-offs would remain ubiquitous and many pressing societal problems—particularly those underlying current concerns and current interest in stakeholder capitalism—would not be alleviated through win-win solutions. Thus, to the extent that capitalism is facing "a world on fire," moving from ESV to SV cannot be expected to have a major effect on the height of the flames.

IV. EQUIVALENCE TO SHAREHOLDER VALUE

The term "enlightened" has positive connotations, and therefore ESV may sound like an improvement on SV. But does ESV in fact lead to different corporate decisions than SV?

The question must be asked because the old-fashioned SV also calls on corporate leaders to take into account stakeholder effects whenever they believe that the treatment of stakeholders would have effects on the long-term shareholder value that corporate leaders are directed to maximize. Indeed, even Milton Friedman, whose views on corporate social responsibility are

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[55] *See* Alex Edmans, *Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices*, 101 J. FIN. ECON. 621, 622 (2011).

[56] *See* Allen Ferrell, Hao Liang & Luc Renneboog, *Socially Responsible Firms*, 122 J. FIN. ECON. 585, 586 (2016).

[57] Edmans, *Grow the Pie*, *supra* note 17, at 137.

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often denounced by supporters of ESV, has indicated that shareholder value maximization may sometimes call for stakeholder-friendly decisions. In his well-known 1970 article for the *New York Times Magazine*, which is often considered a manifesto for the strongest version of SV, he explains that "providing amenities to [the local] community or to improving its government . . . may make it easier to attract desirable employees, it may reduce the wage bill or lessen losses from pilferage and sabotage or have other worthwhile effects."[58]

Thus, under the "old-fashioned" SV approach, corporate leaders should take into account all factors that could affect long-term shareholder value, including any relevant stakeholder issues. The question then arises whether, in practice, the ESV standard should be expected to lead to a fuller or better consideration of stakeholder effects or otherwise produce different outcomes.

Are there circumstances in which, under an ESV standard, corporate leaders would choose corporate actions that are more favorable to stakeholders than under an SV standard? In Part V, we present a systematic analysis of the factors that could arguably lead to more stakeholder-friendly corporate decisions in case of a switch from SV to ESV. To prepare the ground for this analysis, we state below a set of four assumptions under which ESV and SV would be operationally fully equivalent, that is, in every situation they would direct corporate leaders to choose the same corporate action.

Table 1: Conditions for Equivalence of SV and ESV

A1:	Corporate leaders are not myopic and fully take into account the long-term consequences that their choices have on long-term shareholder value.
A2:	Corporate leaders are well informed about the consequences of their choices (or at least as well informed about these consequences as other agents in the economy).
A3:	Courts avoid the micromanagement of corporate decisions and defer to the discretion of corporate leaders under the business judgment rule.
A4:	Because outsiders are well-informed too, only changes in actual treatment of stakeholders, and not merely linguistic changes in the formulation of the decision standard, are taken to be actual changes.

[58] Milton Friedman, The Social Responsibility of Business Is to Increase Its Profits, N.Y. TIMES, Sept. 13, 1970, at SM12.

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Assumptions A1 and A2 ensure that corporate leaders both (i) pay attention to all the factors that could have an effect on long-term shareholder value and (ii) are well-informed about these effects. Given these assumptions, corporate leaders who are guided by the SV maxim should be expected to take stakeholder issues into account to the extent that doing so would be relevant to maximizing shareholder value.

Assumption A3 excludes an external factor—judicial micromanagement whose scale or nature depends on whether ESV or SV is chosen—that could lead corporate leaders to choose differently under the two standards. Finally, assumption A4 excludes the possibility that outsiders would be "fooled" by the mere use of different language if the difference in language does not result in a different treatment of stakeholders by corporate leaders.

Thus, under these four assumptions, ESV would be practically indistinguishable from SV. Whenever treating stakeholders well in a given way would be useful for long-term shareholder value, such treatment would be called for under either ESV or SV. And whenever treating stakeholders well would not be useful for long-term shareholder value, such treatment would not be called for under either enlightened shareholder value or old-fashioned shareholder value. And with ESV-guided and SV-guided corporate leaders treating stakeholders in the same way, well-informed outsiders will perceive their identical treatment of stakeholders in the same way.

The discussion above provides a useful benchmark for examining whether and how a switch to ESV could make a practical and positive difference. In Part V, we will relax in turn each of the above four assumptions, and we will consider the argument for the beneficial significance of ESV that could be introduced in this way.

V. Arguments that Adopting ESV Would Make a Difference

In this Part, we turn to examine four potential arguments (not mutually exclusive) for replacing SV with ESV that could be introduced by relaxing the four assumptions under which SV and ESV are operationally equivalent. Section A relaxes the assumption that corporate leaders take into account both short-term and long-term effects, and it considers the argument that ESV is needed to address corporate leaders' short-term bias. Section B relaxes the assumption that corporate leaders are well informed about the shareholder value effects of stakeholder-friendly decisions, and it considers the argument that adopting ESV would improve decisions by educating and informing corporate leaders about these effects. Section C relaxes the assumption that courts are largely deferential to the discretion of corporate leaders, and it considers the argument that using the ESV formulation would provide corporate leaders legal cover to make more stakeholder-friendly decisions. Section D considers the argument that, even though ESV would not make a practical

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difference for what corporate leaders actually do, using the ESV language would protect capitalism from a backlash and deflect outside pressures and demands for better treatment of stakeholders.

A. Addressing Short-Termism?

There is a long-standing debate in corporate governance scholarship about short-termism.[59] Those concerned about short-termism believe that corporate leaders have incentives to focus on short-term consequences and discount long-term consequences and, therefore, underinvest in activities that have long-term payoffs. Note that, to the extent that such a myopic behavior exists, it would likely adversely affect an array of corporate choices including those that have nothing to do with stakeholders. For example, a standard argument made about short-termism is that it leads corporate leaders to underinvest in R&D and other long-term capital.[60]

Some supporters of ESV argue that switching from SV to ESV would address the suboptimal treatment of stakeholders that is due to short-termism.[61] The underlying theory is that investing in stakeholder welfare is

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[59] For authors supporting the view that corporate leaders are short-termist, see, for example, Leo E. Strine, Jr., Who Bleeds When the Wolves Bite? A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System, 126 YALE L.J. 1870, 1871–72 (2017); Klaus Schwab, Five Leadership Priorities for 2017, WORLD ECON. F., https://www.weforum.org/agenda/2017/01/five-leadership-priorities-for-2017 (last visited Mar. 17, 2022); William W. Bratton & Michael L. Wachter, The Case Against Shareholder Empowerment, 158 U. PA. L. REV. 653, 653–54, 657–59 (2010); Alfred Rappaport, The Economics of Short-Term Performance Obsession, 61 FIN. ANALYSTS J. 65 (2005).

For authors questioning the magnitude of the short-termist problem, see, for example, Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637 (2013); Mark J. Roe, *Looking for the Economy-Wide Effects of Stock Market Short-Termism*, https://ssrn.com/abstract=3986570 (unpublished manuscript). For a recent essay on the significance of the short-termism problem, see Lucian A. Bebchuk, *Don't Let the Short-Termism Bogeyman Scare You*, HARV. BUS. REV., Jan.–Feb. 2021, at 43.

[60] For authors supporting the view that short-termism is leading corporate leaders to underinvest in R&D, see, for example, John C. Coffee Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 580 (2016); William Lazonick, *Profits Without Prosperity*, HARV. BUS. REV, Sept. 2014, at 46.

[61] *See, e.g.*, Harper Ho, *supra* note 9, at 99 ("[u]nder an enlightened shareholder value paradigm then, generating long-term shareholder wealth is the fundamental

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often a long-term investment; thus, encouraging corporate leaders to pay attention to stakeholders produces those long-term benefits that short-termism tends to undercut.[62]

Under this view, for example, a company that treats employees or customers well today will be able to reap substantial benefits in the long term by gaining the loyalty or appreciation of such employees or customers. However, so the argument goes, short-termist corporate leaders tend to ignore or discount such long-term payoffs and therefore will underinvest in their employees or customers. In this view, a switch from SV to ESV, by directing corporate leaders to pay attention to stakeholder welfare, will lead corporate leaders to increase their current investment in their employees or customers, which will operate to enhance long-term value. As we explain below, however, even if corporate leaders were biased toward the short term, the case for ESV would not follow.

To begin with, the relation between short-termism and stakeholder welfare is more complicated than ESV supporters suggest. In fact, companies may choose short-termist strategies that are beneficial to stakeholders as well as long-termist strategies that are detrimental to stakeholders. For example, corporate leaders could decide to pay overly generous bonuses to incentivize employees to boost quarterly sales at the expense of long-term value (stakeholder-friendly short-termism); symmetrically, corporate leaders could decide to relocate all manufacturing plants offshore in order to boost long-term profits by killing tens of thousands of local jobs (stakeholder-hostile long-termism).

Second, to the extent that short-termism is a serious concern, it likely affects all choices that have substantial long-term payoffs and not only those

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objective for corporate decision-making . . . . ESV decision rules must look beyond quarterly earnings or other traditional measures . . . ."); *see also* Lund, *supra* note 19, at 92 (explaining that supporters of ESV have "criticized [SV] as contributing to corporate short-termism" and argue that ESV would ask "management to promote the long-term value of the firm for the benefit of its shareholders").

[62] For institutional investors supporting this argument, see, for example, Larry Fink, *A Sense of Purpose*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 17, 2018), https://corpgov.law.harvard.edu/2018/01/17/a-sense-of-purpose (supporting ESV and arguing that without it, companies "will succumb to short-term pressures to distribute earnings, and, in the process, sacrifice investments in employee development, innovation, and capital expenditures that are necessary for long-term growth"); *CalSTRS Corporate Governance Principles* 2021, *supra* note 45 (arguing that CalSTRS is a "long-term investor" and therefore "unsustainable practices that hurt long-term profits are risks to the [fund]'s investment").

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that are related to stakeholders. If one were to assume that instructing corporate leaders to take certain issues into account would lead them to do so, which we will presently question, there is little reason to have such instructions limited to taking into account stakeholder effects. In particular, if telling corporate leaders to take certain effects into account were expected to lead them to give more weight to such effects, then it would be desirable to provide corporate leaders with similar instructions also with respect to other factors that are generally regarded to have substantial long-term effects such as R&D or long-term capital investments.

Third, and importantly, if corporate leaders have incentives to focus on the short term and thus discount long-term effects, which is the premise underlying short-termism concerns, then there is little basis for believing that telling corporate leaders not to do so would address the problem. After all, if telling corporate leaders that they should not be myopic could be expected to ensure that they make decisions that are optimal from a long-term perspective, the short-termism problem would be easily soluble, and concerns about it would be easily dismissible.

Note that supporters of ESV do not argue for replacing the business judgment rule with increased judicial supervision of managerial discretion. The business judgment rule, under which courts tend to defer to the business judgment of corporate leaders, is widely supported on the grounds that courts have difficulty second-guessing business decisions and that corporate leaders have incentives to use their discretion well.[63] In other words, the underlying assumption for keeping the business judgment rule in place is that the way corporate leaders use their discretion depends primarily on their incentives, not on legal rules or other forms of guidance. Thus, as long as corporate leaders have short-term incentives, pontificating to them about the importance of taking into account long-term effects, either in general or with respect to stakeholders in particular, would not address short-termism problems.

To be sure, some ESV supporters push corporate leaders to adopt internal processes that would facilitate the consideration of stakeholder issues. For example, some institutional investors urge corporate leaders, and support shareholder proposals calling on such leaders, to create board committees or other internal processes that would facilitate such consideration.[64] Again,

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[63] *See, e.g.,* STEPHEN M. BAINBRIDGE, CORPORATE LAW 248 (3d ed. 2015); Rock, *supra* note 3, at 375.

[64] *See, e.g.*, *CEO's Letter on Our 2019 Proxy Voting Agenda*, STATE ST., https://corpgov.law.harvard.edu/2019/01/15/2019-proxy-letter-aligning-corporate-culture-with-long-term-strategy (last visited Mar. 17, 2022) (calling on boards to proactively review and monitor corporate culture, aggressive sales practices and/or unethical behaviors, which negatively impacted long-term company performance).

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however, process requirements cannot be relied on to produce optimal long-term decisions when the incentives of decision-makers pull them in a different direction. To illustrate, to the extent that one is concerned that short-term incentives lead to underinvestment in R&D, this concern would not be expected to be addressed by having a board committee or a report to shareholders about the process that corporate leaders are pursuing to consider the subject.

Thus, because short-termism concerns are grounded in corporate leaders' incentives, the effective way to address such concerns is by changing the incentives of corporate leaders.[65] In our view, and as one of us recently argued in an article on short-termism, the most effective way to provide corporate leaders with incentives that are more long-term oriented is to design executive pay arrangements with this goal in mind.[66] Institutional investors and others who are concerned about short-termism, with respect to stakeholder effects, R&D, or any other factors, should focus on redesigning pay arrangements.

In sum, however concerned one may be about short-termism, telling corporate leaders to take into account factors that have long-term effects should not be expected to be an effective remedy. To the extent that incentives remain perversely short-termist, as some believe they are, instructions not backed by effective incentives would not address the problem. And to the extent that reforms in pay arrangements or other areas ensure that corporate leaders' incentives are appropriately focused on the long term, telling corporate leaders to be long-termist would not make an additional practical difference.

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[65] For this reason, some of those concerned about short-termism support insulating corporate leaders from hedge fund activists and takeovers, which they argue produce incentives to focus on short-term prices rather than long-term value creation. *See, e.g.*, Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187 (1991); Bill George, *Activists Seek Short-Term Gain, Not Long-Term Value*, N.Y. TIMES: DEALBOOK (Aug. 26, 2013, 10:56 AM), http://dealbook.nytimes.com/2013/08/26/activists-seek-short-term-gain-not-long-term-value; Justin Fox & Jay W. Lorsch, *What Good Are Shareholders?*, HARV. BUS. REV.(July 2012), https://hbr.org/2012/07/what-good-are-shareholders.

[66] Bebchuk, *Don't Let the Short-Termism Bogeyman Scare You*, *supra* note 59 (arguing that those concerned about short-termism should focus on redesigning executive pay before considering other changes to address short-term incentives). For a detailed blueprint for how to design compensation arrangements providing long-term incentives, see Lucian A. Bebchuk & Jesse M. Fried, *Paying for Long-Term Performance*, 158 U. PA. L. REV. 1915 (2010).

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B. Educating and Informing Corporate Leaders?

Next, we relax assumption A2, according to which corporate leaders are well-informed about the consequences of their choices for long-term shareholder value, or at least not less informed than other agents. We thus turn to consider the possibility that corporate leaders are imperfectly informed about the impact of stakeholder-friendly decisions on long-term shareholder value, or that some behavioral factors preclude them from fully appreciating such an impact. Indeed, some supporters of ESV have argued that adopting a standard referring explicitly to stakeholder effects would have *informational and educational value* that would improve corporate decision making.[67]

According to this view, some corporate leaders have tended to systematically underappreciate the significance of stakeholder effects for long-term value. Replacing SV with ESV, so the argument goes, would contribute by highlighting and making salient the significance of stakeholder effects and thereby make corporate leaders more likely to take them fully into account. As explained below, however, this argument does not provide a good basis for ESV.

Generally speaking, corporate governance scholars, including those supporting ESV, do not believe that outsiders should micromanage which information corporate leaders acquire in order to make business decisions. For all factors other than stakeholder effects, supporters of ESV seem happy to accept the assumptions that corporate leaders are likely to be in the best position to assess what information would be relevant for their decisions. And there does not seem to be a good reason for why stakeholder effects should be singled out for special attention.

To begin with, it is not clear why stakeholder effects are especially likely to be systematically underestimated by corporate leaders. Consider, for example, the language of the British company law provision whose example the *Restatement of Corporate Governance Law* project is considering following.[68] This provision instructs directors to pursue shareholder value, and reminds them that stakeholder effects may be relevant for assessing how best

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[67] These values were stressed by Alex Edmans in his discussion of our earlier work at a conference at the University of Chicago. For his presentation slides, see https://www.chicagobooth.edu/-/media/research/stigler/pef-2020/slides/edmans_chicago-bebchuk-tallarita-discussion-alex-e.pdf. For additional discussions of the educational value of ESV, see Guido Ferrarini, *Corporate Purpose and Sustainability*, ECGI Working Paper NO. 559/2020 (2020), at 53, https://ecgi.global/sites/default/files/working_papers/documents/ferrarinifinal.pdf. See also Gadinis & Liazad, *supra* note 19.

[68] *See supra* notes 11–13.

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to pursue this goal, yet it does not explicitly mention any of the other factors that unquestionably may be relevant in many situations. Presumably, the implicit assumption is that corporate leaders are well informed about other factors. But what is the reason for believing that corporate leaders are less aware of the relevance of stakeholder effects than they are about the relevance of other factors?

In a debate with one of us, Alex Edmans argued that stakeholder effects often involve the assessment of intangibles and significant uncertainties.[69] However, intangibles and significant uncertainties are also involved in assessing other factors such as effects on the value of the company's brands and the company's intellectual property.[70] It is doubtful, however that anyone would support advocating a normative standard that would guide corporate leaders explicitly to take into account factors such as the value of the company's brand and intellectual property.[71]

Finally, assuming that it is desirable to educate and inform corporate leaders about the significance of stakeholder effects, we are skeptical that using the language of ESV would be an effective way to do so. Consider a corporate leader who erroneously discounts the long-term effects of treating employees poorly because she believes that those effects would be smaller than what in fact they should be expected to be. In this case, even when reminded of the need to take employee effects into account, the corporate leader would still attach to these effects the leader's estimate of their magnitude which we assume in this example to be too low.

Thus, the above analysis does not dispute that the provision of information about the significance of stakeholder effects could be valuable, as

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[69] Edmans, *supra* note 67. Edmans stressed this point also in a virtual debate with one of us, *Stakeholder Capitalism: The Case For and Against*, Eur. Corp. Governance Inst., Dec. 16, 2020, https://ecgi.global/video/stakeholder-capitalism-case-and-against.

[70] For empirical studies showing that investors seem to underestimate the value of research and development expenditures, marketing expenditures, and other intangible assets, see Louis K. C. Chan, Josef Lakonishok & Theodore Sougiannis, *The Stock Market Valuation of Research and Development Expenditures*, 56 J. FIN. 2431 (2001); Rajiv D. Banker, Rong Huang, Ram Natarajan & Sha Zhao, *Market Valuation of Intangible Asset: Evidence on SG&A Expenditure*, 94 ACCT. REV. 61 (2019).

[71] Alternatively, it might be argued that many corporate leaders might have greater difficulty fully appreciating stakeholder effects, such as effects on employees, because of their own life experience. However, to the extent that there are behavioral or psychological impediments to the ability of some corporate leaders to appreciate stakeholder issues, we doubt that telling corporate leaders that doing so would be useful would address the problem.

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would be the case for information about other relevant effects of corporate decisions. Some corporate leaders might well seek such information from their advisers as they do for other types of information. To the extent that some scholars believe that there is insufficient understanding of stakeholder effects, it would make sense for them to seek to educate current and future managers through articles and books, executive education courses, or even MBA courses. However, changes in the language of normative standards are not an effective way for spreading management insights. For the reasons explained above, even accepting that the provision of information could be useful, there is little basis for (i) noting explicitly stakeholder effects but not other types of relevant information that would clearly be worth considering, and (ii) expecting that including such language would have a material effect on actual corporate choices.

C. Providing Cover for Directors Seeking to Serve Stakeholders?

Some supporters of ESV might hope that adopting ESV would enable corporate leaders to provide benefits to stakeholders that would come at the expense of long-term profit. These supporters view stakeholder interests as an end in itself that is worth serving, and their support for ESV is instrumental, as a tactic aimed at facilitating some outcomes that would be desired under a pluralistic conception of stakeholderism. Under their view, to the extent that some corporate leaders might sometimes be willing to serve stakeholders beyond what shareholder value-maximization would warrant, having ESV in place would encourage corporate leaders to do so by providing corporate leaders with "legal cover" and moral support for making such decisions.

According to this view, because courts generally avoid second-guessing the decisions of directors, the language of ESV would allow corporate leaders to use an instrumental rationale to justify a stakeholder-friendly decision, even if the decision was in fact intended to benefit stakeholders but not shareholders. By (insincerely) invoking the view that a stakeholder-friendly approach is believed to increase profits in the long term, corporate leaders would be able to protect the decision from judicial review and thus would be encouraged to make stakeholder-friendly decisions more frequently.

This reasoning, however, is flawed. Even under SV, thanks to the business judgment rule, corporate leaders can readily justify a stakeholder-friendly decision they are interested in making on the grounds that it would contribute to long-term shareholder value.[72] Thus, a switch from SV

[72] BAINBRIDGE, *supra* note 63 at 248 ("[t]he court may hold forth on the primacy of shareholder interests, or may hold forth on the importance of socially responsible conduct, but ultimately it does not matter. Under either approach, directors . . . will

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to ESV would add little to their practical freedom to make such decisions under the current legal framework. Corporate leaders wishing to provide benefits to stakeholders, even at the expense of long-term profits, already have sufficient legal cover to do so. To be sure, if adopting ESV led institutional investors to be more deferential to corporate leaders, the new standard might practically increase the discretion of corporate leaders, but is there any reason to expect that corporate leaders would use their reduced accountability to shareholders to benefit stakeholders? As our earlier work has empirically documented, corporate leaders generally do not have incentives to use their discretion to the benefit of stakeholders.[73]

Finally, note that this argument in support of ESV amounts to a belief that pluralistic stakeholderism is desirable and that ESV could be used as a mere pretext to conceal a pluralistic approach. If this is the practical justification for ESV, corporate governance scholars should rather examine and discuss the merits of the pluralistic approach, rather than its rhetorical camouflage.

D. Improving Corporate Image and Avoiding Regulatory Backlash?

Finally, some supporters of moving from SV to ESV argue that such a move is necessary to prevent regulatory and public backlash against corporations. Under this view, public opinion has become increasingly mistrustful of business,[74] and as a consequence, corporations might face a public backlash that would impose costly reforms on them. In this situation, signaling to the

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be insulated from liability by the business judgment rule"); Jill E. Fisch & Steven Davidoff Solomon, *Should Corporations Have a Purpose?* 99 TEXAS L. REV. 1309, 1325 (2021) ("[e]ven if the Delaware case law is properly understood as conveying a strong commitment to shareholder primacy in the takeover context, we question its relevance to the day-to-day operational decisions that are the focus of the current purpose debate"); Rock, *supra* note 3, at 375–76 ("outside the "end-game" or conflict situations . . . disinterested directors seeking in good faith to promote the value of the corporation have the discretion to the make the decisions that they believe are best for the corporation and its stakeholders").

[73] Bebchuk & Tallarita, *Illusory Promise, supra* note 6, at 139–63; Bebchuk, Kastiel & Tallarita, *For Whom Corporate Leaders Bargain*, *supra* note 7 at 1525–27; Lucian A. Bebchuk, Kobi Kastiel & Roberto Tallarita, Stakeholder Capitalism in the Time of COVID (unpublished manuscript available at https://ssrn.com/abstract=4026803).

[74] *See, e.g.*, Henderson, *supra* note 1, at 119 ("the trust gap between business and the general public is accelerating").

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outside world that they are paying attention to stakeholder interest is a strategy to allay the public's concerns, rebuild social trust in business, and thus mitigate the costs of the regulatory and public backlash.[75]

Whereas each of the arguments discussed in the preceding three Sections focuses on how the move could potentially affect corporate decisions, the fourth argument focuses on how the move would affect the way in which companies are perceived by outsiders. The prospect of improved corporate image, so the argument goes, would make the adoption of ESV worthwhile even if it would not have a material effect on the substance of corporate decisions.

Business leaders and their advisers have long recognized the importance of how outsiders perceive corporations and their impact on stakeholders and society. About five decades ago, the Committee for Economic Development, a think tank established by business leaders, warned that "the corporation is dependent on the goodwill of society, which can sustain or impair its existence through public pressures on government."[76] Fast-forwarding to the present, BlackRock CEO Larry Fink recently stated that companies "[w]ithout a sense of purpose" will "lose the license to operate from key stakeholders."[77] Given these concerns, some supporters of ESV hope that a formal recognition of the ESV view would allay outsiders' concerns about the adverse effects of corporate decisions on stakeholders and society.

However, for those genuinely interested in stakeholder protection, this should be a reason for opposing ESV, not for supporting it. Under the considered argument, the move to ESV would produce benefits not by changing

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[75] For commentators discussing this view, see, for example, ROBERT E. FREEMAN., JEFFREY S. HARRISON & ANDREW C. WICKS, MANAGING FOR STAKEHOLDERS: SURVIVAL, REPUTATION, AND SUCCESS 4 (2007) ("managers must pay attention to supplier and employee relationships, and if they are at all clever they will understand that paying attention to community can help prevent activists, regulators, and others from using the political process to prevent their companies from pursuing profits"); Martin Lipton et al., *The New Paradigm A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth*, INT'L BUS. COUNCIL WORLD ECON. F. 7 (2016) (discussing the New Paradigm as a collaboration among shareholders and other stakeholders working together to achieve long-term value and explaining that without it "the demonstrated success of activists in exploiting short-term mindsets, will provoke regulatory and legislative reforms").

[76] COMM. FOR ECON. DEV., SOCIAL RESPONSIBILITIES OF BUSINESS CORPORATIONS 27 (1971).

[77] Larry Fink, *A Sense of Purpose*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 17, 2018), https://corpgov.law.harvard.edu/2018/01/17/a-sense-of-purpose.

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the substance of corporate decisions but by improving corporate image and thereby precluding public policy reforms that would sacrifice long-term profits for the benefit of stakeholders. But for those interested in stakeholder protection, making stakeholder-protecting reforms less likely by merely improving corporate image—and not necessarily matching this with substantive change—would make things worse, not better.

As two of us explain in detail elsewhere, one of the effects of an illusory hope that ESV would improve stakeholder welfare might be a reduced demand for meaningful legal and regulatory reforms that could effectively protect stakeholders.[78] In this case, the adoption of the ESV principle would not only fail to directly improve stakeholder protection but also indirectly deteriorate the overall level of such protection.

The analysis up to this Section has shown that moving from SV to ESV should not be expected to produce material improvements in the treatment of stakeholders and their protection. That is, not only would such a move fail to produce the major improvement hoped for by those under the win-win illusion discussed in Part III, but it would also produce no material benefits for stakeholders. Whereas our analysis thus far has shown that moving from SV to ESV would not produce benefits for stakeholders, it has not identified any harms that could result from such a move, leaving open the possibility that the change in language would be merely inconsequential and neutral. As we now wish to stress, however, such a move could well be counterproductive and detrimental for the protection of stakeholders.

The reason is that, whereas the change in language would not produce material benefits in how stakeholders are actually treated, it could introduce expectations about the prospect of such improvements. Indeed, to the extent that some of the support for the move to ESV is intended to deflect pressures for reforms that would regulate and constrain companies, then the introduction of such expectations might be part of the motivation for the move. However, because any such expectations would be illusory and unrealistic, as our analysis has shown, the introduction of such expectations would be counterproductive. Those who are seriously concerned about corporate effects on stakeholders should thus be wary of any changes in corporate image that would be largely rhetorical rather than reflecting meaningful changes in the treatment of stakeholders.

VI. Conclusions and Implications

This article has provided an analysis of ESV. We have explained that the appeal of ESV lies partly in the misperception of win-win situations. Our

[78] *See* Bebchuk & Tallarita, *supra* note 6, at 168–75.

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world is one in which trade-offs are ubiquitous, and any discussion of corporate purpose should grapple with this reality. Furthermore, reviewing the full set of possible arguments, we have concluded that replacing SV with ESV would not deliver any value.

At best, such a replacement would be unhelpful but harmless, as it would simply use a seemingly nicer language without making any difference in corporate actions. In such a case, the choice would not matter because it would be operationally inconsequential. Still, it would be useful to be clear-eyed about it, and our analysis would provide the needed clarity.

At worst, however, replacing SV with ESV would be actively counterproductive. This would be the case if such a replacement would produce—and could even be intended to produce—misperceptions as to what corporate leaders can be expected to do. As we have shown, using ESV language should not be expected to produce any material improvement in the treatment of stakeholders. However, using this language could well contribute to misperceptions and illusory expectations that would disserve the interests of stakeholders and society.

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