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# Stakeholder Theory and the Challenge of Welfare Economics

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## Abstract

The dominant view of corporate governance, enshrined in Delaware law, is that directors should manage the corporation for the financial benefit of its shareholders. The primary problem for directors implementing this model thus concerns maximizing the present value of the corporation's shares by trading off present cashflows against future ones. For decades directors have adopted the concepts and methods of financial economics (capital budgeting, discounted cashflow analysis, the CAP-M, etc.) to make such decisions in a rational and disciplined way. The stakeholder model of corporate governance, by contrast, holds that directors should manage the corporation for the benefit of all its stakeholders, including its employees, customers, creditors, suppliers, and the communities in which the corporation operates, and, in an age of climate change, the class of stakeholders may plausibly expand include all human beings now living or to be born in the future. Virtually always, however, the interests and preferences of individuals in such disparate groups conflict, and so the primary problem for directors implementing the stakeholder model thus concerns balancing these interests and preferences, trading off harms to some in order to capture benefits for others. Assuming that, in making these decisions, directors should be guided by the actual preferences of the individuals involved (and not the directors' own normative views about what is good for such individuals), the discipline of welfare economics provides concepts and methods that directors could use to make these decisions in a rational and disciplined way. Indeed, without these concepts and methods, the stakeholder model cannot even be coherently formulated. Hence, as financial economics is to the shareholder model of corporate governance, so welfare economics is to the stakeholder model. Thus far, however, advocates of stakeholder theory have done nothing to adopt the concepts and methods of welfare economics. Boards of corporations that purport to follow the stakeholder model do not perform welfarist analyses before making business decisions, and even the academic advocates of stakeholder theory have utterly failed to adopt the concepts and methods of welfare economics to advance their theory beyond commonsense intuitions and notions in order to develop a rigorous account of corporate governance on a par with the shareholder model. In a word, stakeholder theorists have failed to rise to the challenge of welfare economics, and until they do so, the stakeholder theory of corporate governance will not become fully intellectually respectable.

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# Stakeholder Theory and the Challenge of Welfare Economics

**Robert T. Miller**[1]

*The concept of corporate social responsibility, for all its popularity today, has not had a distinguished intellectual history in America. The idea has never been integrated in any systematic manner into either traditional or more contemporary modes of economic theory.*

Henry G. Manne[2]

***The dominant view of corporate governance, enshrined in Delaware law, is that directors should manage the corporation for the financial benefit of its shareholders. The primary problem for directors implementing this model thus concerns maximizing the present value of the corporation's shares by trading off present cashflows against future ones. For decades directors have adopted the concepts and methods of financial economics (capital budgeting, discounted cashflow analysis, the CAP-M, etc.) to make such decisions in a rational and disciplined way. The stakeholder model of corporate governance, by contrast, holds that directors should manage the corporation for the benefit of all its stakeholders, including its employees, customers, creditors, suppliers, and the communities in which the corporation operates, and, in an age of climate change, the class of stakeholders may plausibly expand include all human beings now living or to be born in the future. Virtually always, however, the interests and preferences of individuals in such disparate groups conflict, and so the primary problem for directors implementing the stakeholder model thus concerns balancing these interests and preferences, trading off harms to some in order to capture benefits for others. Assuming that, in making these decisions, directors should be guided by the actual preferences of the individuals involved (and not the directors' own normative views about what is good for such individuals), the discipline of welfare economics provides concepts and methods that directors could use to make these decisions in a rational and disciplined way. Indeed, without these concepts and methods, the stakeholder model cannot even be coherently formulated. Hence, as financial economics is to the shareholder***

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[2] *First Lecture*, at 1, Henry G. Manne & Henry C. Wallich, RATIONAL DEBATE: THE MODERN CORPORATION AND SOCIAL RESPONSIBILITY 1 (1972).

***model of corporate governance, so welfare economics is to the stakeholder model. Thus far, however, advocates of stakeholder theory have done nothing to adopt the concepts and methods of welfare economics. Boards of corporations that purport to follow the stakeholder model do not perform welfarist analyses before making business decisions, and even the academic advocates of stakeholder theory have utterly failed to adopt the concepts and methods of welfare economics to advance their theory beyond commonsense intuitions and notions in order to develop a rigorous account of corporate governance on a par with the shareholder model. In a word, stakeholder theorists have failed to rise to the challenge of welfare economics, and until they do so, the stakeholder theory of corporate governance will not become fully intellectually respectable.***

The stakeholder theory of corporate governance holds that directors should manage the corporation for the benefit of all its stakeholders—i.e., not only its shareholders but also its employees, customers, creditors, and suppliers, as well as any other individuals affected by the corporation's operations. In an age of climate change and concern about greenhouse gas emissions, the stakeholders of a corporation are often understood to include everyone now living and everyone to be born in the future. The imperative to maximize stakeholder welfare can thus become an imperative to maximize social welfare generally. But, as all serious observers realize, even when the class of stakeholders is drawn as narrowly as possible, it virtually never happens that what is good for one stakeholder is good for all stakeholders. Rather, in the typical case, what is good for some stakeholders is bad for others, and what some stakeholders prefer others disprefer. It is essential to stakeholder theory, therefore, that directors balance the competing interests or aggregate the conflicting preferences of stakeholders in order to choose the course of action that is—in some sense—best for all stakeholders collectively.

In considering what is best for a particular individual, we face a choice. On the one hand, there is *welfarism*, which is the view that what is best for an individual is what the individual himself believes is best.[3] We may hold the welfarist view based on notions of personal autonomy or merely because we think that, although anyone can be wrong about what is best for him, the individual's own view is (at least on average) more likely to be right than anyone else's. On the other hand, we may think that what is best for an individual is what our preferred normative theory says is best for that individual, regardless of what the individual himself may want or believe. This is how we characteristically treat children or the mentally incompetent. In implementing a stakeholder model of corporate governance, a board of directors could take either view, but the assumption here is that directors will adopt the welfarist view. Towards the end of the article, I shall return briefly to consider what happens to stakeholder theory on non-welfarist assumptions.

[3] E.g., Amartya Sen, *On Weights and Measures: Information Constraints in Social Welfare Analysis*, 45 ECONOMETRICA 1539, 1540 (1977). The welfarist assumption excludes the possibility that what is best overall depends on factors other than the welfare of the relevant individuals, such as normative concepts not ultimately reducible to notion of individual welfare. Sen himself mentions Nozick's conception of entitlements or Marx's conception of exploitation, *id.*, but he could have added Kant's categorical imperatives or Aristotle's understanding of the good life for human beings. I will return to the possibility of introducing such robust normative concepts in Part [__] below.

Once we assume that the stakeholder theory of corporate governance is welfarist, the problem of making a business decision under stakeholder theory becomes a paradigm problem of welfare economics. In contradistinction to positive economics, which seeks merely to predict human behavior, welfare economics investigates how to obtain normative orderings of alternative possible states of the world based on information about the welfare of individuals in each possible state. That is, using explicitly stated normative assumptions and the techniques of microeconomics, welfare economics gives precise meaning to the idea that, when there are many alternative courses of action that affect each of many individuals differently, one of these alternatives is "best" for all the individuals collectively. Clearly, this is exactly the kind of problem that a board of directors faces when it is contemplating alterative business decisions that will affect different corporate stakeholders differently. Welfare economics, which goes back to Marshall and Pareto, is a highly developed branch of economic theory (both Arrow and Sen have won Nobel Prizes for their contributions to the field), and it provides sophisticated concepts and methods that a board of directors could adopt in practice in making business decisions in accordance with the stakeholder theory of corporate governance. Adopting the concepts and methods of welfare economics would seem to be the natural things for advocates of stakeholder theory to do.

Thus far, however, this has not happened. Leading stakeholder theorists commonly recommend particular corporate policies (e.g., regarding climate change or economic inequality) as being consistent with or even required by stakeholder theory, but no such theorist has even begun to adopt the concepts and methods of welfare economics to implement stakeholder theory in a disciplined and rigorous way. This is extremely surprising, and it raises the most profound issues for stakeholder theory. Welfare economics has shown beyond any possibility of reasonable dispute that, when there many alternative courses of action that affect different individuals differently, the commonsense claim that a certain alternative is "best" for all the individuals collectively lacks a clear meaning, and when we attempt to state clearly what such claims mean, we encounter very difficult conceptual problems. These are the very problems that welfare economics attempts to solve. If stakeholder theory is even to state coherently the goal that it proposes that corporate directors pursue—doing what is best for all stakeholders collectively or maximizing stakeholder welfare—then stakeholder theory must rely on the tools at hand supplied by welfare economics, such as ordinal and cardinal preferences, Arrow's Impossibility Theorem, cardinal utility functions, Sen's extension of Arrow's framework, the money metric and equivalent income functions, compensating variations and equivalent variations, and cost-benefit analysis. It is also possible, though just barely, that stakeholder theorists could explain why these seemingly obviously relevant concepts are not relevant after all. What stakeholder theorists cannot coherently do, however, is present a theory employing unanalyzed concepts of welfare maximization or doing what is best for a group of individuals collectively while simply ignoring well-known results in a major branch of economic theory that has had considerable success in analyzing such concepts.

An analogy will help. Under the traditional shareholder theory of corporate governance, directors have a fiduciary duty to maximize the value of the corporation for the benefit of its shareholders. Maximizing the value of the corporation, however, involves investing in various projects today in order to receive uncertain returns in the future. In other words, corporate directors must choose among various projects, each requiring different current outlays and promising different but uncertain returns in the future; to do this, they have to balance, in each case, balancing having less money in the present against having more money (they hope) in the future. In the past, managers made such decisions using intuition and commonsense. After various

important advances in financial economics in the twentieth century, however, corporate directors no longer make such decisions in this way. Rather, directors apply the concepts and methods supplied by financial economics, such discounted cashflow analysis, beta as a measure of risk, portfolio theory, the Capital Asset Pricing Model, the weighted-average cost of capital, the French-Fama three-factor model, Monte Carlo simulations, and so on. These are the concepts and tools that managers learn about in corporate finance courses in business school and that companies pay investment bankers immense sums to deploy on their behalf when advising them about major transactions. Indeed, even to assign a clear meaning to the claim that an investment by the corporation today will increase value for shareholders in the future requires the tools of financial economics: the claim is nowadays understood to mean that the expected future cashflows from the investment, discounted to present value at the rate appropriate to the beta of the cashflows as determined by the Capital Asset Pricing Model (or some more sophisticated model in financial economics), exceeds the cost of the investment. Except for decisions involving amounts of money too small to justify the costs of a rigorous analysis, corporate managers and directors routinely use the tools of financial economics in such capital budgeting decisions. Certainly, in considering whether to sell the whole company, it would today be almost inconceivable that the directors would not insist on reviewing a discounted cashflow analysis of the company in order to compare the merger consideration offered by a potential acquirer to the present value of the company's free cashflows on a standalone basis. Investors and even courts do the same. No one today would think that corporate directors should ignore the concepts and methods of financial economics and make major decisions relying on mere intuition and commonsense unaided by economic theory. Indeed, one reading of *Smith v. Van Gorkom* is that, under Delaware law, using the available tools of modern corporate finance may well be required if directors are to comply with their duty of care, at least when selling the whole company.[4]

Directors implementing the stakeholder theory of corporate governance are thus in a position analogous to that of directors implementing the shareholder theory. Both theories can be stated at the level of intuition and commonsense, but, in both cases, the goals that the theories hold that directors ought to pursue—maximizing value for shareholders under the shareholder theory, doing what is best for all stakeholders under the stakeholder theory—lack clear meanings and can be stated coherently, and pursued rationally, only with the aid of economic theory. Generations of economists—financial economists with respect to the problem of value maximization, welfare economists with respect to the problem of welfare maximization—have analyzed the issues involved, made immense progress in understanding them, and have developed highly sophisticated concepts and methods to deal with the relevant problems. On the shareholder side, directors of public companies, which overwhelming operate under the shareholder theory (Delaware law requires it),[5] have for decades routinely employed the concepts and methods of

[4] *Smith v. Van Gorkom*, 488 A.2d 858, 881 (Del. 1985) (although Delaware law does not require directors to obtain a fairness opinion, nevertheless directors breached their duty of care in selling the company because, for among other reasons, the directors did not have before them "adequate information regarding the intrinsic value of the Company, upon which a proper exercise of business judgment could be made."). But see Frank H. Easterbrook & Daniel Fischel, THE ECONOMIC STRUCTURE OF CORPORATE LAW 93, 107-108 (1991) (noting that, we interpret the duty of care in economic terms, directors should gather all the information until the marginal cost of gathering more information would exceed the marginal benefit of such information in making, which means that the decision about how much information to gather before making a business decision is itself a business decision).

[5] See generally, Robert T. Miller, *Delaware Law Requires Directors to Manage the Corporation for the Benefit of its Shareholders and the Absurdity of Denying It*, 48 J. Corp. L. 32 (2023).

financial economics in making business decisions, at least when the decisions involved were significant enough to justify a rigorous analysis. On the stakeholder side, however, things could not be more different. Advocates of stakeholder theory have utterly failed even to begin the work of integrating the concepts and methods of welfare economics into stakeholder theory. They constantly speak in general and undefined terms of directors managing the corporation for the benefit of all stakeholders, of their balancing the interests of different corporate constituencies, or of their maximizing stakeholder welfare as if these expressions had clear meanings,[6] when, in fact, well-known results in welfare economics show indisputably that they do not.

Simply put, if stakeholder theory is to become an intellectually respectable theory of corporate governance, it needs to rise to the challenge of welfare economics. Stakeholder theorists must come to terms with well-known results in that discipline and explain how its concepts and methods can be adapted by corporate directors to make business decisions. Anyone with even a passing acquaintance with welfare economics will realize that this will be a very

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[6] E.g., E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 Harv. L. Rev. 1145, 1156-57 (1932) ("Those who manage our business corporations should concern themselves with the interests of employees, consumers, and the general public, as well as of the stockholders" and should "take into consideration the welfare of employees and consumers," for managers "are guardians of all the interests which the corporation affects and not merely servants of its absentee owners."); Harold R. Bowen, SOCIAL RESPONSIBILITIES OF THE BUSINESSMAN 4 (1953) ("When the far-reaching scope and consequences of private business decisions are recognized, some questions naturally arise: Are businessmen, by virtue of their strategic position and their considerable decision-making power, obligated to consider social consequences when making their private decisions? If so, do they have social responsibilities that transcend obligations to owners or stockholders? The answer to both these questions is clearly yes."); R. Edward Freeman, STRATEGIC MANAGEMENT 52 (1984) ("Organizations have stakeholders," i.e., "groups and individuals who can affect, or are affected by, the achievement of an organization's mission…. [I]f business organizations are to be successful in the current and future environment then executives must take multiple stakeholder groups into account."); Margaret M. Blair & Lynn Stout, A Team Production Theory of Corporate Law, 85Va. L. Rev. 247, 301 (1999) ("[C]orporate directors … enjoy considerable discretion in deciding which members of the corporate coalition receive what portion of the economic surplus resulting from team production," and "[a]lthough the board must meet the minimum demands of each team member to keep the coalition together, beyond that threshold any number of possible allocations among groups is possible."); 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* (2016) 8 ("In developing a long-term strategy, consideration should be given not only to shareholders, but also to the corporation's broader group of stakeholders, including employees, suppliers, customers, creditors and the community."); Business Roundtable, *Statement on the Purpose of a Corporation* (2019) (committing to "[d]elivering value to our customers… [i]nvesting in our employees… [d]ealing fairly and ethically with our suppliers… serving as good partners to the other companies, large and small, that help us meet our missions… [s]upporting the communities in which we work … [and] [g]enerating long-term value for shareholders."); British Academy, *Principles for Purposeful Business* 8 (2019) ("[T]he purpose of business is to solve the problems of people and planet profitably, and not profit from causing problems."); Martin Lipton, *ESG, Stakeholder Governance, and the Duty of the Corporation*, Harvard Law School Forum on Corporate Governance (September 18, 2022) ("We long have advocated for a broader view of corporate purpose … to empower boards to take into account the interests of all stakeholders, including the communities in which corporations operate ... to ensure that directors are encouraged to resist short-termist pressures and can exercise their business judgment to consider the variety of stakeholder interests essential to promoting sustainable success and growth in long-term corporate value."); Colin Mayer, *What is Wrong with Corporate Law? The Purpose of Law and the Law of Purpose?* European Corporate Governance Institute - Law Working Paper No. 649/2022 (June 15, 2022) ("The law can and should both ensure the alignment of the corporation's incentives with individual, societal, and planetary interests and promote the resolution of their problems by enabling one of the most powerful institutional entities that we have created to date, namely the firm, to commit credibly to their resolution."); and see generally, Marcel Kahan & Edward Rock, *Corporate Governance Welfarism*, 15 J. Leg. Stud. 108, 112-13 (2023) (summarizing the views of various stakeholder theorists).

difficult undertaking. While it is no part of the purpose of this paper to suggest that stakeholder theorists could never successfully formulate their theory in accordance with welfare economics, in the balance of this paper I shall explain some of the more difficult issues that stakeholder theorists will have to face, including problems related to Arrow's Impossibility Theorem, the interpretation of cardinal utility functions in Sen's extension of Arrow's framework, Singer's self-despoliation argument, problems using equivalent variations or compensating variations, difficulties in computing the social discount rate, and Parfit's so-called repugnant conclusion in cases where populations vary over time. In advocating for their theory of corporate governance, often in urgent terms, stakeholder advocates give the impression that corporate directors could immediately begin implementing that theory. By emphasizing the difficulty and complexity of the challenge welfare economics poses for stakeholder theory, I shall argue that this impression is flatly false. Rather, in accordance with well-known results in welfare economics, adapting the tools of welfare economics to the kinds of problems that directors typically face would necessarily involve making not only some difficult and controversial value judgments, but also some utterly heroic assumptions concerning about the preferences of stakeholders and the ability of directors to discover them.

In what follows, I begin in Part I by reviewing the traditional shareholder theory of corporate governance, emphasizing the features that allow it to avoid the issue of preference aggregation and thus the problems of welfare economics. In Part II, I take up stakeholder theory and explain how and why it inevitably involves those problems. In Part III, I sketch some of the more important results in welfare economics, including Arrow's Impossibility Theorem, the difference between ordinal preferences and cardinal preferences, problems of measurability and interpersonal comparability, Sen's extension of Arrow's framework, and related matters, discussing along the way how these concepts might be applied to formulate a coherent version of stakeholder theory. In Part IV, I consider some of the more obvious difficulties that stakeholder theorists will face in adopting the concepts and methods of welfare economics. In Part V, I make some concluding remarks.

## I. Shareholder Theory and the Assumption of Uniform Shareholder Preferences

As is well known, the shareholder theory of corporate governance arose organically within the law of corporations.[7] More than a century before the enactment of the first general enabling statute in England,[8] when corporations could still be created only by royal charter, courts of equity already understood the office of a corporate director to be analogous to that of a trustee. In 1742, Lord Hardwicke explained that such an office

> is a mixed office, partly in the nature of a public office, and partly as a private office in trust for other people. It is public, as it rises under a charter, and as the abuse of it tends to affect public credit. But as it does not concern public government, but negotiation of private property, it is therefore a private office, like the directors of the Bank [of England] … and other trading companies, where they are not obliged to qualify by taking … oaths as for a public office, but are only intrusted with the property of the aggregate body: so this is in the nature of a private trust for other

[7] See generally, Robert T. Miller, *Delaware Law Requires Directors to Manage the Corporation for the Benefit of its Shareholders and the Absurdity of Denying It*, 48 J. Corp. L. 32 (2023).
[8] Joint Stock Companies Act of 1844, 7 & 8 Vict. c. 110 (1844).

> persons; and in this view the committee-men [i.e., directors] are responsible to the corporation for breaches of trust, either by commissions or omissions, for acts of malefeasance or nonfeasance.[9]

After the enactment of general enabling statutes in England and the United States in the middle of the nineteenth century and the consequent increase in the number of corporations,[10] the law developed quickly into the basic form it still has today in common-law jurisdictions like Delaware.[11] That is, courts of equity recognized that, in the corporate form, some people (the shareholders) entrust their property to the management of other people (the directors). The courts thus analogized corporations to *cestui que* trusts, with the directors being compared to trustees and the shareholders to trust beneficiaries.[12] On the basis of this analogy and consistent with the cases antedating the general enabling statures, courts imposed fiduciary duties on directors for the benefit of the shareholders.

Perhaps the most important early case in the United States is *Dodge v. Woolsey*, in which in 1855 the United States Supreme Court stated, "It is now no longer doubted, either in England or the United States, that courts of equity, in both, have a jurisdiction over corporations," pursuant to which such courts may "restrain those who administer them from doing acts which would amount to a violation of charters," and may "prevent any misapplication of their capitals or profits, which might result in lessening the dividends of stockholders, or the value of their shares … if the acts intended to be done create what is in the law denominated a breach of trust."[13] Courts in England, New York, Delaware and other jurisdictions routinely held that directors have a duty, within the confines of the law, to manage the corporation for the benefit of its shareholders. Thus, almost a century ago, Berle and Means explained,

> It is traditional that a corporation should be run for the benefit of its owners, the stockholders, and that to them should go any profits which are distributed…. All the powers granted to management and control [i.e., the directors] are powers in trust.
>
> Tracing this doctrine back into the womb of equity, whence it sprang, the foundation becomes plain. Wherever one man or a group of men entrusted another man or group of men with the management of property, the second group became fiduciaries. As such they were obliged to act conscionably, which meant in fidelity to the interests of the persons whose wealth they had undertaken to handle. In this respect, the corporation stands on precisely the same footing as the common-law trust.[14]

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[9] *The Charitable Corporation v. Sutton*, (1742) 26 ER 642, 2 Atk 404 at 503=355.

[10] See generally William Magnuson, FOR PROFIT: A HISTORY OF CORPORATIONS (2022); John Mickelthwait & Adrian Woolbridge, THE COMPANY: A SHORT HISTORY OF A REVOLUTIONARY IDEA (2003); [Harwell's statistics].

[11] Current draft of the Restatement of Corporate Governance (2025).

[12] E.g., *McRitchie v. Zuckerberg*, 315 A.3d 518, 557 (2024) (discussing the development of fiduciary duties of directors on the model of duties of trustees of trusts in early Delaware law).

[13] *Dodge v. Woolsey*, 59 U.S. 331, 341 (1855).

[14] Adolf A. Berle & Gardiner C. Means, The Modern Corporation and Private Property 293-295 (1932, 1991).

This traditional rule remains the law in Delaware today.[15] As the Delaware Supreme Court said in the famous case of *Unocal v. Mesa Petroleum*, the "basic principle" of corporate law is "that corporate directors have a fiduciary duty to act in the best interests of the corporation's stockholders."[16] Similarly, in *NACEPF v. Gheewalla*,[17] the Supreme Court stated,

> An underlying premise for the imposition of fiduciary duties is a separation of legal control from beneficial ownership. Equitable principles act in those circumstances to protect the beneficiaries who are not in a position to protect themselves. One of the fundamental tenets of Delaware corporate law provides for a separation of control and ownership. The board of directors has the legal responsibility to manage the business of a corporation for the benefit of its shareholder owners. Accordingly, fiduciary duties are imposed on the directors of Delaware corporations to regulate their conduct when they discharge that function.[18]

Of course, courts also recognized from the beginning that managing a business in a manner reasonably calculated to maximize value for shareholders by maximizing profits in the long term requires treating employees, customers, suppliers and others fairly and even generously, sometimes by paying them more than the law requires. Thus, as early as 1864, an English court held that an insurance company could pay claims by policyholders even though the losses incurred were excluded from the policies and the company had no legal obligation to pay the claims, because "by paying these small losses, rather than risk the character of the company and the loss of these or other customers," the expenditure was "designed to secure to the Company the largest possible amount of profits in its own proper business."[19] In another early English case, the court held that a corporation could pay a gratuitous bonus of a week's wages to employees because the directors had concluded that "giving this gratuity to workmen in a prosperous year [will] induce the workmen . . . to work better—to carry on the factory in a better way in future."[20] As Lord Bowen famously put it, "The law does not say that there are to be no cakes and ale" at a company-sponsored picnic for the company's employees, but that "there are to be no cakes and ale except

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[15] E.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (holding that "a board may have regard for various constituencies in discharging its responsibility," but this prerogative is subject to the "fundamental limitation" that "there are rationally related benefits accruing to the stockholders."); see Robert T. Miller, *Delaware Law Requires Directors to Manage the Corporation for the Benefit of its Shareholders and the Absurdity of Denying It*, 48 J. Corp. L. 32 (2023) (collecting sources); see also Leo E. Strine, Jr., *Our Continuing Struggle with the Idea That For-Profit Corporations Seek Profit*, 47 Wake Forest L. Rev. 135, 155, 147 n. 34 (2012) ("[C]orporate law requires directors, as a matter of their duty of loyalty, to pursue a good faith strategy to maximize profits for the stockholders," and "stockholders' best interest must always, within legal limits, be the end. Other constituencies may be considered only instrumentally to advance that end."); Leo E. Strine, Jr., *The Dangers of Denial: The Need for A Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 Wake Forest L. Rev. 761, 765–67 (2015) ("Non-stockholder constituencies and interests can be considered, but only instrumentally, in other words, when giving consideration to them can be justified as benefiting the stockholders.").

[16] *Unocal Corp. v. Mesa Petrol. Co*., 493 A.2d 946, 955 (Del. 1985); see also *Malone v. Brincat*, 722 A.2d 5, 8-9 (Del. 1998 ("The board of directors has the legal responsibility to manage the business of a corporation for the benefit of its shareholder owners.").

[17] N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 94 (Del. 2007).

[18] *Id.* at 99.

[19] *Taunton v. Royal Ins. Co*. (1864) 71 Eng. Rep. 413, 415.

[20] *Hampson v. Price's Patent Candle Co*. [1876] 34 LT 711, 712.

such as are required for the benefit of the company."[21] The traditional rule thus allows directors to consider the interests of non-shareholder corporate constituencies, but the directors may consider these interests only instrumentally as means to the end of maximizing value for shareholders in the long term. In this way, directing value to members of other constituencies is fundamentally similar to making any other investments in an effort to maximize value for the shareholders in the long term, whether by purchasing land or equipment, conducting research and development, or advertising in order to build up a brand.

In 1980s, many states adopted statutes that permit or even require directors to consider the interests of non-shareholder constituencies on a par with those of shareholders, thus allowing directors to make business decisions with the intention of benefiting members of non-shareholder constituencies at the long-term expense of shareholders.[22] Delaware, however, never enacted such a statute, and the traditional rule that directors may consider the interests of non-shareholder constituencies only instrumentally in pursuit of maximizing value for shareholders remains the law in Delaware today. Thus, in probably the most famous case it ever decided, the Delaware Supreme Court held in *Revlon v. MacAndrews & Forbes* that "a board may have regard for various constituencies in discharging its responsibility," but this prerogative is subject to the "fundamental limitation" that "there are rationally related benefits accruing to the stockholders."[23] The Supreme Court[24] and the Court of Chancery[25] have each reiterated this holding many times. For example, in a widely cited passage,[26] Vice Chancellor Laster has explained,

> It is, of course, accepted that a corporation may take steps, such as giving charitable contributions or paying higher wages, that do not maximize corporate profits currently. They may do so, however, because such activities are rationalized as producing greater profits over the long-term. Decisions of this nature benefit the corporation as a whole, and by increasing the value of the corporation, the directors increase the quantum of value available for the residual claimants. Nevertheless,

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[21] *Hutton v. West Cork Railway Co*., [1883] 23 Ch D 654, 673.

[22] E.g., Lou R. Kling & Eileen T. Nugent, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 4.06; Martin Lipton & Eric Steinberg, TAKEOVERS AND FREEZEOUTS [__]. Two points about such statutes are worth noting. The first is that, at the time, everyone understood these statutes as being designed to insulate directors from liability to shareholders when the directors acted to thwart hostile takeovers that would be value-maximizing for shareholders. Such statutes were thus primarily designed to protect incumbent management, not work some more general change in corporate governance. Second, although such statutes are often portrayed as allowing directors to balance the interests of one corporate constituency against another, benefiting now this group and now that, in fact any decision permissible under such a statute that would not be permitted under the traditional rule comes at the expense of the shareholders because the claims of other constituencies (such as employees or customers) are fixed by contract or statute and the other-constituency statutes do not, of course, license directors ever to pay less value to such constituencies than they are otherwise entitled to receive. Such statutes thus allow directors to give other constituencies more at the expense of shareholders, but they do not allow directors to give any non-shareholder constituency less than it would otherwise receive in order to benefit shareholders or members of any other non-shareholder constituency. Robert T. Miller, *How Would Directors Make Business Decisions Under a Stakeholder Model?* 77 Bus. Law. 773, [__] (2022). All that said, it seems that, even when operating under an other-constituency statute, directors make no use of the discretion it affords them and still act to maximize value for shareholders. Lucian A. Bebchuk & Robert Tallerita, *The Illusory Promise of Stakeholder Governance*, 106 Cornell L. Rev. 91 (2020).

[23] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

[24] *Mills Acquisition Co. v. Macmillan, Inc*., 559 A.2d 1261, 1282 n.29 (Del. 1989); N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 94 (Del. 2007).

[25] *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1 (Del. Ch. 2010).

[26] E.g., [Cites].

> Delaware case law is clear that the board of directors of a for-profit corporation … must, within the limits of its legal discretion, treat stockholder welfare as the only end, considering other interests only to the extent that doing so is rationally related to stockholder welfare.[27]

Thus, although the shareholder theory allows directors to consider instrumentally the interests of non-shareholder constituencies, this doctrine in no way impairs the general principle that directors must always act for the end of maximizing value for shareholders in the long term.

Now, notice how the legal doctrine treats the preferences of shareholders. In short, it simply does not mention them. The fiduciary duty of directors is to maximize the value of the shares of the corporation. Presumably, this is what all or almost shareholders would prefer, but the duty of directors remains the same, regardless of what the shareholders may actually prefer. As Vice Chancellor Laster recently explained,

> Technically, under this framework, the directors' duties run to the corporation for the ultimate benefit of the shares. Stockholders enter the mix only because shares have owners, and the owners of shares benefit when the value of the firm increases because that value accrues proportionately to the shares. The fact that shares are freely alienable by default means that from the directors' standpoint, the ultimate human beneficiaries of that value are incidental. The obligation is an economic one: care for the capital entrusted to the firm, protect and grow the value of the firm, and thereby increase the value of the shares.[28]

Hence, if some shareholders would prefer that their shares be worth less rather than more (presumably in order to achieve some other end), this is legally irrelevant.[29] Even preferences that shareholders may have about the value of other investments they hold are legally irrelevant; directors are *not* permitted, for example, to choose actions that maximize the value of some

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[27] *Frederick Hsu Living Trust v. ODN Holding Corp.*, No. 12108, 2017 WL 1437308 at *17 (Del. Ch. Apr. 25, 2017) (omission in original) (internal quotations and citations omitted).

[28] *McRitchie v. Zuckerberg*, 315 A.3d 518, 557 (Del. Ch. 2024).

[29] Hart and Zingales have argued that directors should maximize shareholder *welfare* (meaning all shareholder preferences, not just a preference for financial value) rather than shareholder value (meaning the market value of the corporation's shares). Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J. L. Fin. & Acct. 247 (2017). Since shareholders will typically have conflicting preferences regarding non-financial issues, maximizing shareholder welfare involves all the same problems that maximizing stakeholder welfare does and so implicates issues of welfare economics in exactly the same way that full-blown stakeholder theory does. Maximizing the welfare of a group of individuals is the essential problem in welfare economics. In Hart and Zingales, that group of individuals comprises the company's shareholders; in traditional stakeholder theory, it comprises the company's shareholders, employees, customers, creditors, and suppliers, as well as individuals in the communities in which the company operates; in contemporary stakeholder theory, it comprises all human beings now living or to be born in the future. The only difference is how numerous the relevant class of individuals turns out to be, and even there the difference is not as great as may seem. A large public company may have tens of millions of shareholders (in the sense of beneficial owners), which, though two orders of magnitude smaller than the total human population, is still a tremendously large number for all practical purposes. Plus, many of the conceptual problems stakeholder theory has to face (e.g., the interpretation of cardinal preferences) are the same whether the relevant group of individuals be large or small. Hence, the Hart and Zingales must respond to the challenge of welfare economics just as much as full-blown stakeholder theory does.

portfolio of assets that shareholders (or some of them) may hold, such as the market portfolio, at the cost of reducing the value of the shares of the corporation.[30]

Equivalently, we could say that directors are required to do what shareholders prefer, but that the law conclusively presumes that every shareholder always prefers that directors choose, within the universe of legally permissible alternatives, the alternative that maximizes that value of the corporation's shares.[31] The reason for such a presumption is apparent. The assumption that shareholders always prefer more value to less value is a simplifying assumption of the kind that the law often makes.[32] Law, of course, is an administrative system that must be applied by human beings with limited resources, cognitive and otherwise. In many instances, an assumption that is approximately correct (i.e., introduces little error) but that greatly reduces the costs and difficulties of administering a class of cases will be worth making: its benefits will exceed its costs. That is, on the cost side, although public companies almost always have *some* shareholders who would prefer to sacrifice *some* share value in exchange for something else, such as the corporation's adopting certain environmental, social, or governance (ESG) policies,[33] nevertheless, most shareholders do *not* have such preferences (e.g., most ESG shareholder proposals fail by large margins),[34] the relevant preferences of those that do are usually only weakly held (meaning that even shareholders who would give up some value to see their non-value preferences realized would not give up *much* value in order to do so), and the relevant preferences among the shareholders often directly conflict with one another (e.g., one shareholder is pro-ESG but another is anti-ESG), producing a kind of canceling-out effect. As a result, the assumption that shareholders always prefer more value to less value, while not literally true, is likely close to true, and so introduces only little error. On the benefit side, ascertaining the non-value preferences of a

[30] *McRitchie v. Zuckerberg*, 315 A.3d 518, 564 (Del. Ch. 2024) ("The fiduciary duties owed by directors of a Delaware corporation require the directors to seek to maximize the value of the corporation over the long-term for the benefit of the stockholders as residual claimants to the value created by the specific firm that the directors serve. It does not mean striving to maximize value for diversified investors who own equity investments across all firms.").

[31] There is only one exception to this rule, and it is very telling: if each and every shareholder actually prefers a course of action that is not value-maximizing and makes that preference clear by an affirmative vote, then the board may have the corporation pursue that course of action. This is the traditional doctrine that corporate waste may be ratified only by a unanimous vote of the shareholders. E.g., *Michelson v. Duncan*, 407 A.2d 211, 219 (1979) ("It is only where a claim of gift or waste of assets, fraud or Ultra vires is asserted that a less than unanimous shareholder ratification is not a full defense.").

[32] Such simplifying assumptions are a common feature of successful legal regimes. See generally, Richard A. Epstein, SIMPLE RULES FOR A COMPLEX WORLD (1995). Well-known examples include the per se rule against horizontal price-fixing (adopted even though, in very unusual circumstances, horizontal price-fixing can be pro-competitive), *Barry Wright Corp. v. ITT Grinnell Corp*., 724 F.2d 227, 234 (1st Cir. 1983) (Breyer, J.), and the bright-line rule of the Twenty-Sixth Amendment requiring individuals to be 18 years-old to vote (adopted even though some younger persons are mature enough to vote and some older ones are not). Robert T. Miller, *Free Speech and the American Experiment*, PUBLIC DISCOURSE (May 28, 2018). Delaware law is no different. See *McRitchie v. Zuckerberg*, 315 A.3d 518, 547-58 n. 73 (Del. Ch. 2024) (explaining that, under *Gheewalla*, all creditors gain standing to bring derivative suits when the corporation is insolvent even though the reasoning in *Gheewalla* seems to support granting such standing only to the most senior class of creditors who will not be repaid in full, but stating that this result "makes sense for purposes of establishing a reasonably administrable rule.").

[33] See, e.g., Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J. L. Fin. & Acct. 247 (2017); Oliver Hart & Luigi Zingales, *The New Corporate Governance*, 1 U. Chicago Bus. L. Rev. 195 (2022).

[34] E.g., Lindsey Steward, *Voting on ESG: A Gap Becomes a Gulf*, Harvard Law School Forum on Corporate Governance (February 12, 2025) (detailing how support for shareholder proposals for environmental and social is declining).

large, ever-changing group of shareholders would be very difficult and costly and itself subject to much error, which means that any benefits captured from the process would be limited.[35]

But regardless of the merits of this assumption about shareholder preferences, notice how the assumption allows the shareholder theory of corporate governance to avoid the problems of aggregating preferences. Even setting aside the epistemological problem of ascertaining shareholder preferences, if the directors had to consider these preferences when making a business decision, the preferences of the shareholders would inevitably conflict, and so the directors would have to aggregate those preferences into a single business decision that, in some sense or other, best reflected those conflicting preferences. This would be a classic problem of social choice,[36] and so all the issues of welfare economics would be implicated. Shareholder

[35] E.g., Hart and Zingales argue that companies could easily obtain such information by polling their shareholders. Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J. L. Fin. & Acct. 247, 263 (2017) (stating that, although "the cost of reaching a consensus among investors on what objectives (other than money) a company has to pursue" constitutes a "reasonable objection," nevertheless "this problem is insurmountable. Directors can poll their members on some fundamental choices and then decide accordingly."). It is hard to summarize how utterly unrealistic this is. Among the more obvious problems, (a) the number of shareholders (beneficial owners, not institutions managing funds on their behalf—surveying the institutional investors would only push the problem back a level) is tremendous, (b) shareholders come and go on a daily basis, and even the preferences of continuing shareholders change over time, which would make near-constant surveying necessary, (d) shareholders typically hold highly diversified portfolios and would be inundated with surveys from management at hundreds or thousands of companies, perhaps several times per year for each company, (e) shareholders generally ignore proxy solicitations from management for important matters like the election of directors because given the relatively small (often vanishingly small) amounts a typical shareholder has invested in any one company, the shareholder is rationally apathetic, and so, with much less at stake in a survey from management about their non-financial preferences, shareholders would be even less likely to reply (indeed, the only shareholders likely to reply would be outliers with extremely strongly-held views, which would skew the results of the survey). Frankly, it is hard to imagine a less practicable suggestion. Worse, even if it were possible to determine how much each shareholder would be willing to sacrifice in financial returns in exchange for the company's achieving some non-financial goal, inevitably different shareholders would be willing to sacrifice different amounts, and since, if the company chooses to achieve the non-financial goal, the costs of doing so would fall on all of the shares equally, the result would be that shareholders who favor the goal less or not at all would be forced to subsidize the non-financial agenda of those shareholders who do. For example, imagine the company has 100 shares outstanding, each owned by a different shareholder. Of the 100 shareholders, 40 would pay nothing to support the goal, 50 would pay $1 per share, and 10 would pay $2 per share. Hence, in the aggregate the shareholders would pay $70 to achieve the goal. If achieving the goal costs the corporation $60, then achieving the goal makes the value of each share go down $0.60, but it also makes shareholders in the aggregate $10 better off ($70 – $60 = $10). The welfare effect on the shareholders varies, however. The 40 shareholders who would pay nothing to achieve the goal are each harmed by $0.60 (or $24 in the aggregate); the 50 shareholders who would pay $1 each are each benefited by $0.40 (or $20 in the aggregate); and the 10 shareholders who would pay $2 each are each benefited by $1.40 (or $14 in the aggregate). It is difficult to see why the corporation should become a device to force some shareholders to subsidize the non-financial agendas of other shareholders. Worse yet, on the plausible assumption that wealthier shareholders would be more inclined than poorer shareholders to sacrifice financial returns for non-financial goals, the forced wealth-transfer is also regressive. Hart and Zingales do not even advert to these problems, even though similar considerations led Friedman long ago to conclude that shareholders should pursue their altruistic goals with their dividends, not through the corporation (i.e., with their own money, not other people's money). Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG. (Sept. 13, 1970). More generally, given the availability of the benefit corporation under Delaware law, investors who are interested in pursuing non-financial goals through the operation of businesses can easily do so without imposing the costs of their social or political agendas on other investors. See also 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, 428–33 (2021) (discussing potential uses of benefit corporations).

[36] Amartya Sen, COLLECTIVE CHOICE AND SOCIAL WELFARE 45 (exp. ed. 2017) (describing a social choice problem as one in which "social preference … is based on the preference of the members of the society").

theory is saved from all this because the assumption that every shareholder prefers more share value to less share value is, in particular, *an assumption that shareholder preferences are uniform*—an assumption that if one shareholder prefers this alternative to that alternative, then all shareholders prefer this alternative to that alternative.[37] It is this aspect of shareholder theory that allows the theory to avoid the problems of welfare economics.[38] It is *not* important that the assumed uniform preference concerns the financial value of the shares rather than anything else; all that matters, for the purposes of avoiding the problems of welfare economics, is that shareholder preferences are assumed to be *uniform*.[39] As long as all shareholders have the same preferences (whatever those preferences may be), the problems of welfare economics vanish. Of course, the further assumption that the uniform preference of shareholders is for more share value rather than less share value is very important in corporate law in many other ways. But it is not important with respect to avoiding the problems of welfare economics. For that, all that is required is that shareholder preferences be uniform, regardless of what they are uniformly for or against.

## II. Stakeholder Theory and Welfare Economics

Some stakeholder theorists insist that what is good for one corporate constituency is good for every corporate constituency, but this cannot be right. Customers would enjoy getting products for free, or, even more, being paid by the company to take them, but bankrupting the company in this way would not please the shareholders. Professors Kahan and Rock put the matter more gently, observing that although "catering to one's customers, employees and suppliers, and embracing wider concerns of equity and equality, can *up to some point*, make a company more profitable," nevertheless "*beyond that point*, the interests of shareholders and the interests of other stakeholders will conflict."[40] Indeed, this rather understates things: although there may be *some* corporate actions benefit all stakeholders,[41] in general corporate actions that benefit one group

[37] Equivalently, with respect to the set of shareholders, the assumption of uniform preferences coupled with the weak Pareto principle induces a complete order on that set, which emphasizes just how strong the assumption is.

[38] By contrast, as noted above, when Hart and Zingales attempt to substitute maximizing shareholder welfare for maximizing shareholder value, they introduce the possibility (indeed the practical inevitability) of shareholders having conflicting preferences and so involve their position in all the complexities of welfare economics.

[39] Yet another way of conceptualizing the assumption is to observe that assuming all shareholders have identical preferences is equivalent to treating the shareholders as being one individual, whose ordinal preferences then completely order the set of available alternatives. [Epstein, Single Owner Theorem.] That uniformity of shareholder preferences and preferences for value maximization are separable is easily shown. Under the traditional rule, "directors, rather than shareholders, manage the business and affairs of the corporation," *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984); see also 8 Del. Code § 141(a) ("The business and affairs of every corporation … shall be managed by or under the direction of a board of directors."), and so directors have a duty to exercise their own independent judgment as to how to maximize the value of the corporation. It could, however, have been otherwise. We could have had a system in which, although directors have a duty to maximize value for shareholders, they were required to consider the preferences of the shareholders concerning the best way to do this. In other words, the directors would have a duty to pursue, not the projects that the directors themselves thought were value maximizing, but the projects that the directors concluded the shareholders thought were value maximizing. In a public company, the shareholders would inevitably disagree on this question, and so the function of the directors would be, in some way or other, to aggregate the preferences of the shareholders in order to determine which business decisions to make. In a system like this, the purpose of the corporation would still be to maximize shareholder value, but the directors would face a social choice problem in determining how to pursue that purpose.

[40] Marcel Kahan & Edward Rock, *Corporate Governance Welfarism*, 15 J. Legal. Analysis 108, 119 (2023) (emphases in original).

[41] Even this is implausible if the class of stakeholders is expanded to include all of society, i.e., everyone now living or to be borne in the future. A corporate action that made everyone in this group better off would be a weak-Pareto

come at the expense of another.[42] In fact, the situation is even more complicated than this, for corporate actions typically affect different members of even the same constituency differently.[43] Laying off unneeded employees harms the employees laid off but likely benefits the ones who remain. Similarly, refinancing a series of bonds may benefit some creditors but harm others. For directors at public companies, only the most trivial business decisions could benefit all corporate stakeholders. Leaving aside trivial cases, for any serious business decision the directors might make, some stakeholders will benefit and others will be harmed.

But if a stakeholder advocate stubbornly refuses to admit this obvious empirical truth, then there is another argument that quite settles that matter. For, if what is good for one stakeholder is good for all stakeholders, then, since shareholders are stakeholders, what is good for the shareholders is good for all stakeholders. Hence, in making a business decision, the directors could simply determine what is best for the shareholders and then do that, being assured that this course of action was also best for all other stakeholders. Stakeholder theory is thus entirely pointless; we could get exactly the same results by following the shareholder theory. Indeed, this argument can be generalized: if what is good for one stakeholder is good for all, then the directors could merely determine what is best for the corporation's employees, or its customers, or some subset (no matter how small) of either of these constituencies or any other, or indeed they could merely determine what is best for themselves (directors are stakeholders too), and then do that, again being assured that whatever is best for one is best for all. This is obvious nonsense. Stakeholder theory holds that directors should consider the effects of corporate actions on all stakeholders; doing that makes sense only if corporate actions will typically affect different stakeholders differently, so that what is good for one is bad for another, and any decision the directors may make will have disparate effects on different stakeholders.

Indeed, one suspects that when advocates of stakeholder theory say that what is best for one stakeholder is best for all, what they really mean is that there is something that is *best for all stakeholders collectively*, even though this may run counter to the interests and preferences of some stakeholders. This is the same figure of speech we use when we say that a certain candidate, having won the election, is the *choice of the people* when in fact many people voted against the candidate. Of course, this merely highlights how stakeholder theory involves problems of welfare economics. That is, because stakeholder theory requires the directors to manage the corporation for the benefit of all stakeholders, and because typically what is good for some stakeholders is bad for others, the theory thus necessarily requires that the directors somehow choose what, *in some sense*, is best for everyone concerned. This is true whether the directors manage the corporation for the benefit of society generally, considering the effects of corporate action on everyone affected, or the directors consider only the traditional corporate constituencies such as shareholders, customers, employees, creditors and suppliers. In every case, making a

improvement across literally everyone. There may be such actions that a public company could take, but it is difficult to think of plausible examples (even a decision not to murder someone would not qualify provided the individual in question had one deadly enemy), and any there may be are surely trivial.

[42] See generally, Robert T. Miller, *How Would Directors Make Business Decisions Under a Stakeholder Model?* 77 Bus. Law. 773 (2022).

[43] This point is typically conceded in the stakeholder literature, at least that aimed at managers. E.g., R. Edward Freeman, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH 25 (1984) ("each category of stakeholder groups can be broken down into several useful smaller categories. All employees are not alike, just as all governments are not alike").

business decision under stakeholder theory requires determining what is best, *in some sense*, for everyone concerned. It is precisely the purpose of welfare economics to explain what this sense is.

A review of the writings of the more important stakeholder theorists confirms this view. Indeed, from the very beginning, stakeholder theorists have appealed to intuitive concepts implicating problems of welfare economics. Sometimes the appeal has been to *considering the interests or welfare* of different stakeholders. Thus, in 1932, in the Berle-Dodd debate, Dodd said, "Those who manage our business corporations should *concern themselves with the interests* of employees, consumers, and the general public, as well as of the stockholders," and should "*take into consideration the welfare* of employees and consumers."[44] In other instances, stakeholder theorists have appealed to the notion of doing what is *best for society* or taking actions that produce the *best social consequences*. Thus, in 1953, in his seminal book on the *Social Responsibilities of the Businessman*, Bowen wrote,

> When the far-reaching scope and consequences of private business decisions are recognized, some questions naturally arise: Are businessmen, by virtue of their strategic position and their considerable decision-making power, obligated to *consider social consequences* when making their private decisions? If so, do they have social responsibilities that transcend obligations to owners or stockholders? The answer to both these questions is clearly yes.[45]

Hence, we should hope "to secure *socially desirable behavior* on the part of businessmen."[46] Again,

> The term social responsibilities of businessmen … refers to the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are *desirable in terms of the objectives and values of our society*."[47]

Furthermore, "The doctrine of social responsibility rests upon the idea that business should be conducted with concern for the effects of business operations upon the attainment of valued social goals,"[48] and after providing a "tentative list of goals" (including such things as a high standard of living, economic growth, equity in the distribution of income, freedom, community improvement, national security and personal integrity),[49] Bowen concedes that

> Some of the goals are found to be mutually conflicting in the sense that the attempt to achieve one of them may be at the sacrifice of another. For example, security may be achieved at the cost of a lower standard of living or of a reduced rate of progress; justice may interfere with personal security; freedom may conflict with stability; etc. Therefore, in applying these goals we are necessarily faced with

[44] E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 Harv. L. Rev. 1145, 1156 (1932) (emphases added).
[45] Harold R. Bowen, SOCIAL RESPONSIBILITIES OF THE BUSINESSMAN 4 (1953) (emphasis added).
[46] *Id.* at 5 (emphasis added).
[47] *Id.* at 6 (emphasis added).
[48] *Id.* at 8.
[49] *Id.* at 8-12.

> compromises. Different individuals value the various goals differently, and different generations look upon differently in light of their experiences and according to their fundamental views of life.[50]

which, of course, states a classic welfare-economic problem.[51]

Both Dodd and Bowen wrote before Arrow proved his impossibility theorem, which event might be taken as the origin of modern welfare economics, and so it is understandable that Dodd and Bowen would never allude to adopting economic concepts and methods to explicate their ideas. The same cannot be said, however, of later stakeholder advocates, who continue to formulate their accounts by appealing to intuitive concepts that implicate welfare-economic problems. Thus, in 1984, his highly influential book on *Strategic Management: A Stakeholder Approach*, Freeman writes,

> A stakeholder in an organization is (by definition) any group or individual who can affect or is affected by the achievement of the organization's objectives…. The point of strategic management is in some sense to chart a direction for the firm. Groups that can affect that direction and its implementation *must be considered* in the strategic management process.[52]

And again,

> Organizations have stakeholders … groups and individuals who can affect, or are affected by, the achievement of an organization's mission…. [I]f business organizations are to be successful in the current and future environment then executives must *take multiple stakeholder groups into account*.[53]

Freeman is writing more than fifty years after Dodd, but the language is virtually identical: managers must "concern themselves with the interests" and "take into consideration the welfare" of various stakeholders (Dodd), and they "must … consider[]" and "take … into account multiple stakeholder groups" (Freeman). Freeman, however, is writing more than thirty years after Arrow published his *Social Choice and Individual Values*[54] (which proves the impossibility theorem) and almost fifteen years after Sen published his *Collective Choice and Social Welfare* (which extends Arrow's framework to include cardinal utility functions). By this point, welfare economics was a thriving discipline, but Freeman never alludes to its relevance to stakeholder theory and never cites either Arrow or Sen.

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[50] *Id*. at 12.

[51] Bowen's account, which is hardly a model of precision and clarity, may well be taken to be non-welfarist in Sen's sense, see Sen supra note 2, in that it may import values (e.g., "justice" and "the values of our society") that would make the best choice in a given situation *not* a function of the effects of the choice on the welfare of individuals. Still, these values can be interpreted in welfarist terms, e.g., see Louis Kaplow & Steven Shavell, FAIRNESS VERSUS WELFARE 52-58 (2002); Richard A. Posner, THE ECONOMICS OF JUSTICE (1981), and in that case, Bowen's account of corporate governance is still welfarist. Bowen is simply not precise enough a thinker to say for sure.

[52] R. Edward Freeman, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH 46 (1984) (emphasis added).

[53] *Id*. at 52 (emphasis added).

[54] Kenneth J. Arrow, SOCIAL CHOICE AND INDIVIDUAL VALUES (1951).

The story is very much the same with contemporary advocates of stakeholder theory. Thus, the most illustrious non-academic advocate of stakeholder theory is undoubtedly the legendary corporate attorney Martin Lipton, who invented the poison pill antitakeover device and who has led the corporate bar for more than half a century.[55] Over the course of decades, Lipton has issued a widely-read and highly-respected series of client memos arguing for the stakeholder model, culminating in his paper on *The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth*,[56] which was adopted by the World Economic Forum in 2016. According to Lipton, "the New Paradigm recalibrates the relationship between public corporations and their major institutional investors and conceives of corporate governance as a collaboration among corporations, shareholders and other stakeholders working together to achieve long-term value,"[57] and in developing corporate strategies, "*consideration should be given* [by managers and directors] not only to shareholders, but also to the corporation's broader group of stakeholders, including employees, suppliers, customers, creditors and the community."[58] Indeed, "Every director should *represent the interests* of all shareholders and other stakeholders."[59] In the years since the publication of *The New Paradigm*, Lipton has reiterated his views many times in very similar terms. Thus,

> *The New Paradigm* offers a better way: the mutual commitment of directors, corporate executives, asset managers and investors to long-term sustainable economic growth. *Directors can and must mediate the differing and often conflicting interests of the corporation's various stakeholders*. But the principle guiding that mediation should be the imperative to achieve long-term corporate health and value with the active engagement and cooperation of investors—who share with the rest of society an interest in sustainable and equitable economic growth.[60]

And again, contrasting his view with the well-known shareholder-theory view of Milton Friedman,[61] Lipton recently wrote,

> We long have advocated for a broader view of corporate purpose … to empower boards to *take into account the interests* of all stakeholders, including the communities in which corporations operate ... to ensure that directors are encouraged to resist short-termist pressures and can exercise their business judgment to consider the variety of stakeholder interests essential to promoting sustainable success and growth in long-term corporate value…. The growing

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[55] See, e.g., Marty Lipton & Jessica C. Pearlman, *Interview with Marty Lipton*, 75 Bus. Law. 1709 (2020).
[56] Martin Lipton, *The New Paradigm A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth*, available at https://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.25960.16.pdf [hereinafter, *The New Paradigm*].
[57] *Id*. at 1.
[58] *Id*. at 8 (emphasis added).
[59] *Id*. at 15 (emphasis added).
[60] Martin Lipton and William Savitt, *Stakeholder Governance—Issues and Answers*, Harvard Law School Forum on Corporate Governance (October 25, 2019).
[61] Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG. (Sept. 13, 1970).

> acceptance of stakeholder corporate governance is captured by, among other developments, the World Economic Forum's publication of *The New Paradigm*.[62]

In each case, Lipton's language is virtually identical to that of Dodd in 1932, albeit sometimes with the candid admission that the interests of different stakeholders will often conflict. Again, however, there is no allusion to the fact that *considering* or *representing* or *mediating* or *taking into account* the competing interests of different stakeholders implicates the problems of welfare economics. In particular, there is no recognition of that fact that there is no coherent way even of *explaining what such language means* without adopting the concepts and methods of welfare economics.[63]

The same is true of stakeholder statements from both business leaders and academic organizations. Thus, the Business Roundtable's Statement on Corporate Purpose in 2019 declared that the executives signing the statement "share a fundamental commitment to all of our stakeholders," including customers, employees, suppliers, the communities in which their companies operate, and shareholders.[64] Similarly, the British Academy's Principles for Purposeful Business declares that "the purpose of business is *to solve the problems of people* and planet profitably, and not profit from causing problems."[65] Perhaps it is unfair to expect more intellectual vigor in such cases than such language evinces.

It is fair, however, to expect more from scholars. Certainly, Professors Blair and Stout have been among the most influential advocates of stakeholder theory,[66] and although their team-production model of the corporation represents a very particular understanding of stakeholder theory, they nevertheless end up using language virtually identical to that of other stakeholder theorists. Thus, Professors Blair and Stout argue that "public corporation law encourages directors to serve the joint interests of all stakeholders who comprise the corporate 'team,'"[67] and, in their model, directors are "charged with balancing the competing interests of the many stakeholders who comprise the firm,"[68] with the result that "[t]he team production model explains how sacrificing shareholders' interests to stakeholders' can sometimes serve the interests of both groups in the long run."[69] Professor Mayer, perhaps the leading stakeholder advocate of

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[62] Martin Lipton, *ESG, Stakeholder Governance, and the Duty of the Corporation*, Harvard Law School Forum on Corporate Governance (September 18, 2022).

[63] At bottom, this is a philosophical problem. As Herbert Feigl once noted, the characteristic questions of analytic philosophy are, "What do you mean?" and "How do you know?" See Herbert Feigl, *Logical Empiricism*, in Herbert Feigl and Wilfred Sellars, eds., *Readings in Philosophical Analysis* (1949) at 5. Stakeholder theorists owe the world clear answers to the questions, "What do you mean that the directors doing such-and-such is best for all the corporate stakeholders?" and "How do you know that the directors doing such-and-such is best for all the corporate stakeholders?" I think it is clear that, at this point in the development of stakeholder theory, stakeholder advocates are unable to answer either question.

[64] Business Roundtable, *Statement on the Purpose of a Corporation* (2019) (emphasis added).

[65] British Academy, *Principles for Purposeful Business* 8 (2019).

[66] Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 Va. L. Rev. 247 (1999).

[67] *Id.* at 288-89.

[68] *Id.* at 305-06.

[69] *Id.* at 308 n. 157. All that said, Blair and Stout often speak as if the job of directors is not to maximize value or welfare but to allocate wealth that the corporation somehow already has. Thus, "corporate directors … enjoy considerable discretion in deciding which members of the corporate coalition receive what portion of the economic surplus resulting from team production," *id.* at 301, and directors should "decid[e] which members of the corporate coalition receive what portion of the economic surplus resulting from" the corporation's operations. *Id.* at 325. On one

the day, says very similar things.[70] In his view, "the private incentives of the pursuit of profit" under the shareholder theory of corporate governance conflict with "the public interest in human and natural world flourishing and prosperity," and so corporate law should be amended to "address that defect through requiring the adoption of appropriately formulated corporate purposes."[71] Hence, "The law can and should both ensure the alignment of the corporation's incentives with individual, societal, and planetary interests and promote the resolution of their problems by enabling [corporations] to commit credibly to their resolution."[72] Professor Mayer speaks in terms of corporations committing to promoting various interests rather than considering them, but it comes to the same thing: the law should "permit of commitment to objectives beyond the pursuit of the success of the company for the benefit of its members [i.e., shareholders] … through committing to the interests of others" to 'ensure the alignment of the corporation's incentives with individuals, societal, and planetary interests."[73] But as to how commitments to competing interests are to be balanced or how conflicts between those interests are to be resolved, Professor Mayer has nothing to say.

In sum, advocates for stakeholder theory routinely speak about *considering*, *balancing*, or *taking into the account* the interests of various stakeholders, or about directors making decisions that have the *best social consequences* or that are *best for society* as a whole, or even about directors managing the corporation in order to *maximize social welfare*. In so doing, stakeholder advocates implicitly assume that such expressions have a definite meaning.[74] As we shall see below, well-known results in welfare economics show that this is not the case. Rather,

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interpretation, this kind of allocation problem could still comfortably into welfare economics (e.g., if we understand the problem as being one of allocating *value* in order to maximize *welfare*). For other interpretations of the problem, see Robert T. Miller, *How Would Directors Make Business Decisions Under a Stakeholder Model?* 77 Bus. Law. 778 (2022). That fact that the authors themselves seem unaware of the competing economic interpretations is significant.

[70] See generally, Colin Mayer, PROSPERITY 2018.

[71] Colin Mayer, *What is Wrong with Corporate Law? The Purpose of Law and the Law of Purpose?* European Corporate Governance Institute - Law Working Paper No. 649/2022 (June 15, 2022). Mayer sometimes speaks as if the earth or the natural world generally has its own interests ("The law can and should both ensure the alignment of the corporation's incentives with individual, societal, and planetary interests," *id*.), which raises unusual issues from a welfare-economic point of view. Although it strikes me as very implausible to think that inanimate objects have interests analogous to those of human beings, the welfare economist could concede this and treat the earth, or the natural world, or perhaps each planet taken singly, as one more "individual" with preferences to be aggregated. If the earth can have interests, it presumably can also have a cardinal utility function.

[72] *Id.*

[73] *Id.*

[74] To be clear, to say that an expression has a definite meaning is not to say that an expression would not be difficult to apply in particular cases because of empirical uncertainty. To be sure, it would often be difficult to know what the consequences of an action for various stakeholders would be, just as, under shareholder theory, it is often difficult to know which course of action will result in the greatest value for shareholders. With shareholder theory, however, if we abstract from empirical uncertainty, there is then a clear answer as to which alternative is best: it is the one with the highest profitability index. See, e.g., Richard A. Brealey, Steward C. Myers & Alan J. Marcus, FUNDAMENTALS OF CORPORATE FINANCE 248-250 (2012). With stakeholder theory, however, things are different, for even abstracting from empirical uncertainty, it is unclear how to rank various alternatives: if there are 100 stakeholders and one action benefits 20, harms 10, and leaves 70 unaffected, is that action better or worse than an action that benefits 40, harms 30, and leaves 40 unaffected? What if the incremental benefits and harms are not equal? And just what does it mean to say one person was benefited to a greater or lesser extent than another was harmed? It is precisely to address such problems that welfare economics exists, and without investigating such issues, it is impossible to attribute any clear meaning to what stakeholder theorists are saying when the assert that directors should do what is best for all stakeholders or take into consideration the interests of all stakeholders.

such expressions can be interpreted in many different ways, depending on what value judgments we wish to make and what assumptions we choose to accept about the measurement and comparability of the preferences of the individuals involved. To the best of my knowledge, no stakeholder advocate has ever recognized these issues and attempted to deal with them.[75]

## III. A Brief Overview of Welfare Economics

In a general sense, the problem of how best to make decisions that affect a large group of individuals is as old as philosophy itself.[76] Nowadays, such problems are treated in what is usually called the *social choice theory*, with welfare economics being a particular subdivision of that theory. Modern social choice theory began in the eighteenth century with the writings of Condorcet,[77] who proved what is now usually called Condorcet's Jury Theorem[78] and identified what is now universally known as Condorcet's Paradox.[79] Like Condorcet's work, other early results concerned systems of voting, still a major concern of social choice theory. The strand of social choice that would evolve into welfare economics, however, is primarily rooted in the nineteenth century Britain in the classical utilitarianism of Bentham, Mill, and Sidgwick.

The classical utilitarians held that, in any situation, the morally correct action is the one that produces the best consequences, which they understood as meaning the greatest amount of happiness for human beings. Happiness, in turn, they understood as meaning pleasure net of pain, with pleasure and pain being understood in a thoroughly psychological sense.[80] Classical utilitarianism is thus *welfarist* in the sense noted in the introduction: it assumes that the socially-best outcome is a function of facts about individuals, in particular about their pleasures and pains. In the subsequent history of philosophy, some philosophers have agreed with the classical utilitarians that the moral quality of an action depends solely on its consequences but have parted

[75] I am aware of two very limited exceptions to the claim in the text. Magill, Quinzii and Rochet argue that firms partly externalize certain endogenous risks onto employees and customers, which is socially suboptimal, and that creating a system of property rights for employees and customers and then requiring directors to maximize the aggregate value of these rights and the corporation's shares would produce a Pareto optimal result if there is only one firm (though not if there are many). Michael Magill, Martine Quinzii & Jean-Charles Rochet, *A Theory of the Stakeholder Corporation*, 83 ECONOMETRICA 1685 (2015). By its terms, the theory presented considers not all stakeholders but only shareholders, employees and customers; maximizes value, not welfare; and does not work when there is more than one firm in the economy (i.e., the firm must be both a monopolist on its product market and a monopsonist on its supply markets, including the labor market). Building on this paper, Fleurbaey and Ponthière argue that maximizing the sum of the surpluses of customers and suppliers can be achieved, in most respects, by simple management rules similar to those enjoined by the shareholder model (i.e., rules that rely on profit maximization). Marc Fleurbaey & Gregory Ponthière, *The Stakeholder Corporation and Social Welfare*, 131 J. POL. ECON. 2556 (2023).

[76] E.g., Plato, *Republic* and *Laws*; Aristotle, *Politics*.

[77] Nicolas de Condorcet, *Essay on the Application of Analysis to the Probability of Majority Decisions* (1785).

[78] Roughly speaking, the Jury Theorem states that if each member of a group of individuals (e.g., a jury) has an equal and independent probability greater than random but worse than perfect of making a correct judgment on some factual matter (e.g., whether the defendant is guilty), then the majority of individuals is more likely to be correct than any single individual, and the probability that the majority is correct goes to 1 as the size of the group increases.

[79] Condorcet's Paradox is the observation that group preferences can be irrational (in particular, non-transitive) even when all individual preferences are rational. The standard example is a group of three individuals *i, j* and *k* such that *i* prefers alternative *A* to alternative *B, j* prefers alternative *B* to alternative *C*, and *k* prefers alternative *C* to alternative *A*. Hence, there are (two-thirds) majorities for *A* over *B*, for *B* over *C*, and for *C* over *A*, making the aggregated preferences irrational.

[80] Jeremy Bentham, *Fragment on Government* (1776); J.S. Mill, *Utilitarianism* (1864); Henry Sedgwick, *The Methods of Ethics* (1874).

company with the utilitarian view of pleasure and pain and suggested other ways in which one state of the world can be understood to be better than another, some of which are welfarist and some of which are not. Such philosophers are *consequentialists* but not *utilitarians*. Classical utilitarianism was also closely associated with economics (Sidgwick was an important economist as well as an important philosopher), which in part explains the development within economics of the discipline of welfare economics, which, as we shall see, turns out to be the branch of social choice theory most readily adaptable to problems of stakeholder theory.

### A. Welfare Economics Before Arrow

As noted above, classical utilitarians identified the goodness or badness of consequences with the pleasure or pain, respectively, that the consequences involved for human beings. As critics were quick to point out, however, the classical utilitarian view presupposes that all pleasures and pains count equally in the utilitarian calculus, meaning that the pleasure that an altruistic person derives from helping the poor counts equally with the pleasure that a sadist derives from torturing his victims. Arguments like this forced Mill to admit a distinction between what he called higher pleasures and lower pleasures,[81] but almost no one after him has found this solution convincing.[82] Some later philosophers, known today as pluralistic consequentialists, have attempted to deal with the problem by assuming that values in addition to pleasure should be considered in evaluating consequences. G.E. Moore added beauty and truth,[83] and other consequentialists have included friendship, justice, virtue, freedom and other values.[84] In this regard, they anticipated stakeholder theorists like Bowen who included among his goals among his goals for responsible business leaders not only economic goods (like a high standard of living) but what might be thought of as moral goods, such as justice and honesty.[85] Tellingly, the pluralistic consequentialists have never produced a plausible explanation how, judged by these criteria, one state of the world can be shown to be better than another—e.g., how to tell whether a state of the world that includes a great deal of pleasure but a little injustice is better or worse than one that includes much justice but also much pain and suffering. Moore himself resorted to saying that such claims are not susceptible to proof or disproof; rather, people simply have intuitions about these things, and if they disagree, either they are focusing on different aspects of the situation or else one person's intuitions are simply superior to another's.[86] To me, this seems wholly unserious.

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[81] See J.S. Mill, *Utilitarianism*, chp. 2, paras. 2-5 in John Stuart Mill, COLLECTED WORKS OF JOHN STUART MILL, vol. x, at 210-11 (2006) (J.M. Robson ed.).

[82] E.g., Robert Nozick, THE EXAMINED LIFE 103 (1989) (note that "some philosophers modulated the pleasure principle by distinguishing some kinds of pleasure as 'higher,'" but then observing that "adequately fomulat[ing]" "this distinction between higher and lower pleasures" is "something that hasn't yet been done.").

[83] G.E. Moore, PRINCIPIA ETHICA [x, 148] (1902).

[84] E.g., W.D. Ross, THE RIGHT AND THE GOOD 140 (1930) (virtue, pleasure, justice and knowledge are the only things good in themselves).

[85] Harold R. Bowen, SOCIAL RESPONSIBILITIES OF THE BUSINESSMAN 8-12 (1953) (listing as goals "which many thoughtful people would accept, at least in principle" a high standard of living, economic progress (i.e., economic growth), economic stability, personal security (including economic security), order, justice, freedom, development of the person, community improvement (including environmental concerns), national security, and persona integrity (including honesty in fact)).

[86] G.E. Moore, probably greatest philosopher ever to defend a pluralistic consequentialism, is clear that, although claims about which consequences are better than others are objectively true or false, nevertheless such claims are

Classical utilitarianism faces other serious problems as well. Perhaps the most serious (many philosophers consider it fatal) is Nozick's thought experiment involving a so-called experience machine.[87] This machine is attached to a person's brain, and it causes the person to have exactly the same subjective experiences, exactly the same thoughts and feelings, that the person would have if he were engaged in whatever activities he takes to be the most pleasurable imaginable. Much as characters in the *Matrix* franchise, a person attached to Nozick's experience machine will have exactly the same brain states he would have if he really were climbing Mount Everest, making love to the most desirable sexual partners, negotiating world peace or doing whatever else would bring him the most pleasure. All the while, however, he is floating in a tank with electrodes attached to his brain. If, as classical utilitarianism holds, pleasures and pains are all that matter, then pleasures derived from the experience machine should be of exactly equal value in the utilitarian calculus to pleasures resulting from the actual experiences. Almost no one, however, would trade real life, with its real joys and sorrows, for a lifetime of pleasures of the kind provided by the experience machine, even if, after being attached to the machine, he would not know that he was not really living through the experiences that he seems to have. This strongly suggests that the utilitarian solution to the problem of social choice is untenable.

### B. Ordinal Preferences and Arrow's Impossibility Theory

For these and other reasons, contemporary social choice theorists typically eschew consideration of pleasures and pains and begin from the assumption that there is some set of social alternatives and some set of individuals with preferences regarding these alternatives.[88] The alternatives are typically interpreted as states of the world including a complete description of all relevant factors (i.e., not only the allocation of economic resources, but also political and legal arrangements, climate and environmental conditions, and so on). The preferences of individuals are assumed to be merely *ordinal preferences*: for any two alternatives, the individual is assumed to prefer one to the other or else to be indifferent between them, and the individuals preferences are required to meet some minimal rationality conditions.[89] In other words, the individual's preferences *order* the states of the world, from most preferred to least preferred, but there are no assumptions about *how much* an individual prefers one alternative to another (as we shall see below, such issues would involve *cardinal preferences*), and there are no interpersonal comparisons of any kind.

Ordinal preferences have some obviously desirable features. For one thing, claims about such preferences seem to be clearly meaningful. For many pairs of alternatives, the

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incapable of any form of proof or disproof, G.E. Moore, PRINCIPIA ETHICA x, 148 (1902), a position now called "moral intuitionism." E.g., W.D. Ross, FOUNDATIONS OF ETHICS 144 (1939). Few philosophers defend such a position today.

[87] Robert Nozick, ANARCHY, STATE AND UTOPIA 42-45 (1974); Robert Nozick, THE EXAMINED LIFE 104-08 (1989).

[88] The idea it is that a preference to climb Mount Everest is not the same as a preference to have the mental states one would have if one climbed Mount Everest (and which one could also have attached to Nozick's experience machine); the first involves actually climbing Mount Everest, but (as the experience machine thought-experiment shows) the latter does not.

[89] That is, an individual's preferences are assumed to be reflexive, antisymmetric, and transitive, and to produce a complete order on the set of alternatives. More precisely, for the set $S$ of alternatives, the preferences of an individual $i$ generate a complete order $\leq_i$ on $S$ such that for $x$ and $y$ in $S$, $x \leq_i y$ means $i$ either prefers $y$ to $x$ or is indifferent as between $y$ and $x$, and $\leq_i$ is reflexive (for all $x$ in $S$, $x \leq_i y$), antisymmetric (for all $x$ and $y$ in $S$, if $x \leq_i y$ and $y \leq_i x$, then $x =_i y$, meaning $i$ is indifferent as between $x$ and $y$), and transitive (for all $x$, $y$ and $z$ in $S$, if $x \leq_i y$ and $y \leq_i z$, $x \leq_i y$, then $x \leq_i z$). To say that the order is complete means that, for every $x$ and every $y$ in $S$, either $x \leq_i y$ or $y \leq_i x$.

individual will actually prefer one to another, and such preferences will sometimes be publicly ascertainable because, faced with a choice, the individual has *revealed* his preferences by his publicly observable behavior. Even for preferences with regard to which the individual has never had to reveal his preferences in practice, we can easily believe that, had the occasion arisen, the individual would have revealed some preference or other because he had a mental disposition to do so. Needless to say, it may well be difficult to ascertain all the preferences of all the relevant individuals, but the assumption that individuals have the relevant preferences, even if we cannot in practice know them, seems plausible. Under certain idealized circumstances, all preferences of all individuals could be revealed, and this supports the idea that it makes sense to assume such preferences exist even when we cannot in practice know them—just as, for example, we assume that the number of blades of grass in Harvard Yard on Commencement Day in 1903 was either even or odd, even if we have no practical ability to ascertain which.[90]

Now, assume that, for each individual, we use that individual's preferences to construct an order of the possible alternatives, from the least preferred to the most preferred (allowing for ties, where the individual is indifferent as between two alternatives). A set of such orders, one for each individual, is traditionally called a *profile*. The question then is of the relationship between a profile—the totality of individual orderings based on individual preferences regarding the alternatives—and a *social ordering* of the alternatives, a ranking of the alternatives that aggregates individual preferences into one order that is in some sense best for all the individuals collectively. Once again, we make the *welfarist* assumption—that is, we assume that individual preferences completely determine the social ordering. In other words, there is a function (in the mathematical sense) from the set of all possible profiles to the set of social orderings.[91]

One alternative to welfarism is to personify society and assume that society itself has preferences or interests distinct from those of the individuals who compose it. The stakeholder equivalent would be the idea that the corporation itself has some form of personal existence apart from its stakeholders and thus has preferences of its own distinct from, and not determined, by the preferences of the shareholders. The language of some stakeholder advocates could sometimes be interpreted as suggesting such a view,[92] but, if so, this is a decidedly minority view of dubious plausibility.[93] Another alternative to welfarism is to assume some robust moral values according to which certain states of society are better than others, regardless of what the individuals involved may want. As examples of such values, Sen mentions Nozick's notion of entitlements and Marx's notion of exploitation,[94] but most almost any moral notion from outside the utilitarian tradition will suffice, such as Kant's categorical imperatives or Aristotle's understanding of the virtues.

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[90] See Michael Dummett, *Truth* in Michael Dummett, *Truth and Other Enigmas* (1978) (noting that treating a question as having a truth value independent of our ability to know it as the hallmark of realism).

[91] Amartya Sen, *The Welfare Basis of Real Income Comparisons*, 17 J. ECON. LIT. 1 (1979).

[92] See, e.g., Colin Mayer, *The Role of Corporate Law Reconsidered: A Brief Response to Paul Davies' Blog*, ECGI (July 19, 2022) ("The issue is not about shareholder versus stakeholder interests but what is meant by the success of the company, be it restricted to benefits of shareholders in terms of their wealth or welfare or more broadly construed to include those of, for example, employees.")

[93] See Amartya Sen, COLLECTIVE CHOICE AND SOCIAL WELFARE 45 (exp. ed. 1970, 2017) ("It is, of course, possible to take the view that a society is an entity that is independent of the individuals in it, and that social preferences need not be based on the preferences of the members of the society…. Anyone who finds his fulfillment in this assumption is entirely welcome to it.").

[94] Amartya Sen, *On Weights and Measures: Information Constraints in Social Welfare Analysis*, 45 ECONOMETRICA 1539, 1540 (1977).

Such notions are not welfarist because, relying on such notions, we could say that, even though all the relevant individuals in fact preferred a certain state of the world to all others, nevertheless that state was worse than some other states because it involved violations of categorical imperatives or people acting viciously. Of course, rejecting welfarism involves adopting some degree of paternalism, a commitment to saying, at least in some circumstances, that what people believe to be best for themselves is not best for them after all—that we can know better than they do what is best for them. As noted above, welfare economics assumes welfarism, and so shall I for purposes of this Part of this paper. In Parts IV and V, I shall return to the question of welfarism and touch on some non-welfarist interpretations of stakeholder theory.

Now, once we make the welfarist assumption, the question becomes how to map profiles to social orderings. A general way of doing this is called a *social welfare function*. Ideally, we would prefer that a social welfare function be defined on all logically possible profiles (this is called the *complete domain* assumption), and it seems eminently reasonable to require that a social welfare function meet some minimal standards of rationality, such as that the social orderings it yields are transitive,[95] and that it produce a complete ordering of alternatives.[96] Of course, we want more from a social welfare function than just this. We want the social welfare function to be, in some sense, fair and reasonable. The minimal conditions above, for example, are consistent with a social welfare function that effectively anoints one individual a dictator and ranks alternatives exactly the way that individual would do so, regardless of whatever anyone else may prefer. Clearly, we do not want social welfare functions based on dictators.

The inquiry thus turns to potentials additional requirements on social welfare functions. One obvious requirement is *unanimity* or the so-called *weak-Pareto principle*: if every individual prefers alternative *x* to alternative *y*, then the social ordering should prefer *x* to *y* as well. Another requirement, less obvious but also highly plausible, is the *irrelevance of independent alternatives*: for any alternatives *x* and *y*, the social ordering's ranking of *x* and *y* should be determined by the rankings of *x* and *y* by the individuals and so should not depend on how individuals rank any other alternatives; in other words, if we know what every individual prefers as between *x* and *y*, then we should know what the social ordering is as between *x* and *y*. Equivalently, when in two profiles, for every individual, that individual ranks *x* and *y* the same way in both profiles, the social welfare function should map both profiles to social orderings that rank *x* and *y* the same way.[97]

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[95] Again, a ranking is transitive if, for any alternatives *x*, *y* and *z*, if ranks *x* above *y* and *y* above *z*, then it ranks *x* above *z* as well.

[96] Again, a ranking is complete if, for any alternatives *x* and *y*, then it ranks *x* above *y*, *y* above *x*, or ranks them equally; it never regards two alternatives as simply incomparable.

[97] The independence of irrelevant alternatives is not as obscure as it may seem. On an individual level, it means that, if a person is rational, then whether he prefers *x* to *y* does not depend on whether he prefers some third alternative *u* to *x*. The point is often made by recounting a story about the famous philosopher Sidney Morgenbesser: Morgenbesser is in a diner ordering desert, and when the waitress says the diner has cherry pie and apple pie, Morgenbesser chooses cherry; the waitress then remembers that the diner has blueberry pie too, and when he hears this, Morgenbesser says, "Well, in that case, I'll take the apple." The reason Morgenbesser's reply seems irrational is that it violates the independence of irrelevant alternatives. The assumption in Arrow's proof is that the social welfare function is rational in an analogous way: the preferences of individuals about *x* versus *y*, regardless about their preferences concerning another alternative *u*, will determine whether the social ordering ranks *x* above *y*, or *y* above *x*, or ranks them equally.

At this point, things take an astonishing turn. In 1951, Arrow proved that it is mathematically impossible to construct a social welfare function meeting all of the requirements set out above. That is, if we assume that the function is defined on all possible profiles, produces a compete and transitive social order, observes the principles of unanimity and the independence of irrelevant alternatives, and there are no dictators, then no such function can exist.[98] Now known as Arrow's Impossibility Theorem, this result has become foundational to welfare economics.

Indeed, virtually all subsequent work in welfare economics has concerned ways of constructing social welfare functions by weakening the assumptions of Arrow's theorem in order to avoid the impossibility result.[99] The weak-Pareto and non-dictatorship assumptions are extremely difficult to give up, and so attention has generally turned to the assumptions about the universal domain of the social welfare function and the independence of irrelevant alternatives. These can, in some cases, be plausibly weakened. For example, if we weaken the universal domain assumption by limiting the domain to profiles in which all individual preferences are single-peaked (roughly, each individual has a certain alternative that he or she considers best and, using some form of measurement, the individual ranks all other preferences lower than this one based on how much they depart from the preferred alternative), then Black has shown that it is possible to construct social welfare functions on this more restricted domain.[100] Or again, many voting schemes used when there are three or more alternatives violate the assumption about the independence of irrelevant alternatives. As a result, such schemes necessarily encounter other problems. A good example is plurality voting. Such a system violates the independence of irrelevant alternatives, and as a result can produce results in which the plurality winner is an alternative that a majority of voters disprefer to some other alternative.[101]

In general, however, such approaches to dealing with Arrow's Impossibility Theorem are of limited value. Precisely because the assumptions in Arrow's theorem seem so plausible, weakening these assumptions to avoid the impossibility result seems reasonable only in certain special classes of cases. Stakeholder theory is supposed to be a practical theory of corporate governance, and it would be quite unjustifiable to assume, for instance, that the preferences of all stakeholders on all questions that could come before the board of directors are single-peaked so as to justify a weakening of the universal domain assumption. If we are attempting to construct a social welfare function that would be generally applicable to the kinds of decisions faced by directors of public companies, then we need to find another path forward. That path was first marked out in the work of Amartya Sen.

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[98] Kenneth Arrow, Kenneth Arrow, SOCIAL CHOICE AND INDIVIDUAL VALUES [__] (1951, 2d ed. 1963). For a simple proof, see Ning Niel Yu, *A One-Shot Proof of Arrow's Impossibility Theorem* 50 Econ. Theory 523 (2012).

[99] In another surprising result, ordinal preferences are sufficient to prove the welfare theorems, but the catch is that we assume a complete absence of externalities, which ensures that no one objections to transactions to which the individual is not a party, which is a very strong assumption. See Lionel W. McKenzie, CLASSICAL GENERAL EQUILIBRIUM THEORY 15 (2002) (discussing utility functions versus binary preference relations).

[100] Duncan Black, *On the Rationale of Group Decision-Making*, 56 J. POL. ECON. 23 (1948).

[101] In the standard example, if there are three alternatives *x*, *y* and *z*, and 34% of the voters prefer *x* to *y* to *z*, 33% of the voters prefer *y* to *z* to *x*, and 33% prefer *z* to *y* to *x*, then *x* will win the plurality vote (34 to 33 to 33), even though 66% of the voters would prefer *y* to *x*. See Robert E. Goodin & Christopher List, *A Conditional Defense of Plurality Rule: Generalizing May's Theorem in a Restricted Informational Environment*, 50 AMER. J. POL. SCI. 940 (2006).

## C. Cardinal Preferences and Sen's Extension of Arrow's Framework

The assumptions in Arrow's Impossibility Theorem look weak, but there is one sense in which they are actually very strong. In particular, because the individual preferences in the profiles in the domain of the social utility function are only ordinal preferences, Arrow's theorem requires that many situations that we may intuitively think are different for purposes of social choice be mapped by the social welfare function to one and the same social ordering. Thus, imagine that there are 100 individuals, and 51 of these individuals prefer alternative *x* to alternative *y*, and 49 prefer *y* to *x*. If we go beyond the limitations of ordinal preferences and ask *how much* or *how strongly* each of these individuals prefers *x* to *y* or *y* to *x*, we see that limiting the analysis to ordinal preferences can obscure differences that, intuitively, seem important. For example, it could be that all of the individuals hold their preferences with equal strength or intensity: that is, each of the individuals who prefers *x* versus *y* holds this preference by the same amount (whatever "amount" means in such cases), and each of the individuals who prefers *y* to *x* holds this preference by that amount as well. In that case, it would seem clear that the social welfare function should prefer *x* to *y* so that the majority (51 to 49) should get its way. It could also happen, however, that the 51 individuals who prefer *x* to *y* hold their preferences only lightly, so that they are all virtually indifferent as between *x* and *y*, but that the 49 individuals who prefer *y* to *x* hold their preferences very vehemently, so that it matters a great deal to them whether or not they got their way on this issue. In that case, it may be that the social welfare function should prefer *y* to *x*. But since in Arrow's framework we consider only ordinal preferences, and since these two cases reflect the same ordinal preferences, the social welfare function must treat the two cases alike and map them to the same social ordering. In this sense, Arrowian social welfare functions are procrustean—indeed, so inflexible that they do not exist, the constraints placed on them being ultimately mutually incompatible. The question thus becomes whether, if we had more information about the preferences of individuals so that we could distinguish cases that yield the same ordinal preferences and so map different cases to different social orderings, can we define plausible social welfare functions. This turns out to be the case, but, as we shall see, what had been a hopeless absence of social welfare functions becomes an embarrassment of riches.

### 1. Cardinal Preferences, Cardinal Welfare Functions, and Social Welfare Functionals

Here we turn to Sen's extension of Arrow's framework.[102] As in Arrow, we begin by assuming that there is a set of alternatives and a set of individuals with preferences regarding these alternatives. Instead of considering merely the ordinal preferences of individuals, however, we introduce the notion of *cardinal preferences* by assuming that, for each individual *i*, there is a *cardinal welfare function* $w_i$ such that, for each alternative *x*, $w_i(x)$ is a real number, which is interpreted as measuring *i*'s welfare under alternative *x*. Intuitively, we might think that, if $w_i(x) > w_i(y)$, then *i* is better off under alternative *x* than under alternative *y*, and the *amount* by which *x* is better off under alternative *x* than *i* is under alternative *y* is $w_i(x) - w_i(y)$. Similarly, we might begin to make interpersonal comparisons of welfare: if *i* and *j* are difference individuals, then to say that $w_i(x) - w_i(y) = w_j(u) - w_j(v)$ is to say that *i* is as much better off under alternative *x* as compared to

[102] Most of the following discussion is based on Sen's now classic work COLLECTIVE CHOICE AND SOCIAL WELFARE (exp. ed. 2017) originally published in 1970. On the key issue of tracing Arrow's Impossibility Theorem to the paucity of information about individual preferences, see also Kevin W.S. Roberts, *Interpersonal Comparability and Social Choice Theory*, 47 Rev. Econ. Stud. 421 (1980).

alternative *y* as *j* is under alternative *u* compared to alternative *v*, or, equivalently, that *i*'s welfare would increase by the same amount if we move from alternative *y* to alternative *x* as *j*'s welfare would increase if we move from alternative *u* to alternative *v*.

It is important to understand how important the shift from ordinal to cardinal preferences really is. Notice that, for any individual *i*, we may assume that *i* (ordinally) prefers alternative *y* to alternative *x* if and only if $w_i(x) < w_i(y)$. Hence, an individual's cardinal preferences imply his ordinal preferences.[103] The inverse, however, is not true. An individual's ordinal preferences do *not* imply his cardinal preferences; for any ordinal preferences, there will be infinitely many individual welfare functions that imply those ordinal preferences. The relation from cardinal preferences to ordinal preferences is many-to-one, but the inverse relationship from ordinal preferences to cardinal preferences is one-to-many.

Now, assuming there are *n* individuals, we call an *n*-tuple of welfare functions $<w_1, w_2, \ldots w_n>$ a welfare profile, and we can then define a social welfare functional to be a function *F* on a set of welfare profiles such that $F(<w_1, w_2, \ldots w_n>)$ is a preference relation that gives the social ordering of the relevant alternatives. That is, a social welfare functional maps welfare profiles to a social ordering of alternatives. The output of a social welfare functional is thus exactly the kind output—a social ordering—that we found we could not obtain in Arrow's Impossibility Theorem. As we shall see below, we *can* get that output from a social welfare functional, however, because the inputs to the function—cardinal preferences as given by cardinal welfare functions rather than ordinal preferences—are richer and allow us to map to different social orderings welfare profiles that imply the same ordinal profile and thus, in a purely ordinal system like Arrow's, would have to be mapped to the same social ordering.

## 2. Measurability and Interpersonal Comparisons

An individual's welfare function maps alternatives to real numbers. It does not follow, however, that everything we can say in mathematics about real numbers is meaningful when the real numbers are measures of individual welfare. For example, suppose there is an individual *i* with welfare function $w_i(x)$. Now consider the function $v_i(x) = (5/9)w_i(x) - 32$. These would appear to be different welfare functions, but that is not necessarily the case. The temperature of an object *x* can be measured as $C(x)$ using either the centigrade scale or as $F(x)$ using the Fahrenheit scale, and just as $v_i(x) = (5/9)w_i(x) - 32$, so in fact $C(x) = (5/9)F(x) - 32$. Thus, 35 degrees centigrade is equal to 95 degrees Fahrenheit. Although the centigrade function $C(x)$ and the Fahrenheit function $F(x)$ return different numbers, they convey the same information. The same could be true for the two social welfare functions $v_i(x)$ and $w_i(x)$ where $v_i(x) = (5/9)w_i(x) - 32$. The issue is how we interpret the numbers that welfare functions return.

The question of how to interpret cardinal welfare functions is both vexed and vexing. Depending on how we choose to interpret such functions, they can contain more or less genuine information about the preferences of the individual involved. Sen had the great insight to realize that, whatever information welfare profiles contain, two welfare profiles that contain the same information should generate the same social ordering.[104] The relation among profiles that

[103] See Gerard Debreu, *Representation of a Preference Ordering by a Numerical Function*, in Robert M. Thrall et al., Decision Processes 159 (1954).
[104] Amartya Sen, COLLECTIVE CHOICE AND SOCIAL WELFARE (1970, exp. ed. 2017).

obtains when two profiles contain the same information is an *equivalence relation*: such a relation exhaustively divides the set of all profiles into pairwise disjoint subsets such that all the profiles in a given subset (here called an *equivalence class*) contain the same information. Differing assumptions about what information is conveyed by a welfare profile will generate different equivalence relations on the set of all welfare profiles and so different equivalence classes. This will be made clearer by considering the key possibilities about which information welfare profiles may contain.[105]

**Ordinal Comparisons, No Interpersonal Comparisons (ONC).** In Arrow's original system using only ordinal preferences, the only meaningful information conveyed by an individual welfare function would be the individual ordinal preferences it induced. Hence, two welfare profiles will contain the same information if and only if, for each individual, the welfare function for that individual in the first welfare profile induces the same ordinal preferences as the welfare function for that individual in the second welfare profile. This assumption, which assumes ordinal measurability only and allows no interpersonal comparisons of welfare, can be formulated precisely as follows: two welfare profiles $<w_1, w_2, \ldots w_n>$ and $<v_1, v_2, \ldots v_n>$ contain the same information if and only if, for each individual $i$, there is a positive monotonic transformation $T_i$ such that $T_i(w_i(x)) = v_i(x)$ (which implies that for all alternatives $x$ and $y$, $w_i(x) \leq w_i(y)$ if and only if $v_i(x) \leq v_i(y)$). On this assumption, we cannot meaningfully talk about *how much* an individual prefers one alternative to another (because there will be welfare profiles that contain the same information but would lead to different answers to this question), nor can we make any interpersonal comparisons of welfare (for exactly the same reason).

**Cardinal Measurability, No Interpersonal Comparisons (CNC)**. Going one step beyond Arrow, CNC assumes that welfare profiles contain information that allows us, for a given individual, to measure how much that individual prefers one alternative to another (cardinal measurability), but not any information that would allow interpersonal comparisons. That is, there is no common scale across individuals. Hence, two welfare profiles $<w_1, w_2, \ldots w_n>$ and $<v_1, v_2, \ldots v_n>$ contain the same information if and only if, for each individual $i$ and for all alternatives $x$, there exist real numbers $a_i > 0$ and $b_i$ such that $v_i(x) = a_i w_i(x) + b_i$ (i.e., each individual's welfare function is unique up to positive affine transformations).

**Ordinal Measurability with Interpersonal Level Comparability (OLC).** Here too we go one step beyond Arrow but in a different direction from the one taken above in CNC. In CNC, we could measure how much a particular individual preferred one alternative to another but could say nothing about interpersonal comparisons. Here, we cannot measure how much an individual prefers one alternative to another (we have, as in Arrow, only *ordinal* measurability—the ability to say merely that the individual prefers one alternative to another), but we can make simple interpersonal comparisons to say, for example, that one individual is better off in alternative $x$ than a different individual is in alternative $y$. To do that, we assume that two welfare profiles $<w_1, w_2, \ldots w_n>$ and $<v_1, v_2, \ldots v_n>$ contain the same information if and only if there exists a positive monotonic transformation $T$ such that, for all individuals $i$ and for all alternatives $x$, $T(w_i(x)) = v_i(x)$.

[105] The classification that follows largely follows Christian List, *Are Interpersonal Comparisons of Utility Indeterimate?* 58 Erkenntnis 229 (2003).

**Cardinal Measurability with Full Interpersonal Comparability (CFC).** Finally, we can in effect combine the previous two possibilities and assume that welfare profiles contain enough information *both* to measure intrapersonal changes in welfare cardinally (as in CNC) and to make interpersonal comparisons not just ordinally (as in OLC) but also cardinally as well. Unsurprisingly, to do so, we need even stronger assumptions than any made so far. In particular, we assume that two welfare profiles $<w_1, w_2, \ldots w_n>$ and $<v_1, v_2, \ldots v_n>$ contain the same information if and only if there exist real numbers $a > 0$ and $b$ such that, for every individual $i$, $v_i(x) = aw_i(x) + b$.[106]

It is usually assumed that a social welfare function that could handle a broad range of cases requires assumptions as strong as those in CFC. I shall return to the plausibility of those assumptions below. For now, I want to consider what kinds of social welfare functions would be available to stakeholder theorists provided that they can plausibly make the relevant assumptions.

## 3. The Varieties of Social Welfare Functions

Assuming we have cardinal measurability of preferences and full interpersonal comparability, the problem now becomes almost the opposite of what it was with only ordinal preferences. With only the ordinal preferences of individuals, Arrow's Impossibility Theorem implies that there were no reasonable social welfare functions, no reasonable way of aggregating preferences. With the CFC assumptions, however, it turns out that there are a great many possible social welfare functions, each with its own advantages and disadvantages. In particular, if $S$ is a set of alternatives and there are $n$ individuals whose welfare functions on the states $s$ in $S$ are $w_1(s)$ to $w_n(s)$, then, in accordance with the welfarist assumption, we want the social welfare $W(s)$ to be defined exclusively in terms of the $w_i$,

$$W(s) = F\big(w_1(s), w_2(s), \ldots w_n(s)\big). \tag{1}$$

Any such function is called a Bergson-Samuelson social welfare function.[107] The function $W(s)$ would return a real number that represents social welfare in alternative $s$. We can use the function to find the alternative $s$ that maximizes $W(s)$, and that state would then be the socially optimal one.[108] Below I discuss some of the most obvious possibilities.

### (A) The Benthamite Social Welfare Function

Probably the simplest social welfare function is the one implicit in classical utilitarianism. Usually called the Benthamite social welfare function, it defines social welfare to be sum of individual welfares:

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[106] There are many other possibilities beyond these four that I omit in the interest of simplicity and clarity of exposition. See Christian List, *Are Interpersonal Comparisons of Utility Indeterminate?* 58 Erkenntnis 229 (2003); Walter Bossert, *On Intra- and Interpersonal Utility Comparisons*, 8 Social Choice and Welfare 207 (1991).

[107] [Explanatory note on functions and functionals.]

[108] The text assumes for convenience that there would be a unique $s$ that maximizes the value of $W(s)$, but of course we would have to allow for there to be multiple such states and then have some additional criterion (perhaps an arbitrary one) to choose among them.

$$W(s) = \sum_{i=1}^{n} w_i(s) \tag{2}$$

It may seem that this is the obvious or canonical way to proceed, but in fact defining social welfare in this way involves non-trivial value judgments. For instance, this formula assumes that everyone counts equally in the calculation of social welfare,[109] but perhaps that ought not be the case. Maybe poor people should count more heavily than rich people, or our friends more than our enemies, or the morally good more than the morally bad. If so, we can accommodate such concerns by adding coefficients $c_1$ to $c_n$ to the welfare functions in the formula above, thus producing

$$W(s) = \sum_{i=1}^{n} c_i w_i(s) \tag{3}$$

which makes social welfare a weighted sum of individual welfares. Regardless of whether such weighting is plausible in morals, if we are aggregating preferences in stakeholder theory, it might well make sense to weigh the preferences of different corporate constituencies differently. For example, because directors are elected only by shareholders and can be sued only by shareholders, directors will naturally be especially responsive to shareholder preferences.[110] This tendency could be counteracted by weighting the preferences of members of non-shareholder constituencies more heavily than those of shareholders. On the other hand, stakeholders other than shareholders typically hold fixed claims that are legally enforceable against the corporation, and so any decision by the directors giving effect to stakeholder theory (i.e., any decision differing from what shareholder theory prescribes) always involves giving non-shareholder constituencies more than they would be legally entitled to receive otherwise and thus comes at the expense of the shareholders.[111] To counteract this effect, perhaps we should give greater weight, not lesser weight, to the preferences of shareholders.

We can let all this pass for now, however, because maximizing total utility using the Benthamite social welfare function involves other value judgments that many people find unacceptable or even absurd. For one thing, in maximizing total utility, we take no account of distributional effects: an increase in utility for a rich individual counts the same as an equal increase in utility for a poor person. For stakeholder theorists, many of whom are concerned about economic inequality,[112] this would seem misguided. Indeed, because the Benthamite function takes no

[109] Spencer seems to have been the first to point out the possibility of weighting the preferences of different persons differently in the utilitarian calculus, but Mill argued that it was implicit in utilitarianism that everyone's preferences counted equally. See J.S. Mill, *Utilitarianism*, chp. 5, para. 37n, in John Stuart Mill, COLLECTED WORKS OF JOHN STUART MILL, vol. x, at 257-58n (2006) (J.M. Robson ed.). In a way, they are both right. Spencer is right that we can, if we choose, weigh some people's welfare more than that of others (by adding coefficients to the individual social welfare functions summed in the Benthamite function), and Mill is right that, at least implicitly, the classical utilitarians assumed that there would be no such coefficients (or, if there were, they would all be the same).

[110] Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 Wake Forest L. Rev. 761, 766 (2015).

[111] Robert T. Miller, *How Would Directors Make Business Decisions Under a Stakeholder Model?* 77 Bus. Law. 778-81 (2022).

[112] E.g., Harold R. Bowen, SOCIAL RESPONSIBILITIES OF THE BUSINESSMAN 9 (1953) (listing "justice," including "'equity' in the distribution of income" as a goal responsibility business will pursue); [other cites].

account of distributional effects, the function implies that we should harm the poor to help the rich if the benefit to the rich exceeds the harm to the poor.[113] For example, suppose that an industrial company can make tremendous profits by venting into the environment a substance that, while harmless to almost everyone, will kill one or two individuals with a rare genetic susceptibility. Assume that, because the number of individuals likely to be harmed is so small, polluting this way is legal under the environmental laws. Polluting in this way will benefit the company's (at least relatively) wealthy shareholders, but because the company's plants are located in poor neighbors, the individuals who will die from the pollution are very poor. Regardless of how much money the company could make, most stakeholder theorists would say that the company plainly ought not do this, but if the profits are large enough, engaging in such pollution could maximize social welfare under the Benthamite function. This seems to be the exact opposite of what stakeholders advocates would want.

Problems like this have been generalized by Nozick in the form of so-called utility monsters. A utility monster is a being that derives much more utility (i.e., welfare) from possessing or consuming a resource than do other people.[114] Maximizing welfare thus requires transferring resources from other individuals to the utility monster, even when doing so would immiserate other individuals. Utility monsters can derive arbitrarily high amounts of welfare from even the smallest amounts of resources, which presumably no real individual does, and so they are mere philosophical fictions. Nevertheless, exceptionally greedy individuals can approximate utility monsters in the real world, and this can create for stakeholder theory problems analogous to those posed by true utility monsters. For example, if shareholders are much greedier, on average, than employees, then a stakeholder theory that maximizes utility for all stakeholders using a Benthamite social welfare function could require increasing profits at the expense of employees even taking account of the declining marginal utility of wealth, and the greedier the shareholders are, the more likely this will be true. More generally, utility monsters reveal a basic flaw in the Benthamite function: it rewards greed; the more an individual wants something, no matter how unreasonably, the more likely the function is to recommend that he gets it. This would seem to be incompatible with what most stakeholder theorists would prescribe.

But if the Benthamite social welfare is insufficiently egalitarian in the ways noted, it is in other ways perhaps far too egalitarian. That is, because of the declining marginal utility of wealth, transferring resources from richer individuals to poorer individuals will usually increase social welfare. Imagine a well-off individual in a developed nation who is considering spending $100 on some minor luxury, such as a meal in a modest restaurant. Donating the same amount to a charity that assists the poorest people in the least developed nations would certainly increase social welfare more than spending it in the restaurant.[115] Hence, applying a Benthamite social

[113] E.g., in a population of 100 individuals, in which 90 individuals have welfare of 100 and 10 have welfare of 5, a change that increases the welfare of the top 90 from 100 to 101 but reduces the utility of the bottom 10 from 5 to 1 increases total utility from 9,050 to 9,100 and so increases social welfare. Notice that the loss of utility for each of the disadvantaged individuals is greater than the gain in utility for each of the advantaged individuals.

[114] Robert Nozick, ANARCHY, STATE, AND UTOPIA 42-45 (1974).

[115] Such examples arise from the problem of so-called negative responsibility: if all that matters morally about an action is its consequences, then (it may seem) we are as responsible for the consequences we fail to prevent as for those we cause, and, *ceteris paribus*, not saving a starving person on the other side of the world is as bad as murdering one across the street. See Bernard Williams, *Consequentialism and Integrity*, 30-35 in Samuel Sheffler, ed., CONSEQUENTIALISM AND ITS CRITICS 20 (1988).

welfare function, the person should forgo eating out and donate the money to charity. Clearly, this argument, which derives from Singer, can be applied to practically any action of any person in any developed nation, and so maximizing welfare seems to require all but the neediest people in the world to give away their resources to yet more needy people, at least until the point that their lifestyles become comparable to those of the neediest individuals. Call this the *self-despoliation problem*.

If stakeholder theory is based on a Benthamite social welfare function, stakeholder theory will have to face a form of this problem. The intuition underlying stakeholder theory seems to be that the world would be a better place if managers of large companies directed less value to shareholders and more value to other stakeholders, in large part because shareholders are presumably on average wealthier than other stakeholders. The self-despoliation problem, however, suggests that stakeholder theorists have not gone anywhere near far enough. Using a Benthamite social welfare function to maximize stakeholder welfare, managers would have to direct not a little more value to, say, customers and employees, but essentially all available value to the neediest persons that the managers could find.[116] No money could ever be returned to shareholders; it would all have to be donated to the needy.[117] Nor would other traditional corporate constituencies such as employees or customers benefit under stakeholder theory, for they too are generally much better off than the neediest individuals among us. Ironically, in order to maximize social welfare, the directors would have to treat non-shareholder constituencies exactly as they would under shareholder theory—i.e., purely instrumentally: managers could direct value to members of non-shareholder constituencies provided that doing so produced greater profits for the corporation in the long term, because this would maximize the amount available to be donated to the neediest individuals the directors could find. Stakeholder theory is thus vulnerable to a corporate version of the self-despoliation problem, with the result that the corporation becomes a radically eleemosynary institution. It would put people so far before profits that there would never be any profits ever again. It would be the zenith of Nader.

Utilitarians have not found a convincing response to the self-despoliation argument. Responding to an early version of the argument, Mill argued that that, while maximizing utility would require a person to give away most of his wealth, failing to do this is not morally wrong because omitting an action is morally wrong only if the omission makes the person liable to punishment.[118] This seems merely to confuse what is morally wrong with what the law or some other authority punishes, and almost no one today defends this position. Other utilitarians have given up on maximizing the social welfare in favor of *satisficing*: on this view, we have no obligation to do what maximizes welfare but only to do what increases it *enough*.[119] Advocates of

[116] If the directors believe they should manage the corporation for the benefit of society generally, then the neediest individuals would presumably be the poorest individuals in the world. In this case, the beneficiaries of self-despoliation in stakeholder theory are exactly the same persons as in consequentialist moral philosophy generally. If the directors believe they should manage the corporation for the benefit of a more restricted class of individuals (e.g., the conventional corporate constituencies of employees, customers, creditors and suppliers), then the directors would have to identify the neediest individuals among these groups. For most companies, it seems likely this would be some subset of the company's customers or employees.

[117] Even though the company would remain solvent and pay its debts as they come due, because the shares would be worthless, the market price of the shares would go to zero, with very unforeseeable consequences.

[118] J.S. Mill, *Utilitarianism*, chp. 5, para. 14, in John Stuart Mill, COLLECTED WORKS OF JOHN STUART MILL, vol. x, at 246 (2006) (J.M. Robson ed.).

[119] Michael Slote, *Satisficing Consequentialism*, 58 Proc. of the Aristotelian Society 139 (1984).

this view have failed to define coherently what *enough* means in this context, and so few philosophers have found this view plausible. Yet other utilitarians have adopted so-called agent-relative theories,[120] which allow different persons to have different social welfare functions (e.g., different persons would add different coefficients to the Benthamite function in order to make the preferences of the individuals they care about more count more heavily and the preferences of the individuals they care about less count less heavily). But if different agents can have different social welfare functions, it is difficult to see why these functions should still be understood as *social* welfare functions. They seem more like individual preferences. Indeed, if one person's utility function can depend on the utility functions of others (i.e., we have interdependent utilities), then then such a "social" welfare function becomes equivalent to the individual's utility function. Yet other utilitarians, such as Singer, have embraced the self-despoliation argument and concluded that, counterintuitive as it may seem, we *are* morally required to give away most of our wealth to the neediest individuals.[121] Of course, that there is no good solution to the self-despoliation problem in general means that almost certainly there is no good solution to the corporate version of the problem that affects stakeholder theory either.

### (B) The Bernoulli-Nash Social Welfare Function

There are possible social welfare functions besides the Benthamite function. For example, in the Benthamite utility function in equation (2) above, we added the individual welfares to get social welfare; another possibility is to multiply them. If so, we get the Bernoulli-Nash social welfare function:

$$W(s) = \prod_{i=1}^{n} w_i(s) \tag{4}$$

Just as with the Benthamite function, we can also weight the welfares of different individuals differently by adding coefficients to their welfare functions.

The difference between Benthamite function the Bernoulli-Nash function is not merely mathematical. Nor is it merely the case that the switch from the Benthamite function to the Bernoulli-Nash function produces different outcomes in the sense that what maximizes social welfare under one function sometimes does not do so under the other. Rather, the switch involves a genuine value judgment about what is best for society. In particular, the Benthamite function treats utility gains by all members alike, but the Bernoulli-Nash function magnifies the importance of welfare gains by the worse off, thus producing a more egalitarian social welfare function that favors changes that tend to equalize welfare across individuals. For instance, assume there are only two individuals with welfares of 100 and 10. Under the Benthamite function, whether we increase the welfare of either individual by 15 produces the same result (social welfare of 125), but under the Bernoulli-Nash function, adding 15 to the better off individual's welfare increases social welfare much less (social welfare increases from 1,000 to 1,150, an increase of 150) than it would

[120] Samuel Scheffler, THE REJECTION OF CONSEQUENTIALISM 80-114 (1982); Douglas W. Portmore, *Can an Act-Consequentialist Theory be Agent Relative?* 38 Amer. Phil. Q. 363–77 (2001).
[121] Peter Singer, PRACTICAL ETHICS 218-46 (1993).

if we added 15 to the worse off individual's welfare (social welfare increases from 1,000 to 2,500, an increase of 1,500).[122]

The point here is that the two functions represent two competing notions of equality. The Benthamite function implies that all human beings are equal in the sense that a welfare gain of a given amount for one human being is just as important as an equal welfare gain for any other human being. The Bernoulli-Nash function implies that all human beings are equal in the sense that, holding social welfare constant, it is better if differences in the welfare of individuals be smaller rather than larger.[123] Both of these principles have significant intuitive plausibility, but welfare economics will not help us choose between them. Rather, on some basis other than welfare economics, we have to make a value judgment on this issue, and that judgment will be reflected in whether we choose a Benthamite social welfare function or Bernoulli-Nash social welfare function.

Switching to the Bernoulli-Nash function does not solve many of the serious problems associated with the Benthamite function. Problems with Nozick's utility monsters can arise here as well, although the utility monsters have to be assumed to be even more extreme than with the Benthamite function. On the other, the despoliation problem recurs and becomes even more acute. In fact, under the Bernoulli-Nash function, social welfare is always increased whenever any inequality is reduced. As noted above, regardless of the merits of such a theory in political economy, as applied to stakeholder theory, adopting Bernoulli-Nash social welfare function would require the directors to manage the business as a radically eleemosynary institution, diverting all available value to the poorest members of society until society-wide equality had been achieved. Even applied to a more traditional stakeholder that considers as corporate constituencies only employees, customers, creditors, and suppliers, the Bernoulli-Nash function would require directors to direct wealth to their poorest customers and employees rather than return any value to wealthier shareholders, and so on.

### (C) The Rawlsian Maximin Social Welfare Function

Another possible social welfare function commonly discussed in welfare economics maximizes welfare for the worst-off individual:

$$W(s) = min_{i=1}^{n}[w_i(s)] \tag{4}$$

Often called the maximin or Rawlsian formula, this version of the social welfare function can be interpreted as giving effect to Rawls's difference principle, the idea that only those changes should be permitted that provide the greatest benefit to the least advantaged.[124]

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[122] The underlying mathematical point is that, if there are *n* individuals with welfare functions $w_i$ and the sum of their individual welfares is fixed (e.g., because there is a fixed amount of resources that can be distributed among them), then the product of the $w_i$'s is maximized when the $w_i$'s are all equal.

[123] See Robert T. Miller, *Norms of Equality Implicit in Capitalism*, 23 Sup. Ct. Econ. Rev. 235 (2015).

[124] John Rawls, A THEORY OF JUSTICE 266 (1970). Note that Rawls himself interprets the difference principle not in the sense of the subjective satisfaction of actual preferences but in the sense of the objective possession by the individual of certain primary goods. See the discussion below in Section [____].

Again, there are problems with utility monsters. Curiously, the standard utility monster, which gets such great welfare from consuming resources (a "happy" utility monster) that maximizing social welfare requires directing ever more resources to it, is ineffective against the Rawlsian social welfare function. Under the Rawlsian function, as soon as the monster's welfare level is not the lowest in the population, we can stop feeding it. But a monster that gets less and less welfare the more it consumes (an "unhappy" utility monster) will remain the lowest utility individual in the population, and the Rawlsian function implies we should give *all* social resources to the monster. Unhappy utility monsters seem implausible in practice, but the Rawlsian function also suffers from the self-despoliation problem—indeed, in an even more extreme form.[125] On the plus side, however, defining the Rawlsian function does not require the strong assumptions of CFC above; the relatively weak assumptions of OLC suffice.

### (D) More Exotic Social Welfare Functions

The Benthamite, Bernoulli-Nash, and Rawlsian Maximin social welfare functions are merely the best known and probably most intuitively plausible such functions. There are hardly the only ones. As Arrow observed long ago, "we have a choice of different mathematical forms of the social utility function in terms of individual utilities," and "the social utility might be the sum of the individual utilities or their product or the product of their logarithms or the sum of their products taken two at a time."[126] Indeed, this rather understates the matter, for there are in fact an infinite number of possible social welfare functions, and there is no way, using the tools of welfare economics alone, to choose among them. Rather, as the brief descriptions of the Benthamite, Bernoulli-Nash and Rawlsian functions here shows, the choice of a social welfare function is not a mathematical or economic problem but a value judgment or, perhaps better, a related set of value judgments. Each possible choice embodies certain value judgments about how the welfare of individuals should be taken into account in determining what we ought to do.

Anyone attempting to make decisions based on a social welfare function must, whether he likes it or not, settle the relevant normative issues. Ideally, this should be done consciously and explicitly, acknowledging which judgments are being made and giving reasons for making those judgments rather than others. It should not be done merely implicitly by announcing which social welfare function will be used, thus concealing rather than revealing and defending the value judgments being made. The upshot for stakeholder theory is clear. If, in an effort to adopt the concepts and methods of welfare economics, a stakeholder theorist adopts the notion of a social welfare function, the theorist should identify and state clearly the value judgments reflected in that function and be prepared to defend them. As it is, of course, by proceeding an informal and intuitive level, contemporary stakeholder theorists have not even

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[125] That the Benthamite, Bernoulli-Nash and Rawlsian functions all suffer from similar problems is perhaps not surprising when we observe that all three are special cases of the so-called isoelastic social welfare function, which is given by

$$W(s) = \frac{\sum_{i=1}^{n} c_i (u_i(s))^{1-\rho}}{1-\rho}$$

Assuming all $c_i = 1$, the expression reduces to Benthamite formula when $\rho = 0$; it converges to the Bernoulli-Nash formula when $\rho$ goes to 1; and it converges to the Rawlsian formula when $\rho$ goes to infinity. See Robin W. Boadway & Neil Bruce, WELFARE ECONOMICS 141-42 (1984).

[126] Kenneth Arrow, SOCIAL CHOICE AND INDIVIDUAL VALUES 4 (2d ed. 1963).

gotten clear about which social welfare functions they are using, much less what value judgments are implicit in them and why those judgments are superior to competing ones.[127]

## IV. Stakeholder Theory as a Problem in Welfare Economics

Thus far I have argued that, unlike shareholder theory, stakeholder theory requires directors to aggregate the divergent preferences of many individuals (i.e., the members of the various corporate constituencies, however narrowly or broadly these are defined) in order to make business decisions, and for precisely this reason stakeholder theory necessarily involves the problems of welfare economics. The central tenet of stakeholder theory—the proposition that directors should manage the corporation to maximize the welfare of a group of individuals with conflicting preferences—simply cannot be given a clear meaning without adopting the concepts and methods of welfare economics. Nevertheless, stakeholder theorists have utterly failed to recognize this fact. On the contrary, they have made no attempt to adopt the concepts and methods of welfare economics to give a rigorous expression to their theory. This is surprising, for these concepts and methods are well-known in economics, with both Arrow and Sen having received the Nobel Prize for their respective contributions. By contrast, not only academics but also managers, directors, investors, and even courts long ago adopted the concepts and methods of financial economics in applying the shareholder theory of corporate governance.

The overview of welfare economics in Part III indicates some of the more important problems stakeholder theorists will face when and if they attempt to formulate their theory in a rigorous way. In particular, because of Arrow's Impossibility Theorem, stakeholder theorists will almost certainly have to posit cardinal welfare functions and make the strong assumptions regarding individual cardinal preferences required to make such preferences measurable with full interpersonal comparability. Even after they have done this, they have to determine which social welfare function to adopt—e.g., the Benthamite function, the Bernoulli-Nash function, the Rawlsian maximin function, or perhaps some more obscure possibility. All of these possibilities come with well-known difficulties that lack generally accepted solutions, such as the self-despoliation problem, and stakeholder theorists will have to deal with these difficulties as well.

Since stakeholder theorists have thus far failed to engage with welfare economics, it is difficult to say what the results of such engagement would be. Nevertheless, some of the challenges seem fairly obvious. In the balance of this Part, I shall expand on some of the more salient of these, including (a) difficulties related to theoretical extensions of the Arrow-Sen framework that would seem to be necessary in order to deal with the kinds of problems stakeholder theory would have to confront if it is to be applied in practice by directors of public companies to make business decisions, (b) difficulties involved in making a vigorous version of stakeholder theory sufficiently intelligible to the people who are supposed to apply it, namely, directors of public companies, and (c) difficulties regarding the interpretation of the very robust assumptions

[127] [FN on other possibilities in welfare economics, including the money metric, equivalent variations and compensating variations, Kaldor-Hicks efficiency, and cost-benefit analysis.]

about cardinal measurability and interpersonal comparisons needed to apply social welfare functions to the kinds of problems stakeholder theory seeks to address.

## A. The Need to Extend the Arrow-Sen Framework and Related Difficulties

As mathematically and philosophically complex as the Arrow-Sen framework is, there are still ways in which it is clearly insufficiently strong to deal with the kinds of problems that stakeholder theory attempts to address. For one thing, the Arrow-Sen framework does not allow for decisions made under conditions of uncertainty. It can be expanded to take account of such issues, but the expansion comes at the cost of yet further complexity. For another thing, the Arrow-Sen framework also assumes that the population of individuals affected by collective decisions is stable over time, with no additions or subtractions. For decisions with long-lasting effects, this assumption usually fails. Again, the framework can be expanded to allow for variable populations, but this too introduces new problems and difficulties, most importantly Parfit's famous "repugnant conclusion."

### 1. Decisions Under Conditions of Uncertainty

Clearly, business decisions are always made under conditions of significant uncertainty and so always involve risk. Any vigorous account of stakeholder theory must assume, therefore, that the relevant decisions are made in this manner. Indeed, stakeholder theorists often argue that their theory is superior to shareholder theory when it comes to dealing with risks faced by the corporation.[128] The Arrow-Sen framework explained above, however, abstracts from problems of uncertainty and risk; decisions are assumed to invariably produce their expected effects. There are, however, extensions of the framework that allow for such complications. As might be expected, such extensions assume that probabilities can be assigned to the various possible outcomes just as is done in financial economics (e.g., when, in discounted cashflow analyses, we use probability distributions of possible future cashflows and computed their expected values), and then social welfare functions can be used to rank these outcomes, taking account such uncertainty into account.[129] Such an extension of the Arrow-Sen framework requires, unsurprisingly, more complicated mathematics,[130] and, on some interpretations, taking account expected utilities (i.e., utilities discounted by the probability that the relevant alternative will result) implies a Benthamite or Benthamite-like additive social welfare function.[131] But there is no need to explore such complexities here. The point is merely that such issues exist, and stakeholder theorists will need to deal with them.

### 2. Decisions Affecting Variable Populations

Stakeholder theory concerns business decisions by directors of public companies, and many of these decisions tend to have long-lasting effects, which means that they may impact

[128] E.g., Lipton, *The New Paradigm*, supra note [__], at [__].
[129] See generally Philippe Mongin & Marcus Pivato, *Social Preferences and Social Welfare Under Risk and Uncertainty*, in Matthew Adler and Marc Fleurbaey, eds., Oxford Handbook of Well-Being and Public Policy (2016).
[130] It may also affect the nature and interpretation of the assumptions regarding cardinal measurability and interpersonal comparisons in surprising ways. See, e.g., John C. Harsanyi, *Cardinal Welfare, Individualistic Ethics, and Interpersonal Comparisons of Utility*, 63 J. Pol. Econ. 309 (1955); but see Kenneth Arrow, Kenneth J. Arrow, Social Choice and Individual Values [__] (2d ed. 1963) (disputing Harsanyi's interpretation).
[131] E.g., Robin W. Boadway & Neil Bruce, WELFARE ECONOMICS 19 (1984).

the welfare of individuals not yet born. Indeed, decisions related to greenhouse gas emissions and other climate change issues, which have been a critical concern for many stakeholder theorists, are a paradigm example. Business decisions about such issues made today can affect the welfare of individuals who will be born only years or decades (perhaps centuries) in the future; conversely, many people now living will be dead before the full effects of such decisions are felt. The Arrow-Sen framework assumes, however, a fixed population of individuals whose welfare the decisionmaker is attempting to maximize. Hence, to account of decisions affecting variable populations, that framework needs to be expanded. Since this can be done by replacing the single set of individuals assumed by the Arrow-Sen framework with a function that maps each alternative to the set of individuals alive in that alternative, along with other appropriate elaborations of the framework, but again at the cost of additional mathematical complexity.

There are more serious difficulties involved as well. For one thing, we need to make all the strong assumptions about cardinal measurability and interpersonal comparisons of welfare required by CFC not only about individuals who actually exist, not only about individuals who will exist in the future, but even about counterfactual individuals who would exist in the future if the decisionmaker takes certain actions but will not exist if the decisionmaker takes other actions. One need not be as skeptical as Quine of shadowy entities to doubt whether there is any objective reality to the cardinal preferences of persons who do not exist, never have existed, and never will exist, but might have existed had things been different. For another, when populations can vary, maximizing welfare using a Benthamite or many other social welfare functions becomes subject to Parfit's so-called mere-addition paradox.[132] That is, Parfit pointed out that it would often be possible to increase total welfare by increasing the size of the relevant population while reducing average welfare. If we have a population of one million individuals all with welfare of 100, then we will increase total welfare (indeed, quintuple it) if we increase the population to 10 million individuals while reducing the welfare of each individual to 50. Hence, maximizing total welfare would require expanding the population while immiserating it, a seemingly morally unacceptable result that Parfit dubbed the *repugnant conclusion*.

Such problems are of obvious relevance to stakeholder theory. Parfit's examples usually concern governmental policies related to population growth, but corporate decisions can affect population growth as well. For example, when transnational corporations invest in projects in underdeveloped nations, such projects tend to raise the standard of living in these nations, and rising standards of living are correlated with reductions in the rate of population growth.[133] In other words, the corporation would be producing a smaller population in which individuals would have a higher average welfare. Following Parfit's mere-addition reasoning, the corporation might be able to increase total welfare by eschewing such investments so that the population would increase more rapidly, even though the average welfare of the individuals in that population would decline. With a Benthamite social welfare function, this version of the repugnant conclusion would seem to follow.

Even if the universe of corporate stakeholders is drawn more narrowly and comprises only the traditional corporate constituencies of shareholders, customers, employees, creditors, and suppliers, mere-addition problems can still arise. Here, the trick is to expand not the

[132] Derek Parfit, REASONS AND PERSONS 419-41 (1984).
[133] Jeffrey D. Sachs, *The End of Poverty* (2005).

total human population but the set of stakeholders. Thus, the corporation may be able to increase the total welfare of its stakeholders merely by hiring additional low-wage employees for whom the company has no genuine economic need or by increasing the number of its customers by selling cheaper but lower-quality products or even by merely selling below marginal cost. By expanding the number of stakeholders, even stakeholders with lower average welfare, such actions may well increase the total welfare of all stakeholders.

There are ways of expanding the Arrow-Sen framework to allow for variable populations that block Parfitian mere-addition problems,[134] but they are not entirely satisfactory. For example, Blackorby, Donaldson, and Bossert have proposed, as a constraint on social welfare functions for variable populations, what might be called a critical-level restriction: we simply assume that, regardless of the total social welfares in two alternatives, the social welfare functional can rank one alternative ahead of the other if and only if the total number of individuals in the higher-ranked alternative whose individual welfare exceeds some minimal level is greater than the total number of individuals in the lower-ranked alternative whose individual welfare exceeds that level. While clearly in blocking mere-addition problems, the restriction seems ad hoc and inadequately motivated, and the critical level of welfare would not doubt be highly relative to the circumstances.

### B. Practical Problems of Using Welfare Economics in Stakeholder Governance

The problems for stakeholder theory identified above for the most part arise from analogous well-known general problems in welfare economics or social choice theory more generally. There is, however, another serious problem for stakeholder theory that arises, not from these more general problems, but from the fact that the boards of directors of public companies are supposed to apply the theory in practice to make business decisions. The conclusions above show that, even to specify what the theory means requires a good deal of sophisticated philosophical, economic and mathematical reasoning. It may seem difficult to imagine that the kinds of individuals who become directors of public companies will work through the complex reasoning necessary in order to understand the relevant issues in welfare economics. Still, several decades ago, the same may have been said about whether directors of public companies would learn enough financial economics to understand and apply, say, the Capital Asset Pricing Model. Nowadays, most directors certainly understand enough financial economics at least to follow and understand presentations from management and investment bankers, and so this concern about directors coming to understand welfare economics is likely not very serious. At the very least, we should be optimistic and expect that the directors will rise to the occasion.

Let us assume, therefore, that the directors of a public company work through all the relevant problems in welfare economics and agree to use, say, the Benthamite social welfare function to maximize the welfare of their corporate constituencies. To apply this version of stakeholder theory to make a business decision in any particular case, the directors would have to compute, or at least estimate, for each of the various alternatives under consideration, the change in the welfare function for each individual in each corporate constituency that would result from

[134] E.g., see Charles Blackorby, Walter Bossert & David Donaldson, *Intertemporal Population Ethics: Critical-Level Utilitarian Principles*, 63 Econometric 1303 (1995); Charles Blackorby, Walter Bossert & David Donaldson**,** CRITICAL-LEVEL UTILITARIANISM AND THE POPULATION-ETHICS DILEMMA (2008).

their pursuing that alternative. The directors would then apply the Benthamite social welfare function in order to determine which alternative maximized stakeholder welfare. Now, even if the stakeholders are limited to current shareholders, employees, customers, creditors and suppliers, doing all this will virtually always be manifestly impossible. Directors do not have access to the welfare functions of all these individuals, who would likely number in the thousands or maybe millions; they cannot determine the values they need to plug into the social welfare function. It seems, therefore, that even if a board could settle on some particular version of stakeholder theory, the directors could not apply the theory in practice.

There are serious responses to this argument. For one thing, consequentialist moral philosophers commonly argue that we must distinguish between the *fact* that a certain action is right (i.e., the fact that the action produces the best consequences or maximizes social welfare) and the *way we come to know* this fact, the decision procedure, method, or algorithm we use to determine whether the action is right.[135] The fact itself (i.e., that a certain action maximizes social welfare or not) is determinately true or determinately false, regardless of whether anyone knows it or even can know it, practically speaking. There may be, and often are, multiple ways of obtaining evidence that make the matter seem more or less probable. In many areas of endeavor, it is common to use approximating procedures in practice when more accurate but highly cumbersome ones also exist. Even more, since actually computing social welfare functions would presumably be quite costly in most instances, it may well maximize social welfare not to compute such functions but instead follow decision procedures that are cheaper to apply even if they have non-trivial error rates and so do not always identify exactly the right action. Some consequentialists have argued that the rules of commonsense morality comprise just such a decision procedure: following them might not always result in choosing the action that consequentialist theory would identify as the right action, but it usually does, and, at least in general, following the commonsense rules produces better results on average than using any other decision procedure.

Stakeholder theorists could thus argue that, rather than actually computing the utilities of various stakeholders in order to make business decisions, directors could adopt some easily applied decision procedure that would allow them to identify, at least for the most part, the action that their preferred social welfare function would command. This sounds like a promising strategy, but just as the rules of commonsense morality depart from the utilitarian calculus, so too would the correct decision procedures for corporate directors depart from the social welfare function defining stakeholder theory. The results might surprise stakeholder theorists.

For consider what a plausible decision procedure for corporate directors might look like. The first rule of such a procedure would seem to be that the directors should manage the corporation lawfully—that is, cause the corporation always to obey the law. The second rule would be that directors should manage the corporation to fulfill the legitimate legal claims of stakeholders, including both those of stakeholders in contractual relationships with the corporation (such as employees, customers, creditors, and suppliers) and those whose claims against the corporation arise in other ways (such as tort creditors or those having claims against the corporation arising under a statute, such as taxing authorities). This follows from the fact that, under the law, such claims have priority over those of shareholders. The third rule would be that

[135] R. Eugene Bales, *Act-Utilitarianism: Account of the Right-Making Characteristics of Decision-Making Procedure?* 8 Amer. Phil. Q. 257 (1971).

directors should take all actions that benefit at least one constituency but harm none (the strong Pareto principle), which would require directors to take those actions benefiting non-shareholder constituencies that produce greater profits for shareholders in the long-term, just as the shareholder theory requires. This brings us to other conflicts among constituencies. Since the claims of non-shareholder constituencies are fixed, either by contract or by the law generally, all such conflicts ultimately reduce to questions of whether a non-shareholder constituency should be benefited at the expense of the shareholders.[136] Since there appears to be no principled way to determine how much any particular constituency should be benefited at the expense of shareholders,[137] the simplest rule to adopt is that, in such cases, the directors should favor the shareholders. But taken together, these rules just amount to the *shareholder* theory of corporate governance. In other words, if we try to specify a decision procedure for stakeholder theory in order to make the theory usable in the real world, stakeholder theory collapses into shareholder theory. Not is this at all surprising. Corporate law scholars have long thought that traditional rules of corporate law—i.e., the shareholder theory—were the rules that maximized social welfare in the long term. As Hansmann and Kraakman said almost a quarter of a century ago, although the "corporate enterprise should be organized and operated to serve the interests of society as a whole," nevertheless, "as a consequence of both logic and experience, there is convergence on a consensus that the best means to this end (that is, the pursuit of aggregate social welfare) is to make corporate managers strongly accountable to shareholder interests and, at least in direct terms, only to those interests."[138]

Put another way, the shareholder theory, which is merely traditional corporate law, arose when judges in courts of equity made reasonable simplifying assumptions in order to specify fiduciary duties with which directors could reasonably comply. In other words, roughly the same kind of simplifying assumptions that underlay the above attempt to specify a decision procedure for stakeholder theory underlay the creation of traditional rules of corporate law. Similar assumptions thus lead to similar conclusions. Shareholder theory can be understood as an approximation to stakeholder theory that human beings can reasonably be expected to implement in order to make business decisions in real cases. Stakeholder theory thus appears to be not so much a viable theory of corporate governance but the reasonable aspiration that corporate law, like other areas of law, be designed to maximize social welfare. On this view, the mistake in stakeholder theory is to assume that the way to attain that end is merely to invest the individuals empowered by the system, the corporate directors, with authority to pursue that end directly. No one, I take it, would make a similar mistake in, say, constitutional law. There too the ultimate goal may be for the government to govern for the benefit of society as a whole, but rather than empower

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[136] Robert T. Miller, *How Would Directors Make Business Decisions Under a Stakeholder Model?* 77 Bus. Law. 778-81 (2022).

[137] Id. at 781-96.

[138] Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 441 (2001). If one thinks that corporations routinely externalize significant costs, then the rational response is to argue for stricter regulations, which, at least sometimes, has been former Chief Justice Strine's position. Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 Wake Forest L. Rev. 135, 167-72 (2012); Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 Wake Forest L. Rev. 761, 786-89 (2015). Of course, many stakeholder theorists advocate for stakeholder theory precisely because, in their view, governments have failed to enact desperately needed regulations (e.g., a carbon tax). One could as easily say, however, that having considered the matter for a long time, the duly elected representatives of the people have concluded that such regulations would do more harm than good, and advocates of stakeholder theory are merely attempting to gain at the corporate level what they could not achieve by democratic means at the legislative level.

some individual or some body of individual with authority pursue that goal, we create a much more elaborate system with separation of powers and checks and balances, because we think that the simpler system, though *aimed* at the right end, would in fact produce worse results.

### C. Difficulties Regarding the Interpretation of Assumptions about Cardinal Utilities

As noted above, the assumptions about ordinal preferences (ONC) that underlie Arrow's Impossibility Theory are weak in the sense that it seems reasonably clear that these assumptions are, as economists typically say, meaningful.[139] That usage is unfortunate, for it suggests that the issue in question is linguistic or semantic. Analytic philosophers would make the same point by saying that claims about ordinal preferences are *objective* or *factual* or state *facts of the matter*, and they would explain these expressions by saying that such claims are determinately true or determinately false because of the state of the world and independent of what we ourselves think or desire.[140] There are, if you will, realities in the world that make such claims true or false, and we can, at least in many cases, actually find out what those realities are. For instance, for many pairs of alternatives, the individual will actually prefer one to another because he actually has a certain mental state (the state of a man's mind being as much a fact as the state of his digestion, as Lord Bowen famously said),[141] and even for alternatives that the individual has never actually contemplated, he may well have a disposition to prefer one to another if the question were presented to him. These mental states and dispositions are real aspects of the individual existing independently of our beliefs or desires (just as a body's mass or electrical charge is real aspect of the thing existing independent our beliefs or desires), and they presumably are what make statements about the individual's preferences determinately true or determinately false, regardless of our ability to know which. At least potentially, these real aspects of the individual would make an observable empirical difference in his behavior: not only would he choose one alternative over the other given the chance, but, even if we merely asked him about his ordinal preferences regarding a pair of alternatives, his having one preference rather than another would result in his giving one answer rather than another.

Like claims about ordinal preferences, claims about cardinal preferences and interpersonal comparisons of welfare appear on their face to be factual claims about individual human beings and their mental states. Nevertheless, such claims have long met with profound

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[139] E.g., Kenneth J. Arrow, Social Choice and Individual Values 9 (2d ed. 1963) ("interpersonal comparison of utilities has no meaning and, in fact, that there is no meaning relevant to welfare comparisons in the measurability of individual utility.").

[140] E.g., Michael Dummett, "Realism," in his *Truth and Other Enigmas* (Cambridge: Harvard UP, 1978), pp. 145-165; Haim Gaifman, "Ontology and Conceptual Frameworks: Part I," *Erkenntnis*, 9 (1975): 329-353, and "Ontology and Conceptual Frameworks: Part II," *Erkenntnis*, 10 (1976): 21-85; W.V. Quine *What Price Bivalence?*, in his *Theories and Things* (Cambridge: Harvard UP, 1981), pp. 31-37. For instance, since Hamlet is a character in a play and not a real person, statements about Hamlet are not factual in the sense given in the text. Nevertheless, some statements about Hamlet are true (e.g., that he was from Denmark), though only in virtue of what Shakespeare said and other people (reasonably) believe; for similar reasons, other statements about Hamlet are false (e.g., that he discovered electricity). But since Hamlet is not real, many statements about Hamlet are neither true nor false (e.g., that his blood type was AB-). These statements are nevertheless "meaningful" as that word is commonly used, which makes the economists' use of the word *meaningful* to mean *factual* misleading and confusing. To confuse matters further, some philosophers and economists (e.g., Arrow) argue in ways that suggest that if a proposition cannot be known (by us? ideally?) to be true or false (e.g., because the truth or falsity of the proposition makes no empirical difference), then the proposition is not meaningful in the economic sense (i.e., factual in the philosophical sense).

[141] *Edgington v. Fitzmaurice* (1885) 29 Ch D 459.

skepticism, with economists and philosophers generally thinking that they are not meaningful propositions, that they do not describe objective facts about the world, and that their truth or falsity would make no observable empirical difference.[142] As is well known, Arrow held that interpersonal comparisons of welfare, and even intrapersonal measurements of cardinal welfare, were in this sense meaningless.[143] In his view, "During the entire controversy" about the meaningfulness of such propositions, "the proponents of measurable utility [i.e., cardinal preferences], have been unable to produce any proposition of economic behavior which could be explained by their hypothesis and not by those of the indifference-curve theorists," which involve in effect only ordinal preferences.[144] In other words, positing facts about the measurability of cardinal welfare and interpersonal comparisons of cardinal welfare was unnecessary to explain any empirically observable facts. For hard-headed empiricists, natural scientists, and philosophers in the Anglo-American tradition of analytic philosophy, this is generally a strong reason for denying the existence of something.[145] Note that even the most enthusiastic supporters of welfare economics would be hard put to argue this particular point about cardinal utilities making an empirical difference. They tend to agree that the relevant assumptions are necessary, not to explain or predict any observable forms of human behavior (i.e., to make any positive claims), but to ground *normative* claims what is better or worse for society.

While conceding that pessimism about the purported factuality of interpersonal comparisons of utility and related measurements of mental states "has been quite dominant in the economic literature for more than half a century,"[146] Sen takes a more sanguine view of such comparisons, asserting that "even with such mental state comparisons, the case for unqualified rejection is hard to sustain."[147] He argues that, following Davidson, "it is difficult to see how people can understand anything much about other people's minds and feelings, without making some comparisons with their own minds and feelings."[148] In my view, however, this is unconvincing, or, at least, grossly exaggerated. At the very least, Sen is placing a tremendous amount of emphasis on the word *unqualified* when says that "the case for unqualified rejection is hard to sustain," and he practically gives away the game when he says that our understanding of other people's minds and feelings requires "*some* comparisons" with our minds and feelings.[149] That is, of course *some* interpersonal comparisons are seem perfectly well-founded: the young, healthy billionaire sipping a Tom Collins on the beach, surrounded by his adoring family, is much happier than the poor wretch being drawn and quartered for refusing to forswear his religious faith (an interpersonal ordinal comparison, as in OLC), but extreme instances like this fall far short of

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[142] The locus classicus is Lionel Robbins, *An Essay on the Nature and Significance of Economic Science* (1935).

[143] Kenneth J. Arrow, SOCIAL CHOICE AND INDIVIDUAL VALUES 9 (2d ed. 1963) ("interpersonal comparison of utilities has no meaning and, in fact, that there is no meaning relevant to welfare comparisons in the measurability of individual utility.").

[144] *Id*.

[145] In other words, we posit unobservable entities in order to explain observable phenomena. If there is no such need for a posit, we have no reason to believe that posited entity exists and we should conclude that it does *not* exist. This is a common view among practicing scientists of all kinds, and it finds substantial (though of course not universal) support among analytic philosophers. [Cite to Quine.]

[146] Amartya Sen, COLLECTIVE CHOICE AND SOCIAL WELFARE 23 (exp. ed. 2017).

[147] *Id*. at 22.

[148] *Id.* Sen cites Donald Davidson, *Judging Interpersonal Interests* in Jon Elster & Aanund Hylland, eds., FOUNDATIONS OF SOCIAL CHOICE THEORY 195 (1986), which also appears in slightly altered form as *The Interpersonal Comparison of Values*, in Donald Davidson, PROBLEMS OF RATIONALITY (2004).

[149] Amartya Sen, COLLECTIVE CHOICE AND SOCIAL WELFARE 22 (exp. ed. 2017) (emphasis added).

the assumptions in CFC or comparable systems, which are what are needed in robust forms of welfare economics.

Such examples seem to justify two kinds of claims. First, some claims about interpersonal level comparisons are justified, and, second, some claims stronger than mere level comparisons, both intrapersonal and interpersonal, are justified—i.e., claims such as individual *i* not only prefers *a* to *b* and *c* to *d* but he prefers *a* to *b more than* he prefers *c* to *d*, and individual *i* is *much* happier in alternative *a* than individual *j* is in alternative *b*. One could imagine an extension of an ordinal system in which such comparisons, both intrapersonal and interpersonal, could be formalized. Such a system would be stronger than OLC, but it would fall far short of full cardinal measurability and interpersonal comparability as in CFC.[150] Moreover, the new relations would not generate complete orders in either the intrapersonal or interpersonal cases: that is, regardless of whether $i = j$, there would not always be a fact of the matter (in fact, there would generally *not* be a fact of the matter) whether *i* is *much happier* in alternative *a* than individual *j* is in alternative *b*. This would severely limit the usefulness of the framework: it would tend to apply only in cases where it seems intuitively obvious which alternative is socially preferable, which makes a welfare-economic analysis superfluous.

There is, however, a completely different way of interpreting assumptions about cardinal measurability and interpersonal comparisons of welfare. Rather than view those assumptions as factual claims about individuals and their mental states such as their desires, preferences, or dispositions, the relevant statements can also be interpreted as *normative judgments* of the decisionmaker about what it is good for the individuals involved. As the authors of a leading textbook on welfare economics explain,

> What does it mean to say that the planner has available information on the measurability and comparability of utilities? … First, one may take the view that the measurement of utility is, in principle, an objective matter. Once utility levels are empirically determined, they can then naturally be compared among individuals…. A second and more fruitful possibility is to view the information not as being given to the planner from an outside source but as reflecting the planner's own ethical judgment of the measurability and comparability of utility…. This is fundamentally different from the first view outlined above in that it is recognized that the information itself reflects an ethical judgment of the planner (or someone else) and does not comprise some objectively determined data.[151]

In other words, on this interpretation, when we say that Schmatz gets ten times the welfare from a hot meal that Grutz gets from a round of golf, we are really saying at all nothing about Schmatz or Grutz's desires, preferences, dispositions, or other mental states; indeed, we are not saying anything factual about the world at all. Rather, we are asserting that, as a normative matter, we *should trade off* hot meals for Schmatz against rounds of golf for Grutz at a rate of ten to one. More colloquially, we are assuming that it is ten times more important (in some normative sense) for Schmatz to get a hot meal than for Grutz to get in a round of golf. On this interpretation,

[150] Relations such as "much prefers" might also suffer from problems of philosophical vagueness, [cite], but perhaps formalisms could be developed to handle such issues.
[151] Robin W. Boadway & Neil Bruce, WELFARE ECONOMICS 168-69 (1984).

therefore, so-called information about the cardinal preferences of individuals and interpersonal comparisons of welfare reflects only the value judgments of the person applying the social welfare function. This is a radical suggestion, for it amounts to giving up the foundational premise of welfarism, the idea that the socially preferable option is a function of the actual preferences of the affected individuals.

If we adopt this normative interpretation of cardinal preferences and interpersonal comparisons of utility, then stakeholder theory takes on a dramatically different character. First, the difference between stakeholder theory and shareholder theory becomes much more extreme. As long as we maintain the welfarist assumption, stakeholder theory will seek to make decisions based on the actual preferences of the affected individuals, key among whom are shareholders. Shareholder theory seeks to make decisions based on the assumed preferences of shareholders. Both theories respect the individuals involved and try to honor their (actual or assumed) preferences. Albeit in somewhat different forms, both theories assume that each individual is the best judge of what was good or bad for himself or herself, and this in turn justifies giving each individual's preference weight in the social welfare calculus. But once we say that aggregating preferences in stakeholder theory is merely a disguised way for directors to make normative judgments about what is right and good for the stakeholders, then we have quite given up on respecting the preferences of individuals. The actual preferences of actual individuals have no weight at all in the social calculus. The social calculus is not designed to give a group of individuals that they judge is best for themselves; it is designed to give a group of individuals what the decisionmaker has concluded is best for them. The system goes from letting individuals control everything to letting individuals control nothing, from a strong form of individualism to a very strong form of paternalism.

Applied to the stakeholder context, decisions by directors come to resemble political decisions—decisions by people exercising power over others as those exercising power judge best in some strong normative sense, even when the preferences of those over whom power is wielded would clearly prefer an alternative result. Stakeholder theory always had a political cast to it,[152] but the move to a normative interpretation of the cardinal preferences of individuals makes this aspect of the theory fully explicit and self-conscious. Political officials are elected to exercise normative judgment, to implement particular values that they espouse, or to give effect to a certain vision of the common good, and, on the normative interpretation of cardinal preferences, the same would be true of corporate directors. Directors are not trying to give stakeholders what they want; they are giving stakeholders what the directors judge to be best for them. Corporate governance becomes highly paternalistic. On this account, directors are not trustees, whether for the benefit of the shareholders, the stakeholders, or anyone else. They are quasi-public officials, charged with the management of often immense aggregations of economic resources, doing what they think

[152] Margaret M. Blair & Lynn Stout, A Team Production Theory of Corporate Law, 85 Va. L. Rev. 247, 325 (1999) (conceding that, under stakeholder theory, "the returns to any particular corporate stakeholder from participating in the corporation will be determined not only by market forces but by political forces.); see generally, Robert T. Miller, *How Would Directors Make Business Decisions Under a Stakeholder Model?* 77 Bus. Law. 773, 796-99 (2022) (discussing how, under a stakeholder model, decisions by corporate boards would become political decisions rather than business decisions).

normatively best for society as a whole. The closest analogy would be to the commissioners of an independent administrative agency.

Or, at least, this would be true if the commissioners of such agencies were elected by a particular subset of the persons to be regulated by them. Although it is certainly possible to select individuals to wield significant power over others in this way, it is quite absurd to think that individuals elected by one group of people will give due consideration to the interests of other groups of people, at least when the interests of the groups conflict, which the interests of corporate constituencies routinely do. The clear implication is that directors should thus be elected not by shareholders only but by all stakeholders. There is nothing impossible in creating such a system. As is well-known, in the German codetermination system, employees vote in the election of certain directors, and at least some stakeholder advocates have recommended a similar system for American corporations.[153] Presumably, analogous arrangements for creditors and suppliers could be devised as well. Giving the vote to customers, however, would sometimes be extremely challenging. A buyer of advertisements on Google could, in connection with his purchase, be given a number of votes in the next election of Google directors, but it is hard to see how people who merely use Google's search engine would participate in electing Google directors. Professors Hayden and Bodie have recently suggested voting systems that would include not only shareholders, but employees, creditors, consumers, and communities.[154] Even more challenging would be giving votes to everyone affected by the corporation's operations. Plainly, concern about climate change is a major force—probably the most important force—behind the stakeholder governance movement, and so if all stakeholders are to get the vote, then giving votes to everyone affected by climate change would seem to be critical. The difficulties will be considerable. Giving votes to persons yet unborn would prove especially tricky.

For similar reasons, the manner of conducting elections would presumably have to change as well. Given the stakes, we should hope that elections of directors should be regularly contested by candidates supporting different normative views, just as in elections for public office. Candidates should publish not only their resumes but their normative platforms. At least at large companies like those in the Magnificent Seven, it would seem only sensible for the major political parties to nominate candidates and fund elections. Corporate governance would become the stuff of party politics.

But assuming all this could somehow be managed, having everyone or nearly everyone vote to elect directors at thousands of public company every year would surely invite rational apathy. Shareholders, in the sense of the beneficial owners (as opposed to institutional shareholders), are *already* rationally apathetic in most contested elections and even in connection with major transactions. Indeed, only about half of the Americans eligible to vote in presidential elections do so. Employees, who are highly undiversified relative to their employees, may find it worth their time to vote in matters touching their own company, but members of virtually all other non-shareholder constituencies will not. Matters only become worse when we reflect that each

[153] Leo E. Strine, Jr., Aneil Kovvali, & Oluwatomi O. Williams, *Lifting Labor's Voice: A Principled Path Toward Greater Worker Voice and Power Within American Corporate Governance*, 106 Minn. L. rev. 1325, 1381-82 (2021) (arguing for a federal mandate that would require public companies to become Delaware benefit corporations with worker co-determination).

[154] Grant M. Hayden & Matthew T. Bodie, *A Democratic Participation Model for Corporate Governance*, 109 Minn. L. Rev. __ (forthcoming 2025).

individual would be asked to vote in literally thousands of elections every year. In most cases, an individual would be eligible to vote in an election for directors merely because the voter is affected by climate change and the company's operations affect the climate. If this is the only reason to vote, however, it seems very unlikely that most Americans would vote, for Americans consistently rank climate and environmental concerns low on lists of issues they consider most pressing. With very few persons voting, the integrity of elections would be undermined.

We expanded the corporate franchise to virtually everyone, because we wanted all stakeholders to be able to affect corporate policy, but, primarily because individuals would be asked to vote in too many elections in which the stakes were, taken individually, so small, most individuals would become rationally apathetic and not vote. At this point, the solution seems obvious. Rather than have all the stakeholders elect directors directly, let the stakeholders select the directors democratically but indirectly: that is, let public officials, who are already elected by all the stakeholders, choose the directors. In other words, nationalize all the public companies (and maybe the larger private ones as well) and have the President, who is already elected democratically, appoint directors for each company. Of course, this amounts to socialism. The implication is that stakeholder theory, in its normative form, is an inefficient half-measure on the road to socialism.

## V. Conclusion

Shareholder theory has successfully integrated the concepts and methods of financial economics in order to approach, in a theoretically sound and disciplined way, the problem of maximizing shareholder value. Directors, managers, investors, and even courts routinely use discounted cashflow analyses, the weighted-average cost of capital, and the Capital Asset Pricing Model, in order to determine which of various alternatives maximizes value for shareholders in the long term. The problems of stakeholder theory are different. Stakeholder theory requires directors to aggregate the divergent preferences of the members of the various corporate constituencies, however narrowly or broadly these be defined, and then make a decision that is, in some sense, best for all the stakeholders collectively. Such a decision involves a social choice problem, and absent using the concepts and methods of welfare economics, it is not even clear what it means to say that one alternative is better for the stakeholders collectively than another. Nevertheless, advocates of the stakeholder theory have entirely failed to appreciate this fact and have made virtually no efforts to integrate the concepts and methods of welfare economics into their account of corporate governance.

I have indicated some of the many challenges that stakeholder advocates would face were they to begin to do so. Most importantly, they would have to make controversial value judgments (e.g., by choosing one social welfare function over others), and they would have to make some heroic assumptions about the cardinal preferences of individuals, assumptions that are strong enough to support the measurement of cardinal preferences and interpersonal comparisons of cardinal utility. These may seem to be daunting challenges, but until stakeholder theorists confront the problems of welfare economics implicit in their theory and explain, consistent with known results in that discipline, how directors are to aggregate the individual preferences of stakeholders to reach a collective decision, stakeholder theory will not have matured into a serious and intellectually respectable theory of corporate governance.

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