Three Conceptions of Capitalism

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The Wallenberg Lecture

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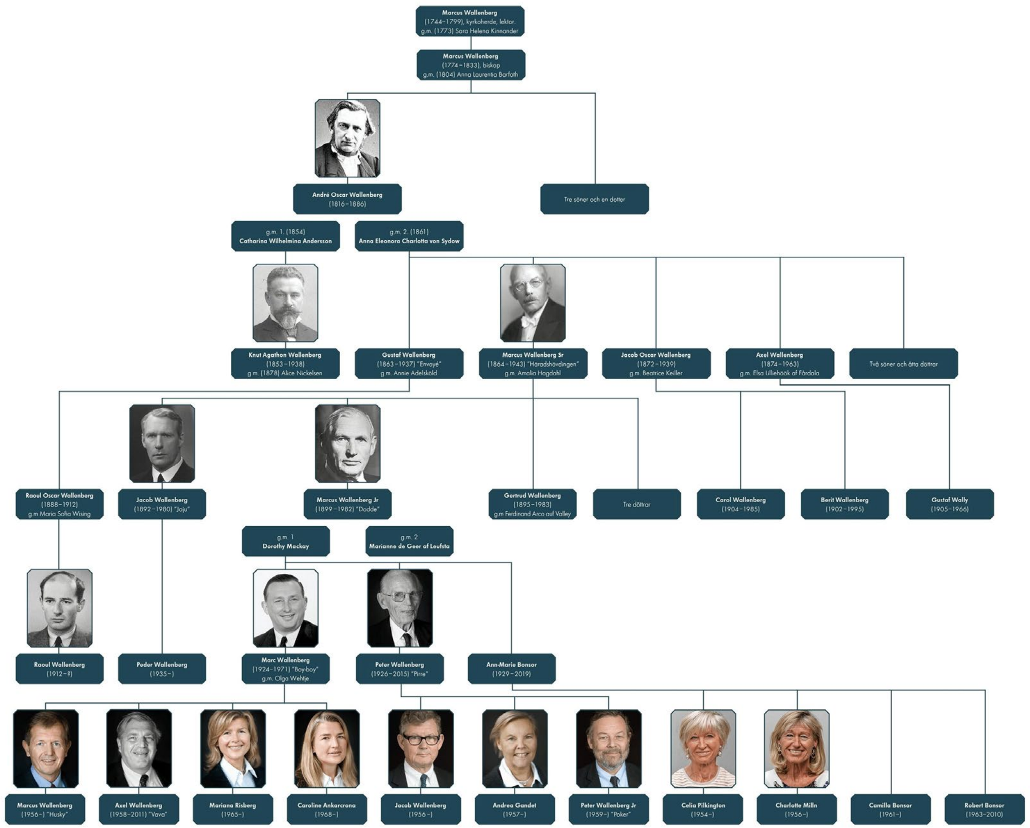
The Wallenberg Family Example

- An inspiring example of using business to produce social benefits
- The assets that the family developed, which represent a significant part of the Swedish economy, are currently owned by family foundations and:
  - The assets are managed with a close attention to stakeholder effects and a long-term orientation, and
  - Much of the value owned to shareholders is contributed by the foundations to projects with societal benefits.



What Should We Learn from the Wallenberg Family Example?

- Should we advocate, and hope, that business leaders follow the Wallenberg example and run business much more to the benefit of stakeholders and society than we have seen thus far?

Yes, we can

No, we cannot

The Wallenberg example should inspire us to look for ways to make capitalism work well for society at large–**even when business leaders are not all driven by the moral and societal commitments that have guided the Wallenbergs over the past century**.

Motivation

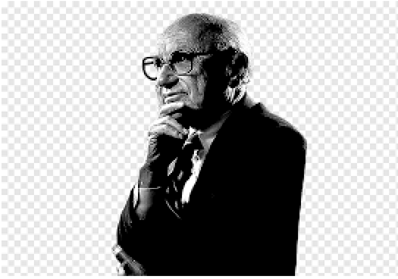
- Provides a framework for thinking about, evaluating, and comparing alternative conceptions of capitalism.
- Use this framework to discuss and explain, based on my work in recent years, my support for one of these conceptions.

Part One: Framework

Three Rival Conceptions:

- Friedmanesque Capitalists.
- Managerial Stakeholderists.
- Democratic Capitalists.

Friedmanesque Capitalism



- Supports a corporate focus on maximizing shareholder profits, and a limited-role government.
- Named after the view put forward by Milton Friedman (1970), and associated also with others at the Chicago School of Economics.

Managerial Stakeholderism

- Advocate encouraging and relying on corporate leaders to use their discretion to serve not only shareholders but also stakeholders.
- Endorsed by many corporate leaders and leader groups, including by the Business Roundtable Statement on Corporate Purpose (2019) and the Davos Stakeholder Capitalism Manifesto (2020).

Managerial Stakeholderism (Cont.)

- Two versions (Bebchuk and Tallarita (2020):
  - Instrumental stakeholderism: Take stakeholder interests into account if, when, and to the extent that doing so would serve stakeholder value.
  - Pluralistic stakeholderism: Corporations should give independent weight to stakeholder interests – and be prepared to serve them in some cases even at the expense of shareholder interests.

Alternative Versions of Stakeholderism (1): Enlightened Shareholder Value

- Corporations should protect stakeholders if/when doing so would serve long-term shareholder value.

But suppose that corporate leaders seek to maximize long-term shareholder value. In this case:

- Enlightened shareholder value would not be operationally different from shareholder value.

Alternative Versions of Stakeholderism (1): Enlightened Shareholder Value (Cont.)

Suppose, however, that corporate leaders do not maximize long-term shareholder value because they have incentives to give some weight to short-term value. Can advocating Enlightened Shareholder Value be used to address such short-termism?

- No, because:
  - Leaving short-termist incentive systems in place, and merely urging corporate leaders (as ESV does) to fully consider effects they are not incentivized to fully consider, is unlikely to have an effect; and
  - The most effective way to address the problem is to fix the incentives of corporate leaders, not to urge them to consider long-term effects.

An Alternative Version of Stakeholderism (2): Pluralistic Stakeholderism

- Corporations should give independent weight to stakeholder interests – and be prepared to serve them in some cases even at the expense of shareholder interests => this <u>can</u> lead to operationally different instructions than Friedmaneqsue capitalism.
- Whichever version of stakeoholderism is used to guide corporate leaders, given the business judgment rule, corporate leaders can use their discretion to serve stakeholders in either an instrumental way or a pluralistic way.

Democratic Capitalism

- Supporters have deep concerns about corporate externalities.
- But are skeptical that corporate leaders could be expected to serve stakeholders beyond what would serve shareholder value.
- To make capitalism work for stakeholders and thus society at large, Democratic Capitalists support adopting external laws, regulations and policies that would constrain and incentivize companies. (e.g., carbon taxes/subsidies to address climate change, labor-protecting laws to protect employees).
- My own view falls within this conception.

Four Questions

- To choose among these conceptions, one should ask oneself four basic questions.
- One’s answer to these questions provides a framework for assessing the conceptions and for making a choice among them.

Question 1: How Well Is Capitalism Working for Stakeholders?

(A) Reasonably Well, Thank You.

Friedmanesque Capitalists

["the free market system [is] the secret of the enormous improvement in the conditions of the working person." (*Free to Choose* at 247)]

(B) Not Well.

Managerial Stakeholderists

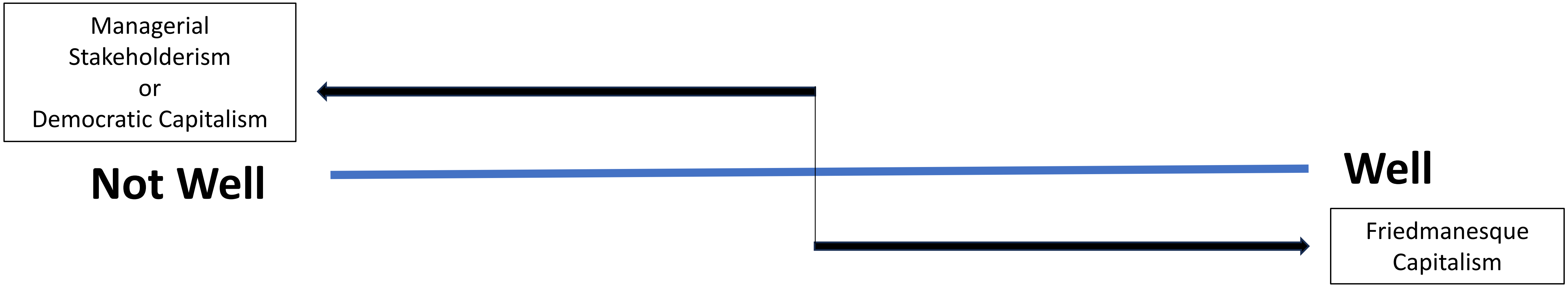
[e.g. Henderson (2020): "[t]he world is on fire")]

Democratic Capitalists

[e.g., Bebchuk and Tallarita (2020)]

Question 1: How Well Is Capitalism Working for Stakeholders? (Cont.)

- The closer one is to viewing capitalism as working well for stakeholders, the more one is pulled toward Friedmanesque Capitalism and away from the other two conceptions.
- Conversely, the closer one is to viewing capitalism as not working well for stakeholders, the more one is pulled toward Managerial Stakeholderism or Democratic Capitalism.



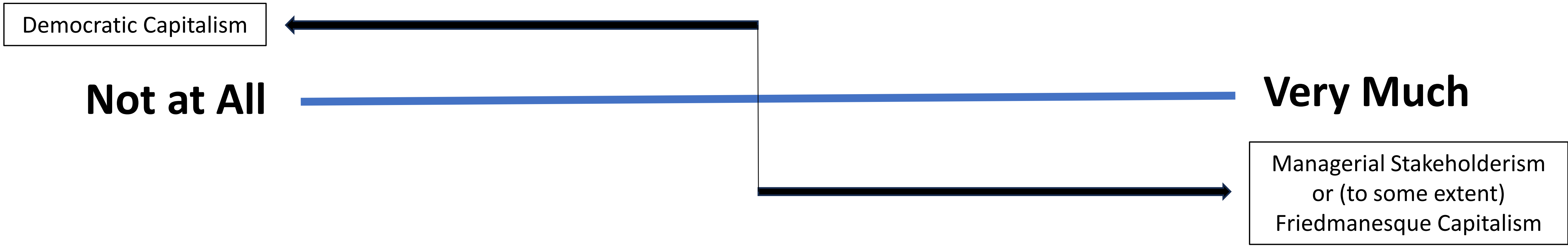
Question 2: Can Corporate Leaders be Expected to Use their Discretion to Protect Stakeholders?

A. Yes, Corporate Leaders can be expected to be guided by the stipulated corporate purpose.
    - Managerial Stakeholderists.
    - Possibly also Friedmanesque Capitalists (Friedman (1970)).

B. No, It’s the incentives, stupid.
    - Democratic Capitalists.

Question 2: To What Extent Should Corporate Leaders be Expected to Protect Stakeholders? (Cont.)

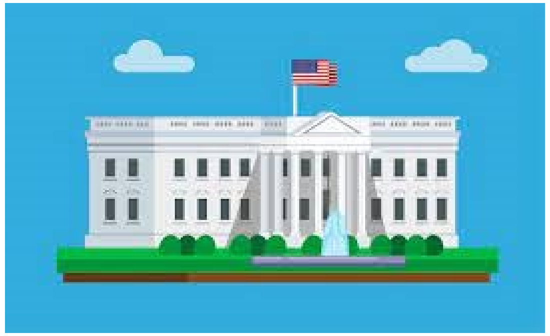
- The closer one is to expecting corporate leaders to generally use discretion to protect stakeholders for this purpose, the more one is pulled toward managerial stakeholderism.
- Conversely, the closer one is to expecting corporate leaders to use discretion awarded to protect stakeholders for this purpose, the more one is pulled toward managerial stakeholdenism.



Question 3: Are Government Interventions Beneficial and Available?

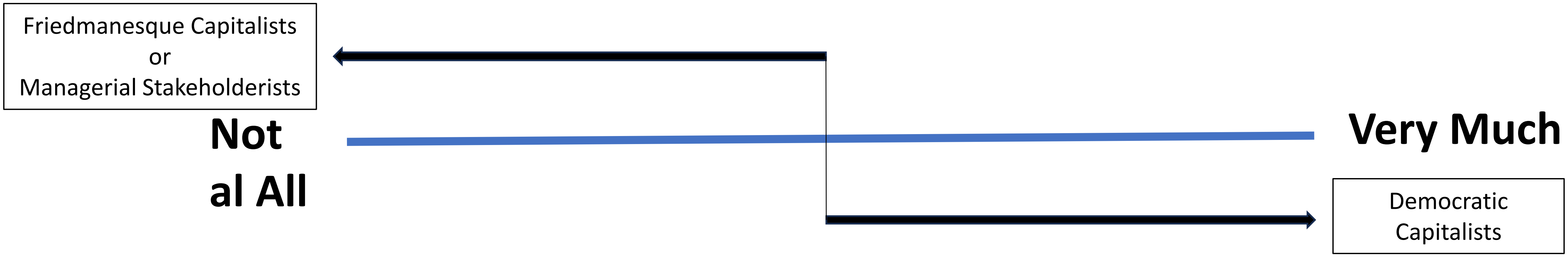
A. No, Government Interventions are Costly or at least Unavailable.
   - Friedmanesque Capitalists – government interventions are the problem, not a solution.
   - Managerial Stakeholderists – stress the need for a private-ordering solution.

B. Yes, Government interventions are indeed indispensable.
   - Democratic Capitalists.



Question 3: To What Extent Should Government Interventions be Expected to Work? (cont.)

- The closer one is to viewing governmental interventions as unavailable or too costly, the more one is pulled toward Friedmanesque Capitalism or Managerial Stakeholderism.
- Conversely, the closer one is to viewing governmental interventions as potentially effective, the more one is pulled toward Democratic Capitalism.



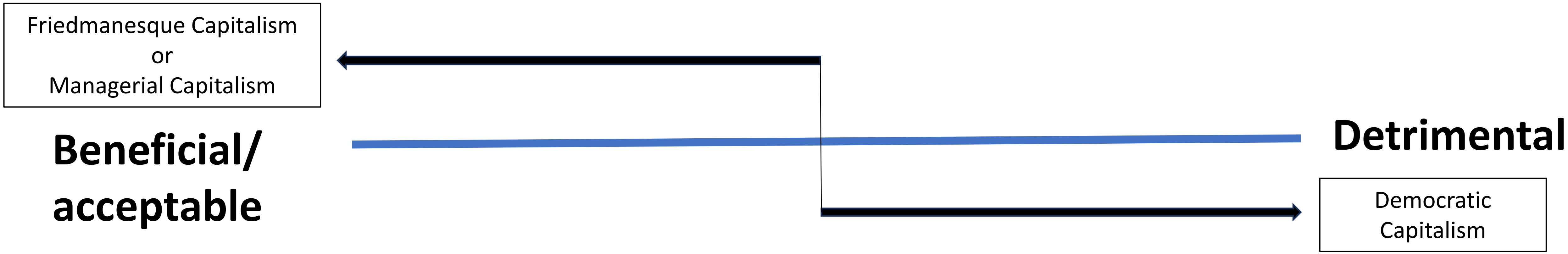
Question 4: To What Extent is Corporate Political Spending and Lobbying Detrimental or Beneficial / Acceptable?

A. Corporate politicking has a beneficial (or at least acceptable) role
   - Friedmanesque Capitalists – corporate politicking is a beneficial check and counterweight to the interventionistic and value-decreasing inclinations of government bureaucrats.
   - Managerial Stakeholderists (take corporate politicking as given).

B. Corporate politicking is detrimental because it weakens the democracy's ability to constrain and regulate corporate behavior.
   - Democratic Capitalists.

Question 4: Is Corporate Politicking Detrimental or Beneficial / Acceptable? (Cont.)

- The closer one is to viewing corporate politicking negatively, the more one is pulled toward Democratic Capitalism.
- Conversely, the closer one is to favoring or at least accepting corporate politicking, the more one is pulled toward Friedmanesque Capitalism or Managerial Stakeholderism.



Implications (1): Alternative Critiques of Managerial Stakeholderism

- Both Friedmanesque Capitalists and Democratic Capitalists reject the currently influential views of Managerial Stakeholderists.

  => this has led some managerial stakeholderists, as well as some commentators, to conflate these two critiques.

  [See e.g., Savitt and Kovalli (2021), Financial Times (2021)]

Implications (1): Alternative Critiques of Managerial Stakeholderism (Cont.)

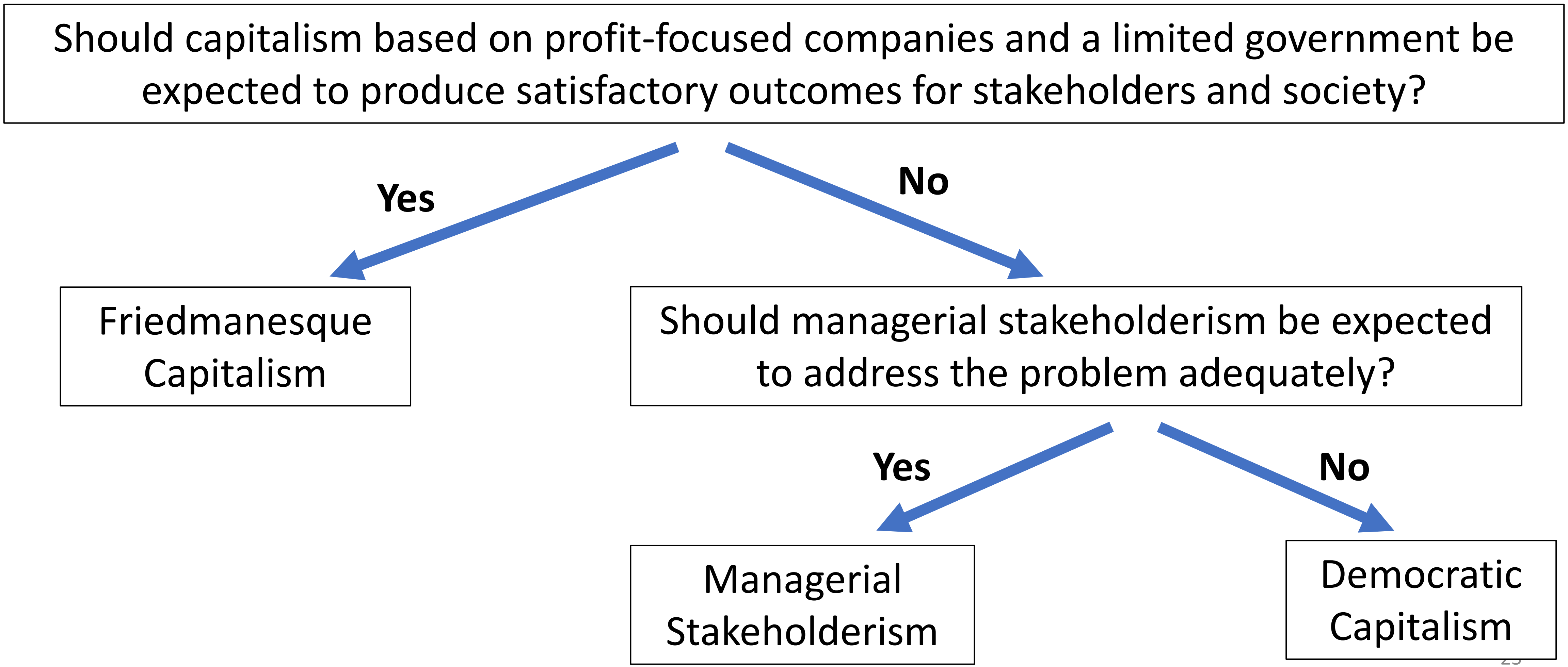
Friedmanesque Capitalists and Democratic Capitalists drastically differ:

- First, Friedmanesque Capitalists and Democratic Capitalists start from very different premises concerning how capitalism performs, and therefore they start with very different motivations.
- Second, whereas both Friedmanesque Capitalists and Democratic Capitalists don't support (or even oppose) urging corporate leaders to protect stakeholders, they do so for very different reasons.
- Third, Friedmanesque Capitalists and Democratic Capitalists fundamentally differ in the role they would like the government to play.
- Fourth, Friedmanesque Capitalists and Democratic Capitalists differ markedly in how they view constraints on the political power of companies.

Implications (2): The Choice that Stakeholder Supporters Face

- For stakeholder supporters, who seek to improve substantially the problems for stakeholders that result from markets with profit-focused companies and limited-role government, face a choice between Managerial Stakeholderists and Democratic Capitalism.

Implications (2):
The Choice that Stakeholder Supporters Face (Cont.)



Choosing among the Three Conceptions: Different Approaches for Different Stakeholder Types?

- Might corporate leaders be more sensitive /attentive to the interests of some stakeholders (who are closer/more visible to them) than of others? Might markets protect some stakeholders (e.g., suppliers) but not others (the planet)?

=>One who identifies major differences might adopt a different approach for some areas than for others. (E.g., be Friedmanesque with respect to suppliers but Democratic Capitalist with respect to protecting the planet.)

Different Approaches for Different Stakeholder Types? (Cont.)

- But there is a limitation to using different approaches for different stakeholder groups:
  - Corporate leaders cannot be expected to serve any stakeholders beyond what would serve stakeholder value.
  - Because it is difficult to limit corporate influence to some areas, even if regulatory interventions are currently not needed for some areas, it is beneficial to have general limits on the ability of companies to spend on politics.

Part Two: Why I Support Democratic Capitalism and Reject Managerial Stakeholderism

This Part Two

Builds on a series of published and current articles in defense of Democratic Capitalism and opposition to Managerial Stakeholderism:

- Bebchuk & Tallarita (2020), The Illusory Promise of Stakeholder Governance.
- ------ (2022a), Will Corporations Deliver Value to all Stakeholders?.
- ------ (2022b), The Perils and Questionable Promise of ESG-Based Compensation.
- Bebchuk, Kastiel, and Tallarita (2021), For Whom Corporate Leaders Bargain.
- ------ (2022a), Stakeholder Capitalism in the Time of Corona.
- ------ (2022b), Does Enlightened Shareholder Value Add Value?
- Bebchuk, Kastiel and Toniolo (2023), How Twitter Pushed Stakeholders Under The Bus.
- Bebchuk and Kastiel (forthcoming), ESG Stewardship
- Bebchuk (forthcoming), The Limits of Nonmanagerial Stakeholderism.

Theory: The Incentives Problem

- My earlier work (Bebchuk & Tallarita 2020), provides analysis of the array of incentives that corporate leaders face, and the various markets within which they operate.
- This analysis concludes:
    - Corporate leaders have incentives **not** to serve stakeholder interests beyond what would serve shareholder value.

Evidence: The Incentives Analysis is Consistent with the Empirical Evidence – Stakeholder Talk is Mostly for Show

- This is the case:
  - Even when corporate leaders are allowed or even required to do so (thus, director duties to stakeholders cannot help)…
  - And even when corporate leaders engage in substantial stakeholder rhetoric ….

Evidence that Current Stakeholderist Talk is Mostly for Show (1): BRT Companies

- CEOs joining the BRT statement generally did not obtain board approval either *ex ante* or *ex post.*

[Bebchuk & Tallarita (2020), Part III]

Evidence that Stakeholderist Talk is Mostly for Show (2): Post-joining Behavior of BRT Companies

- Generally left intact explicit commitment to shareholder primacy in the many cases in which corporate governance guidelines were updated.

[*Will Corporations Deliver Value to All Stakeholders?,* Part III]

- Universally left director compensation substantially linked to stock price without any link to stakeholder metrics.

[*Will Corporations Deliver Value to All Stakeholders?,* Part VI]

- Stated in securities filings in response to many shareholder proposals that they did not expect or plan any changes following their joining the BRT commitment.

[*Will Corporations Deliver Value to All Stakeholders?,* Part IV]

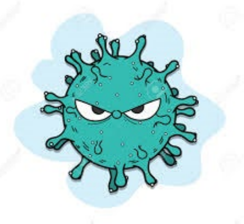
Evidence that Stakeholderist Talk is Mostly for Show (3): For Whom Corporate Leaders Bargain

- This study provides empirical evidence on how corporate leaders used their negotiating power in all sales to private equity buyers in the past two decades that were governed by statutes allowing corporate leaders (and in a few cases requiring them) to give weight to stakeholder interests.
- We found that corporate leaders:
  - Obtained gains for shareholders and for the private interests of corporate leaders; and
  - Did not obtain protections for the interests of employees or any other stakeholders.

[Bebchuk, Kastiel, and Tallarita, *For Whom Corporate Leaders Bargain*, 2021]

Evidence that Stakeholderist Talk is Mostly for Show (4): Stakeholder Capitalism in the Time of Covid

- The Covid pandemic period:
  - Followed the Business Roundtable Statement, the Davos Manifesto, and other stakeholderist pledges;
  - Elevated concerns about the vulnerability of stakeholders; and
  - Was accompanied by many statements that corporate leaders indeed care for their stakeholders.
- This study examines in detail the terms of over 100 acquisitions of $1B+ publicly traded companies during the pandemic (total consideration exceeding $600B).



Stakeholder Capitalism in the Time of Covid (cont.)

- We found that corporate leaders negotiated for:
  - Large gains to shareholders (aggregate premiums exceeding $100B), and
  - Substantial gains to the private interest of corporate leaders.

But corporate leaders generally did not negotiate for **any material protections for stakeholder interests.**

[Bebchuk, Kastiel, and Tallarita (2022), *Stakeholder Capitalism in the Time of Covid.*]

Evidence that Stakeholderist Talk is Mostly for Show (5): Twitter Stakeholders Under the Bus

- This article (Bebchuk, Kastiel, and Toniolo (2023)) provides a case study of how Twitter's leaders pushed their stakeholders under the bus when negotiating the sale to Elon Musk.
- Prior to the sale, Twitter had long expressed commitments to their employees ("the Tweeps") and to various values the company was said to be committed to serve.
- However, when negotiating a sale to Musk that provides shareholders and corporate leaders with massive monetary gains, Twitter's corporate leaders chose not to seek any deal protections for stakeholders to allocate to them part of the surplus.

But Stakeholderism Can’t Hurt?

- It might be argued that, even if stakeholderism should not be expected to deliver material benefits, it can’t hurt from the perspective of stakeholders… and can only move things in a positive direction…
- However, acceptance of stakeholderism would be counterproductive because it would produce two major costs.

The Perils of Stakeholderism (1): Reduced Accountability

- Some corporate leaders and advisors use stakeholderism to urge institutional investors to be more deferential to corporate leaders, and more accepting of arrangements insulating management from market pressures.

- The result: reduced accountability that would raise managerial slack =>This **would benefit the private interests of managers, but not shareholders or stakeholders.**

The Perils of Stakeholderism (2): Chilling Stakeholder-Oriented Reforms

- Acceptance of stakeholderism raises illusory hopes that corporate leaders would protect stakeholders on their own.
- This could substantially chill or impede efforts to obtain regulatory reforms that could produce real benefits for stakeholders.
- For example, illusory hopes that corporate leaders would on their own contribute to addressing climate change would impede reforms based on carbon taxes/subsidies.

[Counter-argument: Stakeholderist rhetoric by corporate leaders makes intervention seem more legitimate? Perhaps, but the problem is that it also makes intervention appear unnecessary.]

Part Three: Can Nonmanagerial Stakeholderism Do Better?

Nonmanagerial Stakeholderism

- Like managerial stakeholderism, nonmanagerial stakeholderism seeks to protect stakeholders by changing internal corporate governance processes.
- Unlike managerial stakeholderism, however, nonmanagerial stakeholderism does not count on managerial use of discretion to serve stakeholders.
- But my earlier and current work:
  - Identifies and discusses five versions of nonmanagerial stakeholderism; and
  - Explains why I do not view any of them as significant improvement over managerial staekholderism.

(i) Mandatory Pro-stakeholder Fiduciary Duties

- Idea: Replace discretion to take into account stakeholder preferences with <u>requiring</u> leaders to take stakeholder preferences into account and maximize aggregate stakeholder interests.

But:

- Aggregate stakeholder interest is hardly a well-defined concept.
- And even if it were, this would have little practical significance as long as the business judgment rule is in place and courts thus do not second-guess the decisions made by corporate leaders.
- And eliminating the business judgment rule would require courts to micro-manage corporate decisions – highly impractical and costly.

[Bebchuk and Tallarita (2020)]

(ii) Stakeholder Directors

- Idea: If current directors are incentivized to focus on shareholder interests, perhaps introduce directors that are committed to stakeholder interests – directors that are elected by stakeholder group/s or at least to represent stakeholder group/s.
- Could perhaps be done for employees through a co-determination system in countries where employees have a union representing them.
- But cannot do it in general because:
    - Would be highly problematic with two or more stakeholder groups.
    - For most stakeholder groups, it is hard to envision a well-functioning system for electing directors and for incentivizing them.

  [Bebchuk and Tallarita (2020)).

(iii) Harnessing shareholder power

- Idea: Count on shareholders (either institutional investors or their beneficial investors) to induce/force managers to protect stakeholders
- Much current work and substantial attention to ESG stewardship of institutional investors.
  - But due to their agency problems and private interests of institutional investors (Bebchuk, Cohen, and Hirst (2017), Bebchuk and Hirst (2019), Bebchuk and Kastiel (2023)), the promise of ESG stewardship by institutional investors is also quite limited -- such investors are likely to talk big but do much less for the protection of stakeholders.

[Partly for this reason, Hart-Zingales (2017, 2022) look to the prosocial preferences of beneficial investors but their mechanism faces substantial implementation problems.]

(iv) Fixing Incentives?

- Can we fix incentives and get corporate leaders to deliver to stakeholders by adopting ESG-based pay arrangements?
- The promise of such pay arrangements is highly questionable (Bebchuk and Tallarita (2022):
    - Current practices fail to provide effective incentives to protect stakeholders; and
    - Because ESG-based compensation is difficult for outside investors to scrutinize effectively, using it would likely increase executive payoffs in a performance-insensitive way, reversing decades of progress, rather than provide effective incentives to protect stakeholders.

(v) Customer and Employee Pressures

- Employees and customers, and especially millennials (Barzuza 2021), might boycott firms and thus discourage mistreatment of stakeholders that would otherwise be profit-maximizing.
- To the extent that this is the case, then even Friedmanesque capitalists would oppose such mistreatment. Thus, to the extent that one concludes that the operations of profit-focused firms do not provide adequate protection, this conclusion already implies that this factor is insufficient.
- But can we count on this factor to be sufficiently strong to take care of the future?
- No because customers and employee pressure is an irrelevant factor in many circumstances (e.g., mistreatment that is not salient, customers and employees that cannot afford to make decisions based on prosocial preferences, sufficient supply and demand from customers and employees without prosocial preferences, etc.).
- And no reason to expect the calculus of customers and employees to overlap with that of societal welfare.

A Final Slide

In this talk I sought to:

- Provide a framework for choosing among the rival conceptions of Friedmanesque Capitalism, Managerial Stakeholderism, and Democratic Capitalism.
- Use this framework to discuss why I support Democratic capitalism and oppose Managerial Stakeholderism (as well as its Nonmanagerial Stakeholderism cousin).

My conclusion:

- The promise of stakeholderism (whether managerial or nonmanagerial) is illusory.
- Instead of attempting to rewire internal corporate governance, those concerned about stakeholders should focus on protecting them through adopting external rules and regulations.