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Corporate Purpose: Theoretical and Empirical Foundations/ Confusions

Law Working Paper N° 664/2022

November 2022

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We thank participants at the conference on "The Public Corporation and Its Environment: How 'Public' Is It?" (Eberhard Karls University Tübingen, June 2022) and Roberto Tallarita for helpful comments, and Rosina Curren for outstanding research assistance.

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Abstract

Does it matter if corporate leaders pursue a broader, social corporate purpose rather than a narrow, shareholder-centric one, and can legal and governance levers influence their choice? Theoretically—and limited by substitution, regulation, and legitimacy—socially-minded corporate decision-making can benefit society ex post, while commitment to either purpose may be required to motivate various constituencies' contributions ex ante. Empirically, however, even structural measures like employee co-determination hardly have detectable effects, let alone mere exhortations such as those in (unenforceable) nuances of (misunderstood) fiduciary duties. Many arguments for or against (particular) corporate purpose(s) are fallacies, red herrings, or, for empirics, cherry-picking.

Keywords: corporate purpose, ESG, CSR, sustainability, fiduciary duties, co-determination, constituencies, shareholder value, shareholder primacy, stakeholders

JEL Classifications: G30, J5, K22

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Holger Spamann & Jacob Fisher [*]

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Contents

Introduction 1
I. Theory of Purpose 2
A. Is Corporate Purpose Irrelevant? 3
1. "Doing Well by Doing Good" 3
2. Friedman's Legitimacy Argument 4
3. Substitution Effects 6
B. Corporate Purpose As Commitment 7
1. Commitment and Contractual Incompleteness 7
2. Shareholder Primacy 8
C. Institutional Underpinnings 9
1. External Regulation 10
2. Fiduciary Duties 10
a) The Shareholder/Stakeholder Distinction is Not Enforceable 11
b) The Nominal Content of Fiduciary Duties in Current Law 11
3. Structural Governance 14
a) Board Elections 14
b) Anti-Takeover/Activist Devices 15
4. Executive Pay 15
II. Empirics of Purpose 16
A. Corporate Purpose Proper 17
B. Fiduciary Duties 18
C. Structure 19
D. Owners 21
E. Sustainability: Disclosure, Performance, and Returns 22
Conclusion 24

INTRODUCTION

"Corporate purpose" is the talk of the town.[1] But what does it mean, what difference might it make in theory, and are there any data to support the theory?[2] Our answers are "many things," "relatively little," and "virtually none."

We mostly focus on corporate decision-makers' ultimate decision criterion, specifically the choice between social values and "shareholder value," and on attempts to influence it through the law or the corporation's governing documents, be it by explicit mandate or implicitly through the corporation's governance structure.

We begin with the theory in part I. Pursuing social values will sometimes generate better social outcomes than profit-maximization. However, the difference may be small. One reason is that individual firms' pro-social actions are often undermined by market substitution and value pluralism. Another reason is that direct regulation of externalities, binding contracts, and market demand constrain profit-maximization to respect most social concerns. The corporation's decision criterion matters only in the gaps left by these constraints. The biggest gap concerns equity investors, i.e., shareholders. By definition, equity has no legal rights to payment; it depends entirely on a corporate commitment to make at least some decisions, such as dividend payments, in their favor. Commitment is provided by structural governance such as board electorates rather than fiduciary duties, which we show to be not nearly as important or sociopathic as often assumed.

We then discuss the empirical evidence, or rather the lack of (good) evidence, in Part II. The challenges to obtaining good evidence in this area are formidable: plausible effects are subtle and arguably systemic, and thus hard to impossible to detect with convincing causal inference. What good evidence we have suggests at most modest immediate effects even of policies that many consider radical, such as employee co-determination.

Our reason to focus on corporations' ultimate decision criterion is that this is what policy makers possibly could and should influence.[3] In the empirical part II.A, we briefly touch upon other ways of understanding purpose that would be germane for management but not regulators. Businesses—legal or not—may operate more successfully if they develop and maintain a coherent organizational identity.[4] But if this is the case, corporate leaders and investors have strong incentives to create such an identity; regulatory intervention is unnecessary.

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[1] *Cf.* Elizabeth Pollman & Robert B. Thompson, *Corporate Purpose and Personhood: An Introduction* to RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD ix (Elizabeth Pollman & Robert B. Thompson eds., 2021) ("Purpose has become the frontline of a wide-ranging debate over shareholder vs. stakeholder primacy and profit maximization vs. broader social purposes.").

[2] *Cf.* Edward B. Rock, *For Whom Is the Corporation Managed in 2020? The Debate over Corporate Purpose*, 76 BUS. LAW. 363 (2021); Edward B. Rock, *Business Purpose and the Objective of the Corporation*, *in* RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD, *supra* note 1, at 27 (distinguishing the legal mandate, finance academics' assumptions, the managerial perspective, and a political debate); Robert T. Miller, *Corporate Personality, Purpose, and Liability*, *in* RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD, *supra* note 1, at 222 (distinguishing different philosophical and legal perspectives).

[3] The stress here is on policy-makers, not on influence. In any understanding, corporate purpose is set by humans, albeit possibly different humans than policy-makers. Even writers who argue that the corporation *has* an (Aristotelian) purpose of its own accept that this purpose is defined by the corporation's community and thus, ultimately, humans. *Cf.*, *e.g.*, Robert C. Solomon, *Aristotle, Ethics and Business Organizations*, 25 ORG'N STUD. 1021 (2004).

[4] This is related to, but distinct, from "corporate culture," a set of values such as adaptability and integrity practiced inside the organization, which corporate leaders find very important. *See* John R. Graham, Jillian Grennan, Campbell R. Harvey & Shivaram Rajgopal, *Corporate Culture: Evidence from the Field*, 146 J. FIN. ECON. 552 (2022).

* * *

We briefly dispense with fallacious arguments denying a real choice between social values and "shareholder value."

On the "shareholder value" side, an argument often associated with Michael Jensen is that a corporation—more specifically, its decision-makers—must have one single purpose because "[i]t is logically impossible to maximize in more than one dimension at the same time."[5] The argument is correct as far as it goes (leaving aside the cognitive-behavioral question whether humans truly maximize in complex situations, whatever their avowed goal). It does not follow, however, that corporate decision-makers can only care about a single constituency such as shareholders. Mathematically, secondary goals can be specified as constraints in a constrained maximization problem, and multiple goals can be transformed into a single maximand by means of an aggregation/weighting function such as a social welfare function. Social welfare is hard to maximize, but so is shareholder value.[6]

On the social values side, asking about "the" corporate purpose—as if there were only one—suggests the false necessity that a broad "social purpose" is the normatively right answer everywhere. We take for granted that policy-makers should create and regulate corporations only for the public interest. In ultimate pursuit of the public interest, however, policy-makers may set a different proximate goal for corporate decision-makers. In particular, policy-makers may *instrumentally* condone purely financial corporate objectives in the belief—*à la* Adam Smith—that the private profit motive unwittingly serves the public interest.[7]

Finally, any enthusiasm for well-sounding social purpose slogans should be tempered by the realization that some of the most pathetic companies were (in)famous for slogans exposed as hollow when the companies collapsed.[8]

I. THEORY OF PURPOSE

What difference can the choice between various corporate purposes make, and how is it made?

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[5] Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 14 J. APPLIED CORP. FIN. 8, 10 (2001).

[6] At a minimum, maximizing "shareholder value" involves a prediction of an action's complex consequences, including trade-offs between many intermediate goals (e.g., customer satisfaction vs. production costs). Perhaps "shareholder value" is on average easier to maximize than "social welfare" because the former takes fewer ingredients than the latter, or because, viewed dynamically as a repeated problem, the former gets some feedback from the stock market. But the additional computational and informational costs of pursuing "social welfare" may be outweighed by the benefits. *Cf.* Dorothy S. Lund, *Enlightened Shareholder Value, Stakeholderism, and the Quest for Managerial Accountability*, *in* RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD, *supra* note 1, at 91 (arguing that various measures other than stock price are already being used to incentivize managerial behavior). For distributional questions (i.e., the division of profits ex post), welfare maximization is ill-defined (i.e., there is no maximum—all divisions are equally good) if one does not consider declining utility of wealth (*see* Robert T. Miller, *How Would Directors Make Business Decisions Under a Stakeholder Model?*, BUS. LAW. (forthcoming 2022)); see section III.B.2. for a related argument that shareholder primacy is particularly compelling as an ex ante rule for distributions.

[7] *Cf.* ADAM SMITH, THE WEALTH OF NATIONS 16 (ΜεταLibri, 2007) (1776) ("It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.").

[8] For a recent example, compare The We Company, Form S-1 Registration Statement (draft filed 8/14/2019) (perma.cc/M5DK-8YKP) at 1 ("We are a community company committed to maximum global impact. Our mission is to elevate the world's consciousness.") with ELIOT BROWN & MAUREEN FARRELL, THE CULT OF WE (2022) (the company's main mission seemed to be to enrich its egocentric founder, and its main impact was to waste investor money).

A. Is Corporate Purpose Irrelevant?

Commentators from both sides of the spectrum have argued that, properly understood, there is *ultimately* no difference between pursuing corporate profit and pursuing the social good. (1) From the social side, a common refrain is that corporations and investors "do well by doing good": doing the right thing ends up being the profitable thing to do.[9] (2) From the other side, Milton Friedman famously argued in 1970: "The Social Responsibility of Business Is to Increase Its Profits."[10] To be sure, these two arguments are diametrically opposed regarding the *proximate* goal that corporations should pursue. (3) A third argument, however, is that this proximate goal does not even matter: substitution from or to other corporations in markets will offset any individual corporation's choice. All three arguments contain a kernel of truth.

1. "Doing Well by Doing Good"

In a trivial sense, "doing well by doing good" describes most of what businesses do. To make money legally, businesses generally must offer a useful product and attractive employment.

Even when regulation runs out, such as sourcing inputs from less regulated countries, companies face long-term reputational constraints through consumer and employee choice. Companies vie for customers and employees through "sustainable sourcing," "fair trade," "living wages," and the like. To the extent this is true, profit and welfare maximization coincide.

However, the interesting cases—the reason to debate corporate purpose—are those where private profit and social good diverge. Such cases surely exist. For example, even if pumping oil is socially harmful and frowned upon, a corporation whose sole asset is an oil well will make more money pumping the oil than shutting the well.[11] In general, regulation is incomplete, and it would be miraculous if reputational penalties always exactly offset the potential gain from doing bad.

For operating companies, an important saving grace of the "doing well by doing good" mantra is commitment: to gain the business of consumers, employees, and suppliers today, the company may have to credibly commit to be good to them tomorrow (*infra* B.1). For investors' capital allocation, however, this point does not hold because, to the extent commitment of capital is important, it is almost always laid down in a binding contract, and the exceptions including relationship banking are irrelevant for standard portfolio investment. Investors thus *must* do (financially) worse by doing (social) good with their money, i.e., preferentially funding "good" businesses.[12] The reason is that old-fashioned, purely money-oriented investors are happy to fund "good" and "bad" projects alike, taking into account any effects of "good" or "bad" on expected returns. "Doing good" by investing thus must mean handing capital to "good" businesses at more favorable terms—i.e., lower cost of capital—than those available from other investors. Businesses'

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[9] *Cf., e.g.*, the very title of INT'L FIN. CORP., WHO CARES WINS: CONNECTING FINANCIAL MARKETS TO A CHANGING WORLD (2004). This report coined the term "ESG." *See* Elizabeth Pollman, *The Making and Meaning of ESG* 11 et seq. (ECGI, Law Working Paper No. 659/2022, 2022).

[10] Milton Friedman, *The Social Responsibility Of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 17.

[11] It could sell the well, but the only profit-minded buyer for the well would be one who pumps the oil.

[12] Cliff Asness, *Virtue Is its Own Reward: Or, One Man's Ceiling Is Another Man's Floor*, AQR (May 18, 2017), https://www.aqr.com/Insights/Perspectives/Virtue-is-its-Own-Reward-Or-One-Mans-Ceiling-is-Another-Mans-Floor (perma.cc/CF3D-N9QL); Ľuboš Pástor, Robert F. Stambaugh & Lucian A. Taylor, *Sustainable Investing in Equilibrium*, 142 J. FIN. ECON. 550 (2021); Lasse Heje Pedersen, Shaun Fitzgibbons & Lukasz Pomorski, *Responsible Investing: The ESG-Efficient Frontier*, 142 J. FIN. ECON. 572, 573 (2021) ("restricting portfolios to have any ESG score other than that of the [mean-variance efficient] tangency portfolio must yield a lower maximum [Sharpe ratio]").

cost of capital and investors' return are two sides of the same coin, however: if one goes down, so does the other. This runs counter to self-interested slogans of a growing "sustainable investment" industry, but it is logically inescapable.

Transition can temporarily mask this logic. While investors worldwide develop a taste for "sustainability" and reallocate funds from "normal" to "sustainable" investment, demand for "good" assets increases such that their prices go up and their initial owners earn high returns.[13] By the same token, however, *future* returns after the transition will be lower (high price = low *expected* return). Moreover, the financial beneficiaries of the transition may well be prescient money-minded investors, not "sustainable investors."

To be sure, people make mistakes. If businesses and investors underestimate the financial promise of "good" products and technologies, then "doing good" will do financially well because it offsets this mistake. There is no reason to suspect that people systematically make this mistake, however: they might just as well be mistaken in the opposite direction.

2. Friedman's Legitimacy Argument

Charitably reconstructed, Friedman's argument was that conflicts between competing social goods or groups pose tradeoffs, that these tradeoffs are democratically decided through regulation, and that corporate executives illegitimately override this decision if, going beyond the regulation, they shift costs on others such as shareholders (through reduced profits) or consumers (through higher prices).[14] In this view, deviating from profit maximization for an ostensible social good ends up hurting the true social good, democratically understood.

Friedman's view has become a punching bag. Many think that "the problems"—especially climate—"are too urgent to wait on the slow course of political processes, that the exercise of social responsibility by businessmen is a quicker and surer way to solve pressing current problems." Friedman anticipated this objection: the quote is from his 1970 essay. He rejected it because, in his view, "it amounts to [] an assertion that those who favor the taxes and expenditures in question have failed to persuade a majority of their fellow citizens to be of like mind and that they are seeking to attain by undemocratic procedures what they cannot attain by democratic procedures."

The common rejoinder is that today's political process is "broken" or "dysfunctional," and thus its outcomes not "really" democratic. The premise raises deep factual and normative questions. At the very least, its suggested practical implication risks backlash. Consider the main lightning rod for much of the contemporary corporate purpose debate, climate change. Policies to curb it, such as (more aggressive) carbon taxes, have not been adopted because they have not garnered sufficient political support. Those that were adopted often faced serious popular resistance, such as the fuel

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[13] Pástor, Stambaugh & Taylor, *supra* note 12.

[14] Friedman framed most of his argument in terms of the "property" right of the "owners of the business," by which he meant the shareholders. But he also wrote: "Insofar as his [i.e., the manager's] actions in accord with his 'social responsibility' reduce returns to stockholders, he is spending their money. Insofar as his actions raise the price to customers, he is spending the customers' money. Insofar as his actions lower the wages of some employees, he is spending their money. . . . But if he does this, he is in effect imposing taxes, on the one hand, and deciding how the tax proceeds shall be spent, . . . He becomes in effect a public employee, a civil servant, . . . If they are to be civil servants, then they must be selected through a political process." *Id*. Similarly, Friedman distinguishes the case of sole proprietors not only on grounds that they spend their own money but also: "In the process, he, too, may impose costs on employees and customers. However, because he is far less likely than a large corporation or union to have monopolistic power, any such side effects will tend to be minor." *Id.* Friedman was particularly concerned with the distribution of corporate profits, on which see *infra* III.B.2.

tax increase that triggered France's yellow vest protests in 2018.[15] Against this background, is it legitimate and sustainable for wealthy corporate CEOs, directors, and shareholders (virtually all shares are owned by the top 1%) to restrict the supply of fossil fuel, or to take other actions that increase product prices? Usually, coordinating—through common shareholder-owners or otherwise—to reduce output would be an illegal cartel. Arguing that (wealth-weighted) investors know better than the (equal-weighted) electorate at large is obviously problematic. Nor is it clear that, if decisions such as the (shadow) cost of carbon were put to investor votes, as some have proposed,[16] these votes would be any less "dysfunctional" than political votes.[17]

A related criticism of Friedman is that corporate lobbying undermines regulation, such that relying on regulation to fix problems is circular and futile. This may be true.[18] But if so, then it is surely an inadequate remedy to call on the CEOs orchestrating the noxious lobbying to make social decisions themselves. The only reasonable request to them is to stop lobbying.

Friedman's legitimacy concern has no purchase, however, for the countless decisions that are out of the political spotlight or could not possibly be regulated effectively.[19] In neither case does regulatory inaction equal political endorsement, even in the most idealistic view of the democratic process. Social control of such behavior is partly by way of moral norms, possibly enforced by social sanctions. Even shareholders probably would and certainly should not want corporations to disregard these norms.[20] Friedman agreed in principle, writing that managers' "responsibility is to conduct the business in accordance with [shareholders'] desires, which generally will be to make as much money as possible while *conforming to the basic rules of the society*, both those embodied in law and those *embodied in ethical custom*" (emphasis added). However, Friedman also wrote that it was wrong for managers "to make [corporate] expenditures on reducing pollution beyond the amount that is in the best interests of the corporation or that is required by law in order to contribute to the social objective of improving the environment." This statement appears too broad.

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[15] *See, e.g.*, Feargus O'Sullivan, *Why Drivers Are Leading a Protest Movement Across France*, BLOOMBERG (Nov. 19, 2018, 6:15 PM), https://www.bloomberg.com/news/articles/2018-11-19/-yellow-vests-why-france-is-protesting-new-gas-taxes.

[16] Oliver Hart & Luigi Zingales, *The New Corporate Governance* (ECGI, Law Working Paper No. 640/2022, 2022); Eleonora Broccardo, Oliver Hart & Luigi Zingales, *Exit vs. Voice*, J. POL. ECON. (forthcoming). They argue that shareholder votes resemble referenda, and that referenda are not as dysfunctional as (bundled) general votes.

[17] Since we first wrote this sentence, the first clear signs of political debates migrating to shareholder votes have emerged. *Cf., e.g.*, Vivek Ramaswamy, *Our Letter to Chevron*, STRIVE ASSET MGMT. (Sept. 6, 2022), https://strive.com/strive-asset-management-letter-to-chevron/ (perma.cc/L639-EBZ9).

For a proposal to import "legitimacy-enhancing" procedural devices from administrative law, see Stavros Gadinis & Christopher Havasy, The Fight for Legitimacy in Corporate Law (Apr. 11, 2022) (unpublished manuscript), https://ssrn.com/abstract_id=4081543. It is questionable, however, whether corporate decisions could ever have anything like the legitimacy of public administrative decisions given that corporate decision-makers are privately appointed (even outside committees are ultimately appointed by corporate insiders).

[18] It surely is true as a factual matter that corporate expenditures on lobbying and (dis-)information campaigns alter the outcome of the political process. But since corporations cannot literally buy political decisions, their expenditures must filter through voters' minds, raising again the question to what extent voters' decisions can be disregarded.

[19] *See* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005).

[20] There is psychological evidence that people do not feel responsibility for delegated decisions, and even strategically delegate to avoid responsibility. *See, e.g.*, John R. Hamman, George Loewenstein & Roberto A. Weber, *Self-Interest Through Delegation: An Additional Rationale for the Principal-Agent Relationship*, 100 AM. ECON. REV. 1826 (2010); Björn Bartling & Urs Fischbacher, *Shifting the Blame: On Delegation and Responsibility*, 79 REV. ECON. STUD. 67 (2012).

For example, the corporation may know about a novel chemical's toxicity long before any regulator. Should the corporation dump this chemical into the environment until the regulator finds out and prohibits it? From a welfare perspective, this would be inefficient. From a social and psychological perspective, individuals would not or at least should not do this, and probably would not want their corporation to do so either. Of course, this argument is only as strong as the moral norms are widely shared. (For the avoidance of doubt, this section is only concerned with abstract possibilities, not legal mandates and their enforcement, which raise a host of other issues considered below.)

3. Substitution Effects

Friedman also touched upon an entirely separate mechanism that limits the effectiveness of individual pro-social actions in markets: substitution effects.[21] The forces of supply and demand work against both boycotts and preferential treatment. If demand for some product or service decreases because some buyers boycott it, its price will go down, attracting other buyers who do not participate in the boycott—and conversely for preferential treatment. Similarly, if some producers increase production of some product because of its perceived beneficial effects, its price will go down, leading other producers to decrease their production—and conversely if some reduce production of harmful products. In the limit of perfect competition, individual consumption and production decisions have no effect whatsoever.[22]

We do not live in a world of perfect competition. Individual decisions do have consequences, especially those of large corporations with market power or consumer movements with collective market power.[23] In the chemical example above, the world will be better off if the company handles the chemical well—except in the rare case that the company cannot survive in this market if it bears the extra cost.

Nevertheless, these forces are powerfully at work. For example, many government or privately held oil and gas producers are increasing production as large publicly held ones hold back under pressure from environmentally-minded investors. Truth Media launched as a reaction to Twitter's ban of certain speech (especially Donald Trump's). And so on.

Substitution in production likely leads to higher cost and thus reduction in total output. Substitution in *ownership* of productive assets may not even achieve that. If public oil companies "reduce" *their* carbon footprint by selling their oil-producing assets to private companies, *the industry's* carbon footprint remains constant.[24]

Finally, what we might call substitution in purpose itself means that some purposes are not even well-defined, and hence implementable, at the level of an individual corporation. The prime

[21] Friedman broached the issue in relation to fighting inflation: "Will his [the manager's] holding down the price of his product reduce inflationary pressure? Or, by leaving more spending power in the hands of his customers, simply divert it elsewhere? Or, by forcing him to produce less because of the lower price, will it simply contribute to shortages?" Friedman, *supra* note 10.

[22] This limit is also the basis of the Fisher Separation Theorem that shareholders will unanimously prefer profit maximization regardless of their own consumption preferences and endowments. It holds only if markets are perfectly competitive. *See generally* Harry DeAngelo, *Competition and Unanimity*, 71 AM. ECON. REV. 18 (1981).

[23] Indeed, the price impact of large corporations' decisions was one reason why Friedman thought it illegitimate for them to pursue social issues. *See* quote *supra* note 7.

[24] *Cf.* Anjli Raval, *A $140bn Asset Sale: The Investors Cashing in on Big Oil's Push to Net Zero*, FIN. TIMES (Jul. 6, 2021), https://www.ft.com/content/4dee7080-3a1b-479f-a50c-c3641c82c142 (tallying sales of oil and gas assets from public companies to private ones); Roberto Tallarita, *The Limits of Portfolio Primacy*, 76 VAND. L. REV. (forthcoming 2023) (manuscript at 21-23).

example is reducing carbon emissions. Even if the world agreed on a percentage target of net emissions reduction (possibly 100%, i.e., net zero), this would not mean that every individual firm should reduce their net output by this percentage. Some particularly carbon-efficient firms or industries might even have to *increase* their activity and thus emissions to reach this global goal. Individual firms are unlikely to be able to coordinate in this way, whatever their purpose. Even if they tried, they would hardly know how to do so without the guidance of a carbon tax or the prices of traded emissions certificates.

Substitution effects are a major reason why most major environmental and other issues are most effectively addressed through regulation. That said, to the extent substitution happens across national borders, large multinational companies may sometimes have an advantage over a national regulator.[25]

B. Corporate Purpose As Commitment

Let us now focus on the situations where corporate decisions do make a difference (no perfect substitution), corporate profits and some competing good are maximized by different actions (doing well and doing good diverge), and sacrificing profit for the competing good is legitimate (pace Friedman). Corporate purpose, as defined in section II, is a commitment to a decision criterion. Viewing corporate purpose as commitment shows how a broader corporate purpose may increase profits (1) but nonetheless underlines the importance of "shareholder value" (2). Commitment is important, but shareholders arguably need it most.

1. Commitment and Contractual Incompleteness

We are not aware of a single firm that openly and unambiguously states that its only goal is to make money for its equity investors.[26] If one did, it would struggle to attract employees and customers. No doubt some firms are insincere. Even so, the question is why firms bother—why does their audience care?

One reason may be the audience's fear of exploitation. A firm that proclaims not to engage in exploitation will find it legally and psychologically harder to do so. The risk of exploitation arises because customers, employees, suppliers, etc. make firm-specific investments. Creditors hand over money in the expectation of being repaid (with interest) in the future. Employees work in the expectation of being paid at the end of the month. Customers pay the purchase price in the expectation that the product will function as advertised. They would not do this if the firm could not assure them that their expectations will actually be met.

The basic solution is contract. If the firm does not pay, creditors and employees can sue for payment under their credit and employment agreements. If the product is unsafe, customers can sue under their warranty. Contracts allow the firm to commit to honoring expectations in the future.

The problem is that contracts are often unavoidably incomplete.[27] Employees make long-term decisions—relocation, rotation, retention—for careers that cannot be mapped out in detail ex ante in the contract. Customers cannot assess products such as advice even *after* using them (so-called credence goods). All contractual claims can be impaired in insolvency, the likelihood of which

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[25] This depends in part on whether national regulators can prevent cross-border substitution through sourcing rules and/or multinational collaboration.

[26] The exceptions are private investment funds, but there the outside investors are better thought of as clients; they have no control whatsoever.

[27] There is an extensive theoretical literature arguing why contracts could possibly be incomplete between fully rational actors. However, nobody seriously doubts that contractual incompleteness exists in the real world.

depends on myriad firm choices that cannot all be constrained in the contract. And so on. This requires non-contractual ways to create trust and, to justify the trust, commitment.

Traditionally, economists have located commitment in hard governance rights, including the allocation of residual discretion (ownership rights).[28] For example, financial institutions and hospitals commonly organize as mutuals or non-profits, arguably reassuring their customers that they will not exploit their superior knowledge to sell expensive but unnecessary services.[29] As another example, co-determination may reassure workers that the company will not engage in opportunistic layoffs in bad times and will honor implicit promises of raises in good times. Perhaps fiduciary duties can create similar commitment through the threat of legal sanctions. We discuss these legal embodiments of purpose *infra* C.

Plausibly, commitment can also be generated by a firm's culture, which may in turn be supported by explicit purpose statements.[30] The more deeply engrained a firm's dedication to its customers, employees, creditors, and suppliers, the less likely the firm is able to exploit them. Employees, including managers, might rebel or quit rather than engage in exploitation. To the extent customers, employees, creditors, and suppliers can distinguish genuine dedication from marketing slogans, better deals can be struck, and the firm may end up making *more* money by credibly committing not to exploit. In this sense—and in this sense only—aiming to do good may do better than aiming to do well, i.e., the firm may paradoxically maximize profits by not trying to do so.

There are two major caveats to this theory. First, a culture of not pushing customers etc. beyond the implicit bargain can easily degenerate into a culture of not pushing, i.e., slack.[31]

2. Shareholder Primacy

Second and relatedly, the constituency whose investment is least protected by hard claims and reputation is shareholders. The contractual claims of creditors, employees, and customers may be imperfect. But at least they do have contractual claims. By contrast, equity investment is *defined by* the absence of contractual claims to payment. The whole business point of equity financing is flexibility without a fixed repayment horizon. Moreover, equity financing is irregular, and much or all of it may be provided early in the firm's lifetime. By contrast, customers and employees—and to some extent creditors—are protected by the repeat-play of their interactions with the firm. For example, if the firm does not pay wages this month, employees are unlikely to show up next month. Even if, e.g., the same customer only buys once from a firm, negative experiences can be shared and will influence the next customer's purchase decision. Not so with equity. Shareholder

[28] The seminal articles are: Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 AM. ECON. REV. (Papers & Proceedings) 112 (1971), and Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration*, 94 J. POL. ECON. 691 (1986).

[29] *See generally* HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE (2000).

[30] *Cf.* Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers*, *in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 33, 38-41 (Alan J. Auerbach ed., 1988) (arguing that to generate the trust necessary for long-term implicit contracts, "shareholders…seek…train…elevate…and entrench…managers" to whom "stakeholder claims, once agreed to, are prior to shareholder claims").

[31] *Cf.* Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972) (arguing that to prevent slacking, control should be vested in a residual claimant—someone who gets what is left over after all contracts have been paid); Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 101 (2020) (stakeholderism "would increase managerial slack and agency costs").

primacy—as an instrument, not an end-goal—responds to shareholders' predicament.[32]

Commitment to shareholder returns is particularly important for payouts. Given diminishing utility of wealth and the fact that shareholders tend to be wealthy, any dollar of corporate profit could generate higher utility as a donation to the poor than as a dividend to shareholders. However, if this ex-post-efficient distribution rule were adopted, nobody would invest in shares ex ante, i.e., corporations would not be able to raise equity financing.

More generally, favoring shareholders, or any other constituency for that matter, will sometimes generate inefficiencies ex post.[33] In a first-best world, this should not happen, as it makes everyone worse off ex ante (when gains could be redistributed by side payments). In a second-best world with agency problems or other reasons why management cannot be reliably entrusted to maximize firm value and distribute (!) gains in accordance with expectations not memorialized in hard claims, however, some inefficiency is unavoidable, and a commitment to shareholders arguably minimizes it ex ante.[34]

Such concerns for equity financing may seem displaced in debates that explicitly or implicitly focus on large existing firms that do not need to raise new outside equity financing.[35] Such firms are the norm in many countries; outside equity is an unimportant form of financing in most of the world. In these cases, weakening shareholders may seem to be costless from the perspective of the economy while reducing (large) shareholders' wealth and political power. The obvious counter is that such policies, or their expectation, may be the precise reason why outside equity financing is unavailable, as only powerful insiders are able to protect their equity investment.[36]

As emphasized above, a corporation serves as a nexus of many purposes. Not all corporate actors must perpetually and exclusively aim to increase shareholder returns. Such a crude incarnation of "shareholder primacy" as an overarching ideology is not only unnecessary but also impossible to enforce in practice (*infra* C.2.a)). However, enabling broad equity investment requires compensating investors for their lack of contractual claims. This will generally require giving shareholders strong governance rights.

C. Institutional Underpinnings

Law—but arguably not fiduciary duties—and governance play a big role in shaping corporate purpose.

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[32] *See*, *e.g.*, OLIVER HART, FIRMS, CONTRACTS, AND FINANCIAL STRUCTURE 9 (1995); Hart & Zingales, *supra* note 16, at n. 7; Miller, *supra* note 6, s. A.

[33] *Cf.* Grossman & Hart, *supra* note 28, at 691 ("inevitably creates distortions").

[34] For these reasons, we disagree that "[s]hareholder primacy is illogical." Frank Partnoy, *Shareholder Primacy Is Illogical*, *in* RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD, *supra* note 1, at 186. It would be if shareholder primacy meant to maximize firm value *ex post*. But it does not, as even the term itself suggests.

[35] The treatment of outside equity is only as relevant as outside equity. If founders are sufficiently wealthy and risk-neutral to self-finance or finance with debt, the canonical principal-agent problem between outside investors and the founder/manager simply disappears. *Cf.* William H. Meckling & Michael C. Jensen, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976) (canonical model predicated on the need for outside financing). There might still be value in lodging control (and residual claims) in a party that has no other role in the enterprise. *See* Raghuram G. Rajan & Luigi Zingales, *Power in a Theory of the Firm*, 113 Q. J. ECONOMICS 387 (1998); Bengt Holmström, *Moral Hazard in Teams*, 13 BELL J. ECONOMICS 324 (1982). *But see* Mukesh Eswaran & Ashok Kotwal, *The Moral Hazard of Budget-Breaking,* 15 RAND J. ECONOMICS 578 (1984) (pointing out that the third party can be bribed). But this is a secondary concern.

[36] *Cf.* Mark J. Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539 (2000).

1. External Regulation

External regulation—such as emissions standards, workplace safety rules, and prohibitions of certain drugs—is by far the most important. It constrains what corporate purpose can be. "Contract killing at its best" or "heroin for all" are simply not permissible purposes. Elaborate enforcement mechanisms implement such regulation, which has been growing steadily over the last century.

To be sure, regulation is not perfect. Purdue Pharma was prosecuted only long after it had started an opioid epidemic that killed hundreds of thousands, and its controlling shareholders may still walk away with billions. DuPont concealed the negative health effects of its Teflon production for decades and might have made a calculated cost-benefit decision that dumping was worth it given uncertain punishment.[37] Oil companies may never face a legal reckoning for their climate disinformation campaigns. Still, regulation's impact is profound. Without it, we would be having a very different, much more urgent debate about corporate purpose.

2. Fiduciary Duties

Most legal debates around corporate purpose emphasize fiduciary duties, i.e., legal directives as to how managers and directors are supposed to exercise their discretion left by external regulation. Specifically, the emphasis has been on shareholder primacy versus "stakeholderism," i.e., a concern for various constituents beyond shareholders. Within shareholder primacy, a distinction is sometimes made between furthering shareholders' financial payoffs ("shareholder value") or their overall wellbeing, which would include the ethical concerns discussed above ("shareholder welfare").[38] Animating this debate is the fear that a pure norm of shareholder value maximization would force managers and directors to sacrifice potentially unlimited social welfare for infinitesimal shareholder wealth gains.

This emphasis and fear are misplaced. The primary reason is that fiduciary duties are not enforceable with this level of precision, i.e., the shareholder/stakeholder distinction makes no practical legal difference. Moreover, even the nominal content of existing fiduciary duties—that might matter to conscientious fiduciaries irrespective of enforcement—is far less shareholder-centric than the grotesque shareholder value norm sketched above. "Shareholder value" can have the feared nefarious effect only through a vulgar version that may have crept into managerial culture.

Our sole concern here is with duties of *corporate* fiduciaries. Investment trustees are subject to stricter fiduciary duties—notably lacking a "business judgment rule"—and have less opportunity to justify "social" acts with the profitability of long-term commitment (*supra* A.1).[39] Presumably, this is the reason why investment funds and their managers consistently claim to pursue social objectives only instrumentally to manage risk.[40] However, the impact of investment trustees' stricter duties is mitigated by the fact that they do not make operational decisions in their portfolio companies, while the fungibility of money neutralizes most impact of capital allocation decisions (*supra* A.3).

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[37] Roy Shapira & Luigi Zingales, *Is Pollution Value-Maximizing? The DuPont Case* (National Bureau of Economic Research, Working Paper 23866, 2017).

[38] Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247 (2017).

[39] *See generally* Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381 (2020).

[40] *See* Hart & Zingales, *supra* note 38, at 16.

a) The Shareholder/Stakeholder Distinction is Not Enforceable

In corporate law, there is not a single case of managers or directors being held personally liable for furthering stakeholder interests over shareholder interests—ever, anywhere. (For injunctions, see below.) Indeed, we are not aware of a single lawsuit or prosecution even attempting this in recent decades.[41] This is hugely revealing because (a) companies take pro-stakeholder actions without rhetorically tying them to shareholder returns all the time[42] and (b) directors and managers are sued all the time for different reasons in the U.S.[43] If it were possible to sue managers and directors for being "too social," somebody would have done so.

But it is not possible, and for good reason. It is a general principle of corporate law that business decisions are not subject to judicial review (except in cases of pecuniary self-interest, which do not concern us here). In the U.S., this is explicit in the "business judgment rule"; elsewhere, it is often implicit in insurmountable procedural hurdles, even though duties may nominally be strict and capacious. This is uncontroversial; even shareholders voluntarily agree to it. As one of us has explained at length elsewhere, judicial review is simply not worth its cost given the tremendous difficulties courts would have in reconstructing the decision environment.[44]

With respect to potential conflicts between profits and stakeholders in particular, the line is usually blurred to the point of being invisible: which social action could not be justified by long-term reputational concerns?[45] Besides, how would a judge trade off ex post costs to one constituency with the need (to make ex ante promises) to give an "adequate" return to another constituency? (In a second-best world, ex ante efficient arrangements often entail ex post inefficiencies.[46]) From a psychological and institutional point of view, it seems difficult to imagine that a judge would come down hard on a manager or director for furthering the social interest. (We distinguish pure transfers of money—donations—which are welfare-neutral as a first approximation.)

b) The Nominal Content of Fiduciary Duties in Current Law

Even to the extent they are not enforced, fiduciary duties might exert influence because faithful fiduciaries do what they are told, or because they foster a culture. If so, the nominal content of fiduciary duties would matter independent of enforcement. We cannot exclude the possibility that

[41] There have been cases where societal interests were in play, but the allegation was classical self-interest. *Cf., e.g.*, Kahn v. Sullivan, 594 A.2d 48 (Del. 1991) (corporation made a large donation to a museum bearing its CEO's name; plaintiff alleged that directors were beholden to CEO; case settled for some additional conditions on the donation and no contribution by directors).

[42] For example, Exxon withdrew from Russia after Russia's invasion of Ukraine. Its press release announcing the withdrawal did not say a word about shareholders. *See* Press Release, ExxonMobil, ExxonMobil to Discontinue Operations at Sakhalin-1, Make No New Investments in Russia (Mar. 1, 2022), https://corporate.exxonmobil.com/News/Newsroom/News-releases/2022/0301_ExxonMobil-to-discontinue-operations-at-Sakhalin-1_make-no-new-investments-in-Russia (perma.cc/J5ML-L6F3). Instead, it talked about Ukraine, employees, and the environment. *Id.* That said, the evidence suggests companies in general withdrew for PR rather than moral reasons. *See* Anete Pajuste & Anna Toniolo, *Corporate Response to the War in Ukraine: Stakeholder Governance or Stakeholder Pressure?* (ECGI, Finance Working Paper No. 839/2022, 2022).

[43] For example, until recently, virtually every M&A transaction attracted a lawsuit in Delaware, where directors and managers were usually named as co-defendants, and many transactions are still litigated today in other fora. *See* Matthew D. Cain, Jill E. Fisch, Steven Davidoff Solomon & Randall S. Thomas, *Mootness Fees*, 72 VAND. L. REV. 1777 (2019).

[44] Holger Spamann, *Monetary Liability for Breach of the Duty of Care?*, 8 J. LEGAL ANALYSIS 337 (2016).

[45] *See, e.g.*, Roland Bénabou & Jean Tirole, *Individual and Corporate Social Responsibility,* 77 ECONOMICA 1, 12 (2010).

[46] *See supra* note 33 and accompanying text.

managerial thinking has or had become infused with a vulgar version of "shareholder primacy" that would have required managers to do great social harm in the name of shareholder profits.[47] We can, however, dispel the myth that anything like this vulgar version is current law.

Fiduciary duties differ by jurisdiction. We focus on Delaware—where most U.S. corporations incorporate—because Delaware most strongly endorses shareholder primacy among major jurisdictions.[48] Nevertheless, even in Delaware, the commitment to shareholder value is rather limited.[49]

Delaware courts routinely assert that managers and directors owe their duties "to the corporation and its shareholders."[50] On occasion, Delaware courts have been more explicit, stating that "directors have a fiduciary duty to act in the best interests of the corporation's stockholders"[51] and even "to maximize the value of the corporation for the benefit of the common stockholders."[52] Perhaps most notoriously, in 2010, *eBay v. Newmark* seemingly held that "[d]irectors of a for-profit Delaware corporation cannot . . . eschew[] stockholder wealth maximization."[53]

A close read of the relevant opinions, however, paints a much more nuanced picture. The ellipsis in the *eBay* quote stands for "deploy a rights plan to defend a business strategy that."[54] Thus, the holding was explicitly limited to use of the "rights plan" a/k/a "poison pill," a rather peculiar anti-takeover device.[55] What is more, the defendant directors and controlling shareholders, Newmark and Buckmaster, won another count and thus the war because it allowed them to keep eBay off of the company's (craigslist's) board. The Chancellor handed them this win even though he explicitly found that "[f]or most of its history, craigslist has not focused on 'monetizing' its site" and that defendants "did prove that they personally believe craigslist should not be about the business of stockholder wealth maximization, now or in the future."[56] The Chancellor did not hold that this vitiated defendants' dealings with eBay, who very much did want to "monetize." Much less did the Chancellor force defendants to change their and craigslist's

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[47] At least in the cross-section of countries, however, directors' and legal shareholderism are uncorrelated. *See* Amir N. Licht & Renée B. Adams, *Shareholders and Stakeholders Around the World: The Role of Values, Culture, and Law in Directors' Decisions* 25 (LawFin Working Paper No. 13, 2021).

[48] *Cf. id.* at Table 1A (rating only the United States a perfect 10 on "legal shareholderism"—the perception of law by local law professors—in a sample of 18 countries comprising most of the world's large economies).

[49] Besides fiduciary duties discussed in the text, cf. also section 122(9) of the Delaware General Corporation Law (explicitly granting corporations "power to . . . [m]ake donations for the public welfare or for charitable, scientific or educational purposes, and in time of war or other national emergency in aid thereof").

[50] *E.g.*, Guth et al. v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939); N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99 (Del. 2007). *See* 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, 768 (2015).

[51] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

[52] *In re* Trados Inc. S'holder Litig., 73 A.3d. 17, 62 (Del. Ch. 2013); *see also id.* at 41 (same phrase, using "residual claimants" instead of "common stockholders").

[53] eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 35 (Del. Ch. 2010).

[54] A page prior, the Chancellor similarly held: "I cannot accept as valid for the purposes of implementing the Rights Plan a corporate policy that specifically, clearly, and admittedly seeks *not* to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders." *Id.* at 34 (underlining added).

[55] craigslist's board had unconventionally deployed the pill to prevent its shareholder eBay from selling its block of shares. The Chancellor's general statements—not tied to, albeit in the context of, the rights plan—were much softer: "[t]he corporate form . . . is not an appropriate vehicle for *purely* philanthropic ends" and its "standards include acting to *promote* the value of the corporation for the benefit of its stockholders." *Id.* (emphasis added).

[56] *Id.* at 8 and 34, respectively.

ways—and, tellingly, eBay never asked for that. Ultimately, *eBay* thus shows almost the exact opposite of what the case nominally stands for: in the normal course of business, directors are free to pursue social goals.

Other Delaware cases dealing with shareholder primacy all concerned sales of the business, conflicts between shareholders and senior investors (creditors or preferred stockholders), or both, and, with one exception, involved a conflict of interest on the board.[57] These details are important. As any lawyer knows, precedents are bound to their facts. The facts where shareholder primacy would be truly worrisome—e.g., a board deciding whether to pollute for the sake of shareholder profits—have never been decided, presumably for the reasons we laid out above.

In the investor conflict cases, the main concern would be that shareholder primacy, strictly applied, would force boards to "gamble for resurrection"—take inefficient risks in the hope of an upside for shareholders, at the expense of senior investors bearing the downside (since thanks to limited liability, shareholders' payoff cannot be less than zero). In the *Gheewalla* case, the Delaware Supreme Court let the shareholder-appointed board get away with such a gamble, illustrating the importance of governance rights that we discuss below. But in the *Trados* case, the Delaware Chancery Court let the preferred-appointed board get away with *not* taking the gamble.[58] Indeed, in *Quadrant Structured Products*, Vice-Chancellor Laster explicitly held that "when directors make decisions that appear rationally designed to increase the value of the firm as a whole, Delaware courts do not speculate about whether those decisions might benefit some residual claimants more than others."[59] No Delaware court has ever forced a board to take the gamble.

This leaves sales. *Revlon* famously held that in a sale, the board's sole duty is to get the highest price and "concern for non-stockholder interests is inappropriate."[60] This might force boards to pick among competing bids the one that offers an extra penny for stockholders even at great harm to other constituencies (e.g., layoffs).[61] Unlike other fiduciary duty details, this one has practical teeth because bids tend to be easily comparable (the sole, limited uncertainties being closing certainty and, in some deals, valuation of the deal consideration). Nonetheless, the potential harm is limited, at least relative to the alternative. First, the board does not need to sell. *Unocal* allowed this for reasons including "the impact on 'constituencies' other than shareholders (i.e., creditors,

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[57] Conflicts, or alleged conflicts, notably existed in Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173 (Del. 1986) (directors were afraid of personal liability if they did not help noteholders), Kahn v. Sullivan, 594 A.2d 48 (Del. 1991), and *Trados*, 73 A.3d 17 (directors were preferred stockholders themselves). The exception is Blackmore Partners, L.P. v. Link Energy LLC, 864 A.2d 80 (Del. Ch. 2004), an LLC case where the board was not alleged to have a conflict in its decision to sell all the assets, turn over all proceeds to the creditors, and dissolve.

[58] *Trados*, 73 A.3d at 17. The court reached this result via a valuation that ignored the option value of the gamble for stockholders, *id.* at 76–78, even though the court was clearly aware of the concept, *id.* at 50 with n. 25. The *Blackmore* case, 864 A.2d 80, involved a similar situation but not a decision on the merits. On motion to dismiss, the court held: "that the Defendant Directors approved a sale of substantially all of Link's assets and a resultant distribution of proceeds that went exclusively to the company's creditors raises a reasonable inference of disloyalty or intentional misconduct. . . . it would appear that no transaction could have been worse for the unit holders and reasonable to infer . . . that a properly motivated board of directors would not have agreed to a proposal that wiped out the value of the common equity and surrendered all of that value to the company's creditors." *Id.* at 86. It is an open question if the *Blackmore* court would have valued common stock as the *Trados* court did.

[59] Quadrant Structured Prods. Co., Ltd. v. Vertin, 102 A.3d 155, 187–88 (Del. Ch. 2014).

[60] *Revlon*, 506 A.2d at 182.

[61] *See* Leo E. Strine Jr., *The Social Responsibility of Boards of Directors and Stockholders in Charge of Control Transactions: Is There Any 'There' There?*, 75 S. CAL. L. REV. 1169 (2002).

customers, employees, and perhaps even the community generally)."[62] Second, if the deal is unpalatable to the point of being repulsive even to shareholders, shareholders can vote it down.[63] Third, shareholders could also vote down the alternative, a constituency-friendly deal for lower shareholder consideration.

3. Structural Governance

a) Board Elections

If boards are effectively unconstrained by fiduciary duties, the key question is who appoints boards.[64] To be sure, some corporate decisions may require approval by shareholders or, rarely, by another constituency such as a works council in addition to, or in lieu of, board approval. Direct shareholder votes have been proposed for corporate matters of social concern such as a corporation's shadow cost of carbon for capital allocation purposes.[65] But most corporate decisions are made by the board alone.

Customarily, shareholders appoint the board. Indeed, equity investment without governance rights is unheard of.[66] This is not a coincidence, given our discussion of commitment *supra* B.2: Board representation is all that shareholders have to get a return on their money.

That said, the need to give shareholders something does not imply that they need to get everything and be free to choose whomever they want. Most European jurisdictions reserve at least some board seats in some companies to employee representatives (so-called co-determination); there are also various levels of shop-floor representation (so-called works councils).[67] Some have advocated other constituency directors.[68] In addition, the last two decades have witnessed a trend towards mandatory quotas for certain groups, particularly women, on corporate boards, which restricts shareholders' choice. Employee representation explicitly aims to change the goal of the corporation from pure shareholder primacy to broader social goals.[69]

Putting competing groups on the board changes board dynamics.[70] Some fear that inevitable conflict on the board will render it dysfunctional. The empirical evidence reviewed below does not bear out the worst of such fears. In any event, any allocation of governance rights involves a

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[62] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

[63] Mergers or sales of substantially all assets generally require a shareholder vote.

[64] *Cf.*, *e.g.*, Bebchuk & Tallarita, *supra* note 31, at 139-147 (directors have incentives to favor their electorate, shareholders).

[65] Hart & Zingales, *supra* note 38; Broccardo, Hart & Zingales, *supra* note 16. The latter show that voting ("voice") beats divestment ("exit") because it avoids substitution in capital markets (but not in product markets) (*supra* III.A.3). Voting also avoids Friedman's legitimacy critique (*supra* III.A.2) as far as shareholder interests are concerned.

[66] Some companies issue non-voting stock, but they also issue voting stock that cannot receive payments unless the non-voting stock receives them too.

[67] *See* Simon Jäger, Shakked Noy & Benjamin Schoefer, *What Does Codetermination Do?*, 75 INDUS. & LAB. RELS. REV. 857, 860–62 (2022).

[68] *Cf.*, *e.g.*, Paul Pfleiderer, *The Milton Friedman Constraint: A Proposal for Improving Corporate Governance* (working paper, 2020, revised 2021) (proposing that one director be held liable for any fines imposed on the company, thus giving that director a strong incentive to prevent corporate wrongdoing).

[69] Mandatory quotas are sometimes advocated in the name of shareholder payoffs. This argument seems dubious: if it were good for shareholders, why wouldn't shareholders do it voluntarily? It may be explained by the U.S. Supreme Court's case law, which allows consideration of group status only in the name of diversity, i.e., to help everyone, not just the favored group.

[70] *See* Katharina Pistor, *Codetermination: A Sociopolitical Model with Governance Externalities*, *in* EMPLOYEES AND CORPORATE GOVERNANCE 163, 191 (Margaret M. Blair & Mark J. Roe eds., 1999).

tradeoff. Frictions may be a price worth paying for better direction.

b) Anti-Takeover/Activist Devices

A frequently heard argument for anti-takeover and anti-activist devices is that they protect non-shareholder constituencies like employees and the environment.[71] The devices' direct effect, however, is merely to shift power from shareholders to boards and managers. The reason is that neither takeovers nor activists could succeed without support from other shareholders (provided minimal protections are in place to prevent "herding" of shareholders through tactics like two-tiered front-loaded tender offers).[72] It is a priori unclear why this shift should benefit any constituencies other than managers and directors. Concern for constituencies may be pretext.[73] For example, a recent paper on "Pills in a World of Activism and ESG" proposes to liberalize anti-activist pills generally, untethered from specific ESG concerns.[74]

4. Executive Pay

Finally, a very important lever for the direction of the corporation is executive pay. It is generally set by the board.

In recent decades, executive pay has become heavily focused on the stock price.[75] This strongly orients executives to the pursuit of shareholder value. To the extent "doing well by doing good" holds (*supra* A.1), this is socially optimal. Otherwise, partially or fully replacing stock-based compensation with other metrics can be socially beneficial, for example in countering excessive risk in banks.[76] In recent years, many companies have augmented their stock-based pay with ESG performance metrics.[77]

A major problem is that ESG performance metrics are coarse at best. For shareholder value, the stock price is the ultimate object of interest, and the current stock price is at least a very good predictor of the long-run stock price. There are no obvious candidates for such a forward-looking, all-encompassing metric for social welfare or any of its other components. This measurement problem exacerbates the ever-present concern that managers will abuse an ostensible pay-for-performance scheme to line their own pockets without performance.[78]

Nonetheless, ESG concerns should not be dismissed out of hand. An imperfect proxy may be better than no proxy. Only paying for stock price performance is also a weighting scheme: one that

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[71] *Cf.*, *e.g.*, Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 130 (1979) ("The directors should consider the impact of the takeover on employees, customers, suppliers, and the community. National policy is a proper consideration.").

[72] *See*, *e.g.*, Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 974, 999–1004 (2002) ("Against Veto"); Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 883 (2005).

[73] *See*, *e.g.*, Bebchuk, *Against Veto*, *supra* note 72, at 1023–25; Bebchuk & Tallarita, *supra* note 31.

[74] Caley Petrucci & Guhan Subramanian, *Pills in a World of Activism and ESG*, 1 U. CHI. BUS. L. REV. (forthcoming 2022).

[75] Kevin J. Murphy, *Executive Compensation: Where We Are, and How We Got There*, *in* 2 HANDBOOK OF THE ECONOMICS OF FINANCE 211 (George Constantinides, Milton Harris & Rene Stulz eds., 2013). Alex Edmans, Xavier Gabaix & Dirk Jenter, *Executive Compensation: A Survey of Theory and Evidence, in* 1 HANDBOOK OF THE ECONOMICS OF CORPORATE GOVERNANCE 383 (Benjamin Hermalin & Michael Weisbach eds., 2017).

[76] Lucian A. Bebchuk & Holger Spamann. *Regulating Bankers' Pay*, 98 GEO. L.J. 247 (2010).

[77] Lund, *supra* note 6; Shira Cohen et al., *Executive Compensation Tied to ESG Performance: International Evidence* (ECGI, Finance Working Paper No. 825/2022, 2022).

[78] *See generally* LUCIAN A. BEBCHUK & JESSE M. FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004).

puts zero weight on other concerns. This may be the best weighting scheme if other concerns are negligible. If they are large, however, and if sensible metrics for these other concerns cannot be found, then the standard result from the multi-tasking literature is not to give *any* performance incentives: paying for the one dimension that is measured—stock price—will create perverse incentives to neglect or harm the other dimensions.[79] It is thus fundamentally misguided to conclude from the difficulty of measuring and aggregating multiple dimensions of executive behavior that one should focus on only one (stock price). It depends on the importance of the other dimensions.

II. EMPIRICS OF PURPOSE

There is an overwhelming empirical literature about or, mostly, around corporate purpose. And yet, we have disappointingly little empirical knowledge about corporate purpose. The reasons are twofold.

First, empirical studies about corporate purpose are objectively very difficult and often simply impossible. The theoretical predictions we discussed are subtle: they are context specific, concern complex organizations and their environment, more likely to manifest through culture than individual rules and firms, and most likely small. Small effects are hard to pin down (in statistical terms, studies will lack power), "culture" is difficult to operationalize as an empirical variable, society-wide shifts are difficult to impossible to isolate from other social trends, and lab experiments have virtually no chance of credibly capturing countless, complex interactions between highly specialized actors in very special settings. Even when studies focus on individual companies, there are the ever-present problems of endogeneity (reverse causation and omitted variables), limited empirical variation (too few firms change relevant attributes too rarely and too little—another source of low power), and noise.

To be sure, much of the literature is acutely aware of many or all these problems and tries to devise fixes, above all for the endogeneity problem. Not to put too fine a point on it, however, most of these attempts are not credible or answer very limited questions, as we will discuss in examples below. More generally, there is now widespread awareness of a credibility problem in empirical research in the social sciences. Part of the problem is that researchers have enormous flexibility in designing empirical studies in ways that materially affect results: variables, model, sample, statistics, and interpretation. Researchers may not make the right choice if there is one, or fail to reveal the fragility of their results when multiple choices could be justified. The other part of the problem is that the publication process selects for "results," i.e., studies confirming rather than disconfirming an effect, leading to massive publication bias. Each part would be a problem on its own, but together they turbocharge each other as researchers consciously or unconsciously try various specifications to "get a result" (also known as *p*-hacking). These problems have been well known in principle for a long time[80] but have recently (again) caught the attention of the profession,[81] in part thanks to powerful empirical demonstrations of the problem.[82]

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[79] Bengt Holmström & Paul Milgrom, *Multitask Principal-Agent Analyses: Incentive Contracts, Asset Ownership, and Job Design*, 7 J.L. ECON. & ORG. 24 (1991).

[80] *See, e.g.*, Edward E. Leamer, *Let's Take the Con Out of Econometrics*, 73 AM. ECON. REV. 31 (1983).

[81] *See, e.g.*, Garret Christensen & Edward Miguel, *Transparency, Reproducibility, and the Credibility of Economics Research*, 56 J. ECON. LITERATURE 920 (2018).

[82] *See, e.g.*, Joseph P. Simmons, Leif D. Nelson & Uri Simonsohn, *False-Positive Psychology: Undisclosed Flexibility in Data Collection and Analysis Allows Presenting Anything as Significant*, 22 PSYCH. SCI. 1359 (2011);

For these reasons, making sense of countless, often contradictory results in all areas relevant to corporate purpose would be a fool's errand. The very source of the credibility problems just discussed is the difficulty for outside readers to assess the strength of a paper's evidence and the depth of the "file drawer" of unpublished negative results. We merely review some papers that we find relatively informative and discuss some issues to sensitize the reader to the problems.

A. Corporate Purpose Proper

We start by noting a glaring absence. Prominent publications touting purpose's importance, such as the Enacting Purpose Initiative's, do not cite any empirical studies of corporate purpose.[83]

To be sure, it is exceedingly difficult to study corporate purpose proper empirically. To study corporate purpose empirically, one would first need to define the concept, or more to the point, one needs to specify *which concept* one wants to study: a regulatory directive, a motivational slogan, or something else. Once defined, one would have to find empirically observable manifestations of the concept, i.e., to operationalize it. Easily observable facts will rarely match the concept of interest. For example, a corporation's "purpose statement" on its website may have nothing to do with its true purpose as understood by its owners, managers, or employees—it may be mere make-believe. Thus, a study of "purpose statements" is exactly that, not a study of purpose per se. In any event, something like a "purpose statement" would be completely endogenous. If "purpose statements" correlate with corporate success, it may be because purpose statements facilitate success, or because success creates room for purpose statements, or because some third factor, such as a thoughtful workforce or management, is responsible for both. And that is assuming one has ruled out chance as an explanation. Finally, even if one could show that purpose or purpose statements *cause* success (or whatever else), the policy implications would be doubly unclear. First, purpose (statements) may only work for the few firms that have (voluntarily) adopted them, and might be useless or counterproductive for other firms and/or if all firms adopted them. (Indeed, forcing all firms to adopt them might destroy the distinguishing value even for the firms that initially adopted them voluntarily.) Second, a regulator can only set minimum requirements for mandatory purpose statements, which might end up being different from voluntary purpose statements. (The second problem does not apply to corporate boards contemplating corporate purpose.)

We have found one good paper—by Gartenberg, Prat, and Serafeim—that studies "Corporate

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Annie Franco, Neil Malhotra & Gabor Simonovits, *Publication Bias in the Social Sciences: Unlocking the File Drawer*, 345 SCI. 1502 (2014); Wei Jiang, *Have Instrumental Variables Brought Us Closer to the Truth*, 6 REV. CORP. FIN. STUD. 127 (2017); Albert J. Menkveld et al., *Non-Standard Errors* (University of St. Gallen, School of Finance Research Paper No. 2021/17, 2021); Bernard S. Black, Hemang Desai, Kate Litvak, Woongsun Yoo & Jeff Jiewei Yu, *The SEC's Short-Sale Experiment: Evidence on Causal Channels and on the Importance of Specification Choice in Randomized and Natural Experiments* (ECGI, Finance Working Paper No. 813/2022, 2022).

[83] ENACTING PURPOSE INITIATIVE, ENACTING PURPOSE WITHIN THE MODERN CORPORATION: A FRAMEWORK FOR BOARDS OF DIRECTORS (2020), https://enactingpurpose.org/assets/enacting-purpose-initiative---eu-report-august-2020.pdf cites no study whatsoever. A separate "Bibliography" document on the organization's website, ENACTING PURPOSE INITIATIVE, EU REPORT: REFERENCES & FURTHER READING BIBLIOGRAPHY (2020), https://enactingpurpose.org/assets/epi---eu-report-references---bibliography.pdf, lists under the heading "Purpose" only programmatic books or articles by the project's two academic leaders (Colin Mayer and Robert Eccles), a law firm memo by one of the project's sponsors (Wachtell, Lipton, Rosen & Katz), a letter from BlackRock's CEO Larry Fink, and a website advocating for corporate purpose (blueprintforbusiness.org). The Business Roundtable's 2019 Statement on the Purpose of a Corporation, BUS. ROUNDTABLE, STATEMENT ON THE PURPOSE OF A CORPORATION (2019), https://opportunity.businessroundtable.org/ourcommitment/ [perma.cc/3P7R-RZAF]) cites no evidence either.

Purpose and Financial Performance" in for-profit corporations.[84] To be more precise, the paper studies one particular conception of corporate purpose, namely whether the corporation's employees perceive a sense of purpose in their work, measured through surveys prepared for Fortune's "100 Best Companies to Work For" competition. The paper finds no association of this measure with ROA (return on assets) or Tobin's Q (market value over book value of equity). The paper then uses "exploratory factor analysis" to break its purpose measure into four separate parts. One of these parts—whether management provides clarity—positively covaries with ROA and Q. Whether this association is credible, and if credible, whether it is causal, is an open question.

B. Fiduciary Duties

As we mentioned previously, legal debates around corporate purpose have largely centered on fiduciary duties. We expressed theoretical skepticism that the variations of fiduciary duties considered in these debates would make any difference (*supra* I.C.2.a)). Ultimately, however, the question is empirical. Answering it convincingly would have immediate policy payoff because legislators or courts directly control this lever.

One type of company that has more inclusive fiduciary duties than the standard "shareholder primacy" business corporation (at least in Delaware) is the public benefit corporation (PBC). One might therefore think of comparing the behavior of PBCs to other corporations. However, such comparison would not be able to identify the effect of fiduciary duties because of selection bias: different types of founders etc. may select different corporate structures, and any observed difference between structures may be due to differences between the founders etc. that tend to use them.[85]

To avoid such selection issues, the empirical literature has focused on the adoption of state statutes that change the content of fiduciary duties for all (normal) corporations in a state. Many U.S. states passed so-called "constituency statutes" allowing or mandating concern for non-shareholder interests in the 1980s or later. Researchers have attempted to trace the effect of these statutes in firm-level panel data, i.e., data on many firms from different states over time. The statewide statutory change is plausibly exogenous for almost all firms (in particular, there is no selection bias), and firms from states without a statutory change can serve as the control group. Notwithstanding, this literature is plagued by massive and mostly insurmountable methodological problems, in addition to myriad errors in individual studies.[86] The main systematic problem is that most corporations never experience a change in the applicable law. Delaware, home and legislator to more than half of U.S. public corporations, never enacted a constituency statute, and neither did the runner ups California and New York. Those that did usually did so in combination with, or at least close temporal proximity to, other related statutes.[87] Even controlling for the other statutes,

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[84] Claudine Gartenberg, Andrea Prat & George Serafeim, *Corporate Purpose and Financial Performance*, 30 ORG. SCI. 1 (2019). For non-profits, see Zannie Giraud Voss, Daniel M. Cable & Glenn B. Voss, *Organizational Identity and Firm Performance: What Happens When Leaders Disagree About "Who We Are?"*, 17 ORGANIZATION SCI. 741 (2006).

[85] That said, it is unlikely that the rules for PBCs make a meaningful difference. *Cf.* Jill E. Fisch & Steven Davidoff Solomon, *The "Value" of a Public Benefit Corporation*, *in* RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD, *supra* note 1, at 68 (PBCs organizational structure does not meaningfully differ from standard corporations, and most large PBCs' "purpose statements" are vacuous).

[86] Emiliano M. Catan & Marcel Kahan, *The Law and Finance of Antitakeover Statutes*, 68 STAN. L. REV. 629 (2016).

[87] Jonathan M. Karpoff & Michael D. Wittry, *Institutional and Legal Context in Natural Experiments: The Case*

the paucity of affected states creates great difficulty for statistical inference, such that only implausibly large effects would be detectable in the data, i.e., the studies lack power for small effects.[88] As we argued in the theoretical part, however, we would expect any effects to be small.

Bebchuk, Kastiel & Tallarita take a different tack and examine deal terms in a sample of M&A deals involving firms from constituency states as sellers.[89] The official justification for adopting constituency statutes was generally to protect employees in such deals. Yet Bebchuk et al. find terms protecting employees in virtually none of the deals. Of course, this leaves open the possibility that boards used their discretion in less visible ways.

C. Structure

Unlike fiduciary duties, structure must make a difference, at least if we consider sufficiently strong variation. After all, the organizational differences between for-profits and non-profits, cooperatives and share corporations, etc. seem too large, and the distribution of these organizational forms across the economy too uneven, to think that they are exchangeable.[90]

Within the for-profit corporate form, however, the variation is much smaller, and the effects much less obvious. Short of nationalization, the biggest structural variation is co-determination (*supra* I.C.3.a)). Nevertheless, even for co-determination, the best available evidence suggests that it barely makes a difference, if any—neither for shareholder nor for workers.[91] The best, if unsatisfactory, explanation of this surprising null-finding is that co-determination is part of a package of social-democratic policies, none of which is individually determinative.[92]

Until recently, the main live empirical debate regarding corporate structure was about corporations' vulnerability to takeovers and activists, i.e., anti-takeover provisions. Most of this literature considered the adoption of state anti-takeover statutes and suffered the same methodological problems as the constituency statute literature discussed in the prior section. Some instead considered firm-level provisions such as dual-class and staggered boards, but these are endogenous (i.e., selected) and hence lead to the same selection bias as PBC status; there were also other problems.[93]

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of State Antitakeover Laws, 73 J. FINANCE 657 (2018).

[88] Allen Hu & Holger Spamann, *Inference with Cluster Imbalance: The Case of State Corporate Laws* (ECGI, Finance Working Paper No. 644/2019, 2019).

[89] Lucian A. Bebchuk, Kobi Kastiel & Roberto Tallarita, *For Whom Corporate Leaders Bargain*, 94 S. CAL. L. REV. 1467 (2021).

[90] *See generally* HANSMANN, *supra* note 29. For an empirical example, see Ryan Bubb & Alex Kaufman, *Consumer Biases and Mutual Ownership,* 105 J. PUB. ECON. 39 (2013). That said, even there, differences are not always what one would think. For example, non-profit hospitals are not measurably more charitable than for-profit hospitals according to Ge Bai et al., *Analysis Suggests Government and Nonprofit Hospitals' Charity Care Is Not Aligned with their Favorable Tax Treatment*, 40 HEALTH AFFS. 629 (2021); Ge Bai, Hossein Zare & David A. Hyman, *Evaluation of Unreimbursed Medicaid Costs Among Nonprofit and For-Profit US Hospitals*, 5 JAMA NETWORK OPEN (2022).

[91] Simon Jäger, Benjamin Schoefer & Jörg Heining, *Labor in the Boardroom*, 136 Q.J. ECONOMICS 669 (2021); Christine Blandhol, Magne Mogstad, Peter Nilsson & Ola L. Vestad, *Do Employees Benefit from Worker Representation on Corporate Boards?* (National Bureau of Economic Research, Working Paper 28269, 2020); *cf.* Jäger, Noy & Schoefer, *supra* note 67, at 85 ("The conclusion suggested by the evidence [is] that codetermination in its current form has limited consequences for core economic outcomes").

[92] *Cf.* Jens Dammann & Horst Eidenmüller, *Codetermination: A Poor Fit for US Corporations*, 2020 COLUM. BUS. L. REV. 870 (2020) (arguing that co-determination interacts with other policies such as collective bargaining).

[93] Emiliano Catan & Michael Klausner, *Board Declassification and Firm Value: Have Shareholders and Boards Really Destroyed Billions in Value?* (NYU Law and Economics Research Paper 17-39, 2017).

Today's main debate concerns the effects of board diversity. A recent review documents disparate results from dozens of papers.[94] In part, the disparity is explained by the variety of questions studied and not always clearly distinguished—i.e., by a disparity of effects. A first distinction is between effects on different groups, especially shareholders versus other stakeholders. Another distinction is between the variation and settings studied. It makes a big difference whether diversity is mandated or voluntarily adopted, by how much diversity increases how fast, and from what level (e.g., going from two to three directors in five years is very different than going from zero to parity in one). Similarly, effects are unlikely to be identical for different diversities (e.g., gender, race), countries, time-periods, and perhaps industries.

In other part, the disparity of results is likely due not to disparity of effects but to the aforementioned problems of the research machine. Diversity is a hot topic. Thousands of researchers are looking in all corners of the world whether some outcome occurred more or less often when some measure of some diversity was higher. Even if diversity has no influence on outcomes whatsoever, some outcomes are bound to be unevenly distributed across some measure of diversity by mere chance. Moreover, ideological commitments and (journals') prioritization of papers that "find" an effect (as opposed to null-findings) will lead many researchers, consciously or unconsciously, to tweak specifications to "find" an effect, and perhaps some journal editors to be less critical of the methods used. The consequence is randomness masquerading as scientific findings.

To give a sense of possible issues, we briefly discuss one well-known study, Ahern & Dittmar's (AD) study of Norway's 2003 gender quota, published in one of the top economics journals.[95] To identify the causal effect of the quota on firm value as measured by stock price changes, AD compared firms with varying gender gaps (possibly zero) before the quota: the greater the gap, the greater the required adjustment, i.e., treatment. AD found negative effects in the short run (event study) and long run (fixed effect panel regression using Tobin's Q). An obvious limitation of AD is conceptual: if quotas address non-shareholder concerns, share value effects are at most part of the story, whereas if quotas address shareholder concerns, the underlying rationale is probably that the market does not understand the value of diversity (or else the quota is arguably unnecessary), such that stock price reactions are simply beside the point. In any event, a careful re-analysis by Eckbo et al. showed that AD's event study lumped together offsetting events (i.e., political news regarding the quota), that pre-quota variation in gender representation was correlated with other possible drivers of post-quota returns, and, most importantly, that cross-sectionally correlated errors created more noise than accounted for by AD.[96] Correcting these issues, Eckbo et al. found neither short- nor long-run valuation effects. This does not necessarily mean that the quota had no effect on valuation—but none large enough to detect in the noisy data.

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[94] Anzhela Knyazeva, Diana Knyazeva & Lalitha Naveen, *Diversity on Corporate Boards,* 13. ANN. REV. FIN. ECON. 301 (2021). Beyond diversity, the literature finds surprisingly little or consistent effects of board structure in general. *See* Bryce C. Tingle, *What Do We Really Know About Corporate Governance: A Review of the Empirical Research Since 2000*, 59 CANADIAN BUS. L.J. 292 (2017); Renée B. Adams, *Boards, and the Directors Who Sit on Them, in* 1 HANDBOOK OF THE ECONOMICS OF CORPORATE GOVERNANCE, *supra* note 75, at 291; Ryan Krause & Matthew Semadeni, *Apprentice, Departure, and Demotion: An Examination of the Three Types of CEO-Board Chair Separation*, 56 ACAD. MGMT. J. 805 (2013).

[95] Kenneth R. Ahern & Amy K. Dittmar, *The Changing of the Boards: The Impact on Firm Valuation of Mandated Female Board Representation*, 127 Q.J. ECONOMICS 137 (2012).

[96] B. Espen Eckbo, Knut Nygaard & Karin S. Thorburn, *Valuation Effects of Norway's Board Gender-Quota Law Revisited*, 68 MGT. SCI. 4112 (2022).

D. Owners

An evergreen empirical debate is about the effects of different types of owners, particularly financial investors—private equity (PE) and activist hedge funds—and, in recent years, "common" or "universal" owners that hold a broad portfolio of firms, particularly index funds. We defer "sustainable investing" to the next section.

Activist hedge funds' main strategy is to purchase a company's stock, agitate for change, and then sell, on the expectation that the change will increase the company's stock price. Unsurprisingly given activists' persistence and success, academic studies confirm that activists do indeed tend to increase targets' stock price.[97] Allegations that this is due to stock-market short-termism presume an implausible degree of market inefficiency and find no support in the data.[98]

The more interesting question is activism's and private equity's effect on non-shareholder constituencies. It would not be surprising if that effect were negative because activists and PE funds squeeze rents out of creditors, workers, customers, and others. On the other hand, constituencies may benefit from efficiency improvements brought about by activism and PE. The evidence is mixed and, for PE, depends on the type of target (private or public).[99] In any event, activism's and PE's effects ought to be evaluated at the economy-wide level, as companies may adjust behavior to the mere threat of activism or takeovers, and adjustments at many firms may have ripple effects through the economy. Convincing direct empirical evidence of economy-wide effects is, however, virtually impossible to obtain.

Theoretical predictions of the effects of ownership overlap, particularly index fund ownership, are similarly ambiguous. The "common ownership" literature analyzes the malign anti-competitive effect: common owners have incentives to restrict competition between their portfolio firms. By contrast, the "universal ownership" literature analyzes the benign pro-social effect: universal owners have incentives to limit negative externalities.[100] Both literatures recognize that ownership overlap leads to partial internalization of cross-firm externalities, but they differ in the

[97] *See* Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FINANCE 1729 (2008) (seminal empirical paper); Alon Brav, Wei Jiang & Rongchen Li, *Governance by Persuasion: Hedge Fund Activism and Market-Based Shareholder Influence*, *in* OXFORD RESEARCH ENCYCLOPEDIA OF ECONOMICS AND FINANCE (Jonathan H. Hamilton et al. eds., forthcoming 2022) (most recent survey).

[98] Null results for long-term stock returns are due to increased noise in long-term returns, not a disappearance of the effect. *Cf.* Ed DeHaan, David Larcker & Charles McClure, *Long-Term Economic Consequences of Hedge Fund Activist Interventions*, 24 REV. ACCT. STUD. 536 (2019); Andrew C. Baker, *The Effects of Hedge Fund Activism,* (working paper, 2021), https://andrewcbaker.netlify.app/publication/baker_jmp/Baker_JMP.pdf (reporting such null results).

[99] *See* Brav, Jiang & Li, *supra* note 97; Hadiye Aslan, *A Review of Hedge Fund Activism: Impact on Shareholders vs. Stakeholders*, *in* THE OXFORD HANDBOOK OF HEDGE FUNDS 283 (Douglas Cumming et al. eds., 2021); Steven J. Davis et al., *The (Heterogenous) Economic Effects of Private Equity Buyouts* (working paper, 2021), https://ssrn.com/abstract=3465723; Morten Sorensen & Ayako Yasuda, *Impact of Private Equity*, *in* 1 HANDBOOK IN ECONOMICS: CORPORATE FINANCE: PRIVATE EQUITY AND ENTREPRENEURIAL FINANCE (Gordon M. Phillips & B. Espen Eckbo eds., forthcoming 2022). *Also see* Sophie A. Shive & Margaret M. Forster, *Corporate Governance and Pollution Externalities of Public and Private Firms*, 33 REV. FIN. STUD. 1296 (2022) (finding no differences between PE owned and public firms, although both pollute more than other privately held firms).

[100] *See* Madison Condon, *Externalities and the Common Owner*, 95 WASHINGTON L. REV. 1 (2020); Jeffrey N. Gordon, *Systematic Stewardship*, 47 J. CORP. L. 627 (2022). *But see* Tallarita, *supra* note 24; Dhammika Dharmapala & Vikramaditya S. Khanna, *Controlling Externalities: Ownership Structure and Cross-Firm Externalities* (ECGI, Law Working Paper No. 603/2021, 2021); Marcel Kahan & Edward B. Rock, *Systemic Stewardship with Tradeoffs* (NYU Law and Economics Research Paper 22-01, 2021) (questioning the efficacy of "universal ownership").

type of externality they emphasize. The empirics of "common ownership" are hotly contested.[101] The ultimate effects of "universal ownership" would be even harder to estimate. There is evidence that institutional ownership (most of which is presumably broadly diversified) leads to increases in portfolio firms' sustainability ratings,[102] but whether those ratings mean anything is another matter (see next section).

E. Sustainability: Disclosure, Performance, and Returns

Sustainability (or ESG or CSR—we gloss over differences between them[103]) is not the same as corporate purpose. Nevertheless, integrating sustainability into corporate purpose is arguably the main impetus of the purpose debate. There is considerable demand for "sustainable investment."[104] According to an industry group, the global sustainable investment industry now has $35 trillion under management.[105] Institutional investors increasingly affirm that they care about issues like climate change,[106] and some have successfully engaged portfolio companies on such matters.[107] This warrants a brief mention of the key empirical debates in the burgeoning literature on sustainability and corporate governance.[108]

An initial problem is how to define and measure sustainability. Researchers have documented enormous divergence between different commercial sustainability ratings.[109] Worse, one popular rating is being rewritten retroactively, and positive associations between returns and ratings only exist in the rewritten data.[110]

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[101] For reviews, see Martin C. Schmalz, *Common-Ownership Concentration and Corporate Conduct*, 10 ANN. REV. FIN. ECON. 413 (2018); Martin C. Schmalz, *Recent Studies on Common Ownership, Firm Behavior, and Market Outcomes*, 66 ANTITRUST BULL. 12 (2021); Matthew Backus, Christopher Conlon & Michael Sinkinson, *Empirical Studies of the Effects of Common Ownership* (working paper, 2021).

[102] Alexander Dyck et al., *Do Institutional Investors Drive Corporate Social Responsibility? International Evidence*, 131 J. FIN. ECON. 693 (2019).

[103] On differences, see Pollman, *supra* note 9.

[104] *See, e.g.*, Samuel M. Hartzmark & Abigail B. Sussman, *Do Investors Value Sustainability? A Natural Experiment Examining Ranking and Fund Flows*, 74 J. FINANCE 2789 (2019); Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243 (2019).

[105] GLOB. SUSTAINABLE INV. ALL., GLOBAL SUSTAINABLE INVESTMENT REVIEW 2020 4 (2020), http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf.

[106] *See, e.g.*, Philipp Krueger, Zacharias Sautner & Laura T. Starks, *The Importance of Climate Risks for Institutional Investors*, 33 REV. FIN. STUD. 1067 (2020).

[107] *See, e.g.*, Elroy Dimson, Oğuzhan Karakaş & Xi Li, *Active Ownership*, 28 REV. FIN. STUD. 3225 (2015); Caroline Flammer, Michael W. Toffel & Kala Viswanathan, *Shareholder Activism and Firms' Voluntary Disclosure of Climate Change Risks,* 42 STRATEGIC MGMT. J. 1850 (2021); S. Lakshmi Naaraayanan, Kunal Sachdeva & Varun Sharma, *The Real Effects of Environmental Activist Investing* (ECGI, Finance Working Paper No. 743/2021, 2021).

[108] For a finance-focused survey, see Stuart L. Gillan, Andrew Koch & Laura T. Starks, *Firms and Social Responsibility: A Review of ESG and CSR Research in Corporate Finance*, 66 J. CORP. FIN. 101889 (2021).

[109] Aaron K. Chatterji et al., *Do Ratings of Firms Converge? Implications for Managers, Investors and Strategy Researchers*, 37 STRATEGIC MGMT. J. 1597 (2016); Dane M. Christensen, George Serafeim & Anywhere Sikochi, *Why Is Corporate Virtue in the Eye of the Beholder? The Case of ESG Ratings*, 97 ACCT. REV. 147 (2022); Florian Berg, Julian F. Koelbel & Roberto Rigobon, *Aggregate Confusion: The Divergence of ESG Ratings*, REV. FINANCE (forthcoming 2022); David F. Larcker et al., *ESG Ratings: A Compass Without Direction* (Rock Center for Corporate Governance Working Paper, 2022).

[110] Florian Berg, Kornelia Fabisik & Zacharias Sautner, *Is History Repeating Itself? The (Un)Predictable Past of ESG Ratings* (ECGI, Finance Working Paper 708/2020, 2021).

Even setting aside measurement issues, interpreting the evidence is difficult, especially for returns. Many studies find that sustainable investments outperformed the market in recent times.[111] Does that mean that sustainable investments are better investments going forward? Not necessarily. First, "past performance does not necessarily predict future results"[112]: it could have been luck. In particular, an unexpected taste transition to "sustainable investment" will temporarily generate high returns for "sustainable" assets (*supra* I.A.1).[113] Second, high expected returns are usually a reward for higher risk—why else would rational investors buy assets with different expected returns?[114]

Theoretical arguments that are legitimate in the abstract can unwittingly become tools to dismiss inconvenient evidence and thus, ultimately, undermine all evidence. As Gillan et al. note, "papers that draw similar overall conclusions . . . do so from opposite results. For example, researchers have concluded a positive causal effect of ESG/CSR from results that indicate ESG/CSR produces high values today and low returns going forward. Others conclude a positive effect from results that indicate low values today and high returns going forward."[115] Indeed, a researcher could insist on "a positive causal effect of ESG/CSR" even if values were low today *and* returns were low going forward: after all, if the market gets it wrong today, it might get it wrong for a long time. Ultimately, Gillan et al.'s observation illustrates the impossibility of learning from data unless one commits to certain background understandings such as market efficiency (which humans arguably achieve, more or less, by triangulating and insisting on consistency).

On the regulatory side, the main corporate sustainability initiatives have been supply chain monitoring, which is best thought of as an extension of external regulation (*supra* I.C.1), and sustainability disclosure.[116] Teasing out the consequences of mandatory disclosure is complicated.[117] As far as investors are concerned, one might think that mandated disclosure must

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[111] Gillan et al., *supra* note 108, at 13. But cf. the meta-analysis by Lars Hornuf & Gül Yüksel, *The Performance of Socially Responsible Investments: A Meta-Analysis* (CESifo Working Paper No. 9724, 2022) (estimates are unstable, better publications find less).

[112] U.S. Sec. & Exch. Comm'n, *Mutual Funds, Past Performance*, INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/glossary/mutual-funds-past-performance (perma.cc/ZV28-8JAW) (last visited Oct. 11, 2022).

[113] *See* Rajna Gibson, Philipp Krueger & Shema F. Mitali, *The Sustainability Footprint of Institutional Investors: ESG Driven Price Pressure and Performance* (Swiss Finance Institute Research Paper No. 17-05, 2020); Ľuboš Pástor, Robert F. Stambaugh & Lucian A. Taylor, *Dissecting Green Returns*, 146 J. FIN. ECON. 403 (2022).

[114] Whether, and which, sustainable assets should be low risk or high risk is a surprisingly hard question. Some may appear to be a natural hedge against, e.g., climate change. However, the inverse is also possible. Certain sustainable assets—think expensive abatement technologies—may be economically viable only if the economy is doing very well and thus has a need for the technology. *See generally* Stefano Giglio, Bryan Kelly & Johannes Stroebel, *Climate Finance*, 13 ANN. REV. FIN. ECON. 15 (2021).

[115] Gillan et al., *supra* note 108, at 13.

[116] This is after the defeat of more far-reaching European proposals that were arguably not very sensible. *Cf.* Mark Roe, Holger Spamann, Jesse M. Fried & Charles C. Y. Wang, *The Sustainable Corporate Governance Initiative in Europe*, 38 YALE J. ON REGUL. BULL. 133 (2021) (critiquing the initial proposals). The U.S. is only considering disclosure so far. *Cf.* The Enhancement and Standardization of Climate-Related Disclosures for Investors, Release Nos. 33–11042 & 34–94478, 87 Fed. Reg. 21334 (Apr. 11, 2022); *cf. also* Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices, Release Nos. 33–11068 & 34–94985, 87 Fed. Reg. 36654 (June 17, 2022).

[117] *See generally* Christian Leuz & Peter D. Wysocki, *The Economics of Disclosure and Financial Reporting Regulation: Evidence and Suggestions for Future Research*, 54 J. ACCT. RSCH. 525 (2016).

be cost-benefit inefficient because investors—and the founders and managers they interact with—have incentives to pick the optimal disclosure regime, such that regulation can only make matters worse. Sustainability is a different matter, however, because it involves externalities. Some studies have found mandated sustainability disclosure to reduce externalities at the firm or local level[118]—which is encouraging but raises the usual question whether the offending activities simply migrated to different firms and locations (*supra* I.A.3). Christensen, Hail & Leuz provide a thorough survey.[119]

CONCLUSION

Our review of theory (I) and empirics (II) leaves us skeptical that "corporate purpose" can live up to the hype. If we gave in to the temptation of the follow-up question "whence the hype," we might hypothesize that "corporate purpose" is an elaborate decoy orchestrated by CEOs, boards, and their lawyers to relieve pressure from regulators and shareholder activists. But we would have as little evidence for this hypothesis as for the importance of "corporate purpose."

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118 Hans B. Christensen et al., *The Real Effects of Mandated Information on Social Responsibility in Financial Reports: Evidence from Mine-Safety Records*, 64 J. ACCT. & ECON. 284 (2017); Yi-Chun Chen, Mingyi Hung & Yongxiang Wang, *The Effect of Mandatory CSR Disclosure on Firm Profitability and Social Externalities: Evidence from China*, 65 J. ACCT. & ECON. 169 (2018); Benedikt Downar et al., *The Impact of Carbon Disclosure Mandates on Emissions and Financial Operating Performance*, 26 REV. ACCT. STUD. 1137 (2021).

119 Hans B. Christensen, Luzi Hail & Christian Leuz, *Mandatory CSR and Sustainability Reporting: Economic Analysis and Literature Review*, 26 REV. ACCT. STUD. 1176 (2021).

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