

Socially-Minded Investors and Corporate Behavior

Finance Working Paper N° 916/2026

March 2026

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ECGI Working Paper Series in Finance

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We thank Afra Afsharipour, Ryan Bubb, John Coffee, Quinn Curtis, Gregory Day, Katherine Florey, Stavros Gadinis, Victor Goldberg, Jeff Gordon, Zohar Goshen, Joan Hemmingway, Dorothy Lund, Andrew McKinley, Josh Mitts, Viviane Prado, Alex Raskolnikov, Mark Roe, Reilly Steel, and Eric Talley, as well as participants at Columbia Law School's 10-10 Faculty Workshop, the 2024 National Business Law Scholars Conference, the Conference on Shareholders and Corporate Governance in honor of Randall Thomas at the Free University of Bolzano, the ECGI Conference on Corporate Governance & Law at UC Berkeley School of Law, the FGV-Sao Paulo Law School Faculty Workshop, the American Law & Economics Association 2025 Annual Meeting, the 2026 BYU Law School Winter Deals Conference, and the University of Sao Paulo Law School Business Law Colloquium for helpful suggestions. Rawit Assamongkol, Isabella Hopkins, Seung Hyung Lee, and Liem-Lucas Nguyen provided excellent research assistance.

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Abstract

Many equity investors are concerned with the world's worsening social and environmental problems and are losing faith in the capacity of political institutions to respond. Where corporate behavior is contributing to these problems, these investors would, at least if fully informed as to costs and benefits involved, favor corrective changes even where that would lessen their investment returns. Two important questions arise: (1) given existing law, are such willing-to-sacrifice equity investors currently affecting firm behavior; and (2) should there be legal reform that makes firms more sensitive to these willing-to-sacrifice investors' preferences? This Article seeks to answer these two questions, applying the teachings of corporate governance and financial economics. We go back to first principles to explore, relative to the politics of governmental regulation, this alternative way of harnessing people's other-regarding values to improve social welfare. Under current corporate governance arrangements, a firm's business decisions are, in the first instance, the product of its managers, not its shareholders. If willing-to-sacrifice investors are to have any effect on firm behavior, it must be through some indirect means. One possible channel is to elect directors who pledge to make the firm conform to these investors' wishes. A second is through these investors' impact on the workings of the incentive structure within which the firm's managers operate. A third possible channel—identity investing—involves these investors confining their stock portfolios to firms whose social behavior they approve, thereby affecting share prices in ways that incentivize managers to choose the approved behavior. Theory, we show, predicts that under current law, willing-to-sacrifice equity investors will not significantly affect firm behavior through either of the first two channels, and we see little evidence to the contrary. As for the third, theory suggests that identity investing will have some impact on share prices. Empirical evidence is mixed as to whether the effect is currently large enough to incentivize managers of excluded firms to significantly change their behavior. Should there be legal reform that makes the system more sensitive than now to the preferences of willing-to-sacrifice investors? Some scholars have championed allowing binding shareholder votes on individual business decisions to increase this sensitivity. The upside is that allowing such votes might sometimes alter corporate behavior in socially useful ways. This upside is likely more than counterbalanced by the downsides. Specifically, all vote-based choice systems, whether public or private, expend resources and political energy in informing and mobilizing voters, and require these voters' time and effort in response. The reform would divert such resources and effort from the public political process, one where, because of the scale of impact, results can be attained more efficiently. Moreover, to give managers the discretion needed to implement the results of such a shareholder vote, their incentive structure needs to be made less constraining in ways that would simultaneously allow managers to alter firm behavior simply to benefit themselves. Modifying securities and pension law offers an at least modestly more promising path forward. Mandating disclosure of a firm's social impacts, for example, would facilitate more identity investing, with its resulting impact on corporate behavior through its effect on the firm's share price. The difficult question, one worthy of experimentation to answer, is whether that impact would be great enough to justify such disclosure's considerable costs.

Keywords: Corporate Governance, Corporate Social Responsibility, Corporate Finance, Shareholder Voting, Managerial Incentives, Securities Regulation

JEL Classifications: M14, K2, D02, G3

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March 24, 2026

Many equity investors are concerned with the world's worsening social and environmental problems and are losing faith in the capacity of political institutions to respond. Where corporate behavior is contributing to these problems, these investors would, at least if fully informed as to costs and benefits involved, favor corrective changes even where that would lessen their investment returns. Two important questions arise: (1) given existing law, are such willing-to-sacrifice equity investors currently affecting firm behavior; and (2) should there be legal reform that makes firms more sensitive to these willing-to-sacrifice investors' preferences? This Article seeks to answer these two questions, applying the teachings of corporate governance and financial economics. We go back to first principles to explore, relative to the politics of governmental regulation, this alternative way of harnessing people's other-regarding values to improve social welfare.

Under current corporate governance arrangements, a firm's business decisions are, in the first instance, the product of its managers, not its shareholders. If willing-to-sacrifice investors are to have any effect on firm behavior, it must be through some indirect means. One possible channel is to elect directors who pledge to make the firm conform to these investors' wishes. A second is through these investors' impact on the workings of the incentive structure within which the firm's managers operate. A third possible channel—identity investing—involves these investors confining their stock portfolios to firms whose social behavior they approve, thereby affecting share prices in ways that incentivize managers to choose the approved behavior.

Theory, we show, predicts that under current law, willing-to-sacrifice equity investors will not significantly affect firm behavior through either of the first two channels, and we see little evidence to the contrary. As for the third, theory suggests that identity investing will have some impact on share prices. Empirical evidence is mixed as to whether the effect is currently large enough to incentivize managers of excluded firms to significantly change their behavior.

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Modifying securities and pension law offers an at least modestly more promising path forward. Mandating disclosure of a firm's social impacts, for example, would facilitate more identity investing, with its resulting impact on corporate behavior through its effect on the firm's share price. The difficult question, one worthy of experimentation to answer, is whether that impact would be great enough to justify such disclosure's considerable costs.

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Introduction

The primary focus of the contemporary study of corporate governance is minimizing agency costs.¹ Standard models assume that the principal—a firm’s shareholders—all seek to maximize risk-adjusted returns and thus uniformly wish their agent—the firm’s managers—to maximize share value.² In reality, many equity investors, at least if fully informed, would be willing to sacrifice a portion of their returns to advance one or more socially-oriented objectives, particularly given our worsening social and environmental problems and waning faith in government’s ability to cure them.

This Article applies the teachings of corporate governance and financial economics to answer two questions, one positive and one normative: (1) given existing law, are these willing-to-sacrifice equity investors actually affecting firm behavior; and (2) should there be legal reform that makes firms more sensitive to these investors’ preferences?

This inquiry’s perimeters, and its distinctive contributions, should be delineated at the outset. First, while there are certainly situations in which a firm’s change in behavior would both advance some social objective and increase its share value,³ we analyze the more challenging and more frequent circumstance in which advancing a social objective requires diminishing the firm’s

¹ See, e.g., Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 769 (2017) (“[A]gency costs ha[ve] dominated the study of corporate law and governance”).

² See, e.g., Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 314 (1976); ANDREU MAS-COLELL, MICHAEL D. WHINSTON & JERRY R. GREEN, MICROECONOMIC THEORY 317, 384, 387-400 (1995). A few prominent scholars identified the reality that shareholders can have differing goals, but do not systematically explore how, if at all, that can affect firm behavior or whether legal reforms are desirable in recognition of such differences. See HENRY HANSMANN, *THE OWNERSHIP OF ENTERPRISE* (2000) 40; Daniel J.H. Greenwood, *Fictional Shareholders: For Whom are Corporate Managers Trustees, Revisited*, 69 S. CAL. L. REV. 1021 (1996).

³ In contrast to the analysis here, scholarship discussing this kind of situation are really just extending the currently dominant agency cost reduction literature that assume all shareholders share the same maximizing goal. See note 21, *infra*.

profits and share value. Consider, for instance, a firm that can reduce its level of pollution only by sacrificing share value through either more expensive processes or reduced production.

Second, we focus on the dispersed ownership, publicly traded for-profit corporation, which is the dominant kind of productive enterprise in the United States.⁴ Scholars have studied these firms intensively, prompted by both their economic importance and their uniquely complicated governance problems. Unlike here, however, most of this literature assumes equity investors all want firms to seek share-value-maximization.⁵

Third, the questions addressed here are distinctly different from the more-studied question of whether a corporation's other stakeholders—such as its workers, customers, and local community—should play a direct role in corporate governance, or whether managers, acting on

⁴ Dispersed ownership means no single shareholder or organized group maintains control over its decisions. Such firms constitute 96.4% percent of S&P 500 firms and 91.6% percent of Russell 3000 firms. See Kosmas Papadopoulos, *CEO Ownership, Corporate Governance, and Company Performance*, Harvard Law School Forum on Corporate Governance (2019), <https://corpgov.law.harvard.edu/2019/05/13/ceo-ownership-corporate-governance-and-company-performance/>. As of 2015, this corporate type represented 90.12% of total capitalization of S&P 1500 companies. See Edward Kamonjoh, *Controlled Companies in the Standard & Poor's 1500*, IRRC Institute (2016), <https://bpb-us-w2.wpmucdn.com/sites.udel.edu/dist/8/12944/files/2022/08/Controlled-Companies-IRRCI-2015-FINAL-3-16-16.pdf>). Despite the recent rise in privately held firms, publicly traded firms continue their central role in the economy. They have almost 30% of the total workforce, and have increased their level of investment as a percentage of GDP over the last 30 years, with their aggregate capitalization increasing from about 50% to 100% of GDP. See Mark Roe & C.Y. Wang, *Half the Firms, Double the Profits: Public Firms' Transformation, 1996-2022*, J LAW FIN. & ACCT (forthcoming), https://Articles.ssrn.com/sol3/Articles.cfm?abstract_id=4372070. Though not dominant for most countries outside the United States, dispersed ownership, publicly-traded for profit corporations play an important role in their countries as well. See Gur Aminadav & Elias Papaioannou, *Corporate Control Around the World*, 75 J. FIN. 1191, 1203 (2020) (globally, 43% of publicly traded firms weighted by market capitalization have no single shareholder with greater than 5% holdings); Wolf-Georg Ringe, *Changing Law and Ownership Patterns in Germany: Corporate Governance and the Erosion of Deutschland AG*, 63 AM. J. COMP. L. 493 (2015). The importance of this form of enterprise for countries outside the United States is also the product of the fact that many U.S. dispersed ownership firms are multinational in their reach.

⁵ Only a handful of studies seriously consider the impact on dispersed-ownership firm behavior of investors willing-to-sacrifice socially oriented investors. See note 7 and 10 *infra*. This absence of attention to shareholder differences is in contrast to the academic literature on closely held and controlled corporations, where differences among shareholders play a major role. See, e.g., Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735 (2001). Analysis of intra-shareholder conflicts also has received some attention in the literature on venture-backed startups. See, e.g., Robert P. Bartlett, *Venture Capital, Agency Costs, and the False Dichotomy of the Corporation*, 54 UCLA L. REV. 37 (2006); Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155 (2019). There is also a literature evaluating intra-shareholder conflicts and preference differences in corporations with a control person. See, e.g., Simone M. Sepe, *Corporate Agency Problems and Dequity Contracts*, 36 J. CORP. L. 113 (2010); Ronald J. Gilson & Jeffrey N. Gordon, *Doctrines and Markets: Controlling Shareholders*, 152 U. PA. L. REV. 785 (2003).

their own initiative, should cause the corporation sacrifice share value for social ends.⁶ This Article represents a comprehensive effort to study the remarkably little-studied missing piece: the role of equity investors who are potentially willing to sacrifice share value for social ends.

Fourth, when we refer to a shareholder or an equity investor, we include two groups of persons. One is any person who holds the shares of the corporation directly. The other is any person who has an equity interest only derivatively through an investment or pension fund, even though it is the fund that holds legal title to the shares and usually votes them. This is because our interest is the preferences of the persons who are the ultimate sources of the money that acquired the shares in question. Where this source of funds is someone in this second group – an investor in a fund -, this person, by choosing her fund, chooses who decides what shares their money goes to purchase and how these shares are voted. This focus on the ultimate source of funds also distinguishes our study from one considering the possibility of fund managers, on their own initiative, taking equity-return-reducing measures in furtherance of their views of the social good, with whatever legitimacy questions that exercise of power involves.

Finally, we take an equity investor's preference to mean what the investor would prefer *if she were fully informed* as to the negative social consequences of a firm's behavior and the costs of mitigating them. So, when we refer to an investor as willing-to-sacrifice, we are describing their underlying values and what their preferences would be if they were fully informed. By assigning "equity investor," "shareholder," and "preference" these meanings, our positive and normative analyses will have as their central focus the costs of generating, transferring, acquiring, and acting on information, and the likelihood that the information acted upon is accurate. Accordingly, much of our attention will be devoted to the processes by which these incipient preferences (i.e., what

⁶ For discussion of these other lines of inquiry and how our analysis relates to them, see notes 103 and 213, *infra*, and accompanying text.

an investor who is not fully informed would prefer if she were fully informed) can become manifest and drive individual behavior.

Parts I and II of this Article evaluate the positive question of the extent to which willing-to-sacrifice equity investors are currently affecting firm behavior. Under existing legal arrangements, a firm's behavior is in the first instance determined by the firm's managers, not its shareholders. Thus, if willing-to-sacrifice investors are to have any effect on this behavior, it will be through some indirect means.

One such indirect means by which these shareholders might influence corporate behavior is by electing directors pledged to pursue their preferred social ends. A second would be through the effect of their presence on the workings of the various elements making up the managers' incentive structure. This incentive structure consists of both sticks (hostile takeovers, activist campaigns, block sales, and fiduciary suits) and carrots (share-price-based compensation and managerial share ownership). The third indirect means of influence is identity investing, which is when investors exclude from their portfolios the shares of issuers whose behavior they disapprove. To the extent that this behavior reduces the share prices of the disapproved firms relative to those of the approved ones, it can influence what activities firm managers have their firms engage in.

Answering the positive question of whether willing-to-sacrifice equity investors currently affect firm behavior proceeds in two stages. In the first stage, undertaken in Part I, all investors, willing-to-sacrifice or not, compose their portfolios based on ordinary financial considerations unrelated to their views on the issuers' social impact. Under this assumption, each firm's shareholder base will be roughly representative of the overall economy's equity investors in terms of shareholders willing to sacrifice for various social ends.

This setup allows a first cut at answering whether willing-to-sacrifice shareholders will, under current law, significantly affect the behavior of the typical firm through either of the first two indirect means: ordinary director elections and the managerial incentive structure. We conclude that they will not: the firm will act no differently than if all its shareholders preferred share value maximization. As for ordinary director elections, shareholders are rationally apathetic. Thus, electing directors pledged to a particular set of policies requires interested individuals to expend large amounts of resources and political energy to inform and mobilize these shareholders. This is generally an insurmountable barrier for persons seeking to change a firm's behavior in furtherance of some social end. Moreover, candidates need to be judged by many other criteria as well, including, most importantly, their ability to manage the firm efficiently as a more general matter. This means their stance on social issues can get lost in the noise. Our conclusion is similar regarding the effect of willing-to-sacrifice shareholders on the workings of the managerial incentive structure's sticks and carrots. We show that only in narrow circumstances will their presence lead to the firm making decisions differently from where all shareholders prefer share value maximization.

Part II, the second stage of the positive analysis, recognizes that some investors – identity investors – confine their stock portfolios to firms whose behavior they approve. Recognizing identity investing reinforces Part I's first-cut conclusion regarding the first two channels. This is because the disapproved firm will have a smaller percentage of willing-to-sacrifice shareholders than otherwise and so, in general, their presence is even less likely to affect firm behavior through these channels. On the other hand, theory shows that identity investing depresses the price of the excluded firms' shares, which would potentially affect managerial decisions in the direction of avoiding disapproved activities. Empirical evidence, however, is mixed as to whether, at current

levels, identity investing's price impact is more than negligible and big enough to affect firm behavior.

Part III addresses the normative question of whether the law should be reformed to make firms more sensitive to the preferences of the economy's willing-to-sacrifice equity investors. This inquiry addresses the fundamental question of how members of society in their various capacities – citizens participating in the public political process, consumers, suppliers of labor and other factors of production, and investors – participate in the processes that shape corporate behavior. A portion of society's members are equity investors, and some part of those have willing-to-sacrifice preferences. Should legal reform, in the form of changes to corporate, securities, or pension law, be undertaken in ways that would give the preferences of these particular members of society greater weight than they currently have?

Two very prominent economics scholars – Oliver Hart and Luigi Zingales – believe so, suggesting that firms should allow shareholders to propose and vote on binding resolutions mandating specific share-value-reducing corporate behaviors.⁷ If such a proposal came before the shareholders in isolation, it will not risk getting lost in the noise the way it would if it were an additional issue at play in a general election for directors. As a result, some such proposals would likely pass, leading to socially beneficial changes in corporate behavior. Still, this may not happen often. Each firm whose behavior is changed would need its own particularized political system. As in the governmental political system, the process by which voters become informed and their votes mobilized would consume substantial resources and require considerable energy from public-spirited persons, who are of finite availability. Although various methods of delegating

⁷ See Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J. L. FIN. & ACCT. 247 (2017) (“*Shareholder Welfare*”); Oliver Hart & Luigi Zingales, *The New Corporate Governance*, 1 U. CHI. BUS. L. REV. 195 (2022) (“*Corporate Governance*”). Presently, shareholder proposals are merely advisory.

voting power might ameliorate these problems somewhat, they would likely remain significant. Moreover, to the extent that the reform proves successful at changing corporate behavior, the energy and resources needed to bring about these changes would otherwise likely have been devoted to reforming the governmental political system to better control corporate externalities and achieve greater equity in society. This diversion of resources and energy would be unfortunate. Resources channeled into the public sphere can be concentrated to affect the behaviors of a broad swath of firms, rather than being dispersed among piece-meal battles relating to hundreds or more individual, sometimes even competing, firms.

Additionally, for a binding shareholder vote to change firm behavior, managers must implement what the vote calls for. Without a general weakening of the managerial incentive structure's current push to maximize share value, managers will drag their heels. Such a weakening, while helping to implement whatever binding resolutions are adopted, will, for the rest of the time, result in higher agency management costs: corporate behaviors that simply benefit managers at a cost to the larger economy.

A different reform – requiring more disclosure concerning the social impact of issuer behavior – is more promising, enough so to be at least worthy of serious further consideration and experimentation. These disclosures might lead to a substantial increase in identity investing, with the potential to change corporate behavior through the resulting price effects. Changing corporate behavior through identity investing avoids both the diversion of resources and political energy from the public sphere. It also avoids the increased agency costs of management that would be associated with changing corporate behavior through binding shareholder votes. It relies instead on information-cost and agency-cost economizing market mechanisms. Managers would continue to work within the existing incentive structure that encourages them to enhance share value, and

so, among other measures in service of that goal, they would seek to identify and implement changes in behavior that will increase share price by attracting identity investors. The difficult policy question, and one that selective experimentation might help answer, is whether these new disclosures, and accompanying changes in pension law and investment company law, would lead to changes in firm behavior socially valuable enough to justify the additional disclosure's considerable costs.

Part IV concludes. We start by exploring how our analysis advances the existing small body of academic literature related to willing-to-sacrifice equity investors. Much of this work concludes that identity investing has no meaningful effect and suggests that the focus of scholars and policymakers should therefore be on how willing-to-sacrifice equity investors can change firm behavior through the shareholder franchise.⁸ In contrast, this Article shows that under current law, such investors cannot meaningfully change firm behavior through the franchise. The proposed legal reform that might make this channel more effective – allowing a binding shareholder vote – would likely be of only limited effectiveness, and, to whatever extent it is, likely not be worth its cost. We instead suggest that, regardless of whether the current level of identity investing is having a meaningful effect, it has the potential to be effective at higher levels and could bring about corporate change without some of the franchise reform's costs.

We also explore how our analysis advances the larger literature on how corporations can be prompted to pursue social ends. Our analysis provides new insights regarding the perennial debate on corporate purpose, variously labelled Environmental, Social, and Governance (ESG), Stakeholderism, and Corporate Social Responsibility (CSR). Our analysis allows greater understanding of both what, from a political economy perspective, is at stake in shifting corporate

⁸ See *infra* note 210.

purpose away from share-value-maximization, and what legal reforms are needed to enable that shift. We show that whatever gains in efficiency or reductions in income or wealth inequality might arise from a move to such an alternative ends approach, the move cannot be expected to arise organically, even if favored by a majority of the economy's equity investors. Nor can it arise from simply adjusting managers' fiduciary duties.

We end by turning to how our analytical apparatus developed in Parts I and II could be extended to study shareholder heterogeneity arising from factors other than shareholders' social preferences. Specifically, we outline how our framework can generate valuable insight into two other sources of shareholder heterogeneity: (1) when some shareholders want firms to sacrifice returns for purely selfish, rather than social, reasons, and (2) when shareholders have different beliefs about how firms can best maximize share value.

I. Shareholder Influence on Corporate Behavior, Holding Fixed Each Firm's Shareholder Base

Standard economic models of corporate governance assume that all equity investors wish to maximize their risk-adjusted returns and thus want each firm in which they invest to maximize its share value.⁹ Everything else being equal, this is certainly the case. Often, though, everything else is not equal. An equity investor may have one or more other-regarding values that would leave her, if fully informed, willing to sacrifice a portion of her returns to advance some social end. This has led some commentators to hope that such willing-to-sacrifice investors can act as critical agents for solving the serious social and environmental problems that government has failed to solve.¹⁰

⁹ See *supra* note 2.

¹⁰ See e.g., Hart & Zingales, *Shareholder Welfare*, *supra* note 7, at 249 ("If political change is hard to achieve, action at the corporate level is a reasonable substitute"); Michal Barzuzza, Quinn Curtis & David H. Webber, *The Millennial Corporation: Strong Stakeholders, Weak Managers*, 28 STAN. J.L. BUS. & FIN. 255, 262 (2023); Alice Ross, *Can*

To what extent, though, does the existence of these willing-to-sacrifice equity investors currently affect firm behavior? Our answer proceeds in two stages. In the first stage, undertaken here in Part I, we take the shareholding makeup of each corporation as given. We assume that it has resulted from all of the economy’s equity investors composing their portfolios based on ordinary financial considerations unrelated to any concerns about the social impact of these issuers’ behaviors (an approach we label as “unconstrained investing”). This setup allows us to consider for a representative firm whether having a portion of its shareholders willing to sacrifice to advance some social end will lead to a meaningful difference in firm behavior relative to all having all of its shareholders prefer share-value-maximization. Then, in Part II, the second stage, we complete the picture by recognizing the fact that some investors do compose their portfolios accounting for social aspects of issuer behavior, and we see what difference recognizing this fact makes.

A. Equity Investors in a Representative Corporation

An equity investor, like most other individuals, is a full human being with a variety of values beyond maximizing her wealth. A corporation in which she is a shareholder may be able to change behavior in a way that advances one or more of these social concerns but decreases the corporation’s share value. If she were fully informed concerning how much the change would advance her concern and how much it would reduce the corporation’s share value, she might view the tradeoff as worthwhile. Another fully informed shareholder of the same corporation might not.¹¹

Investors Save the Planet?, THE EUROPEAN MAGAZINE (Apr. 27, 2022), <https://the-european.eu/story-27225/can-investors-save-the-planet.html>

¹¹ See, e.g., Scott Hirst, Kobi Kastiel & Tamar Kricheli-Katz, *How Much Do Investors Care About Social Responsibility*, 2023 WISC. L. REV. 977 (experimental results showing that some investors are willing to forgo gains to advance a social interest but others are not); Brad M. Barber, Adair Morse & Ayako Yasuda, *Impact Investing*, 139 J. FIN. 162 (2021) (empirical study of VC and growth equity funds showing that investors are willing to accept lower financial returns to advance societal objectives); Stefano Giglio, et al., *Four Facts About ESG Beliefs and Investor Portfolios*, 164 J. FIN. ECON. 103984 (2025) (survey showing that investors generally expected ESG investments to underperform the market); Arno Riedl & Paul Smeets, *Why do Investors Hold Socially Responsible Mutual Funds?*,

There is no reason to think that financial considerations, which by assumption in this Part I is all that determines an unconstrained investor's portfolio choices, would correlate with her willingness to sacrifice for particular social ends.¹² Given this lack of correlation and the assumption, made here in Part I, that all equity investors engage exclusively in unconstrained investing, all corporations' shareholder bodies would roughly resemble that of a representative corporation whose shareholder body mirrors that of the economy's equity investors as a whole in terms of proportions who, if fully informed, would prefer sacrificing financial returns in order to advance each of a range of social ends. In essence, each firm's shareholder body represents a random draw in these regards from the economy's overall collection of equity investors.

B. The Roles of Shareholders Versus Managers in Determining Firm Behavior

A fundamental feature of current U.S. corporate law is its default arrangement, almost always followed, that the corporation is managed under the direction and authority of its board of directors.¹³ The directors in turn choose the firm's officers, who make day-to-day decisions (we will refer to the combination of the board and these officers as "management" or "managers"). The role of shareholders is limited to certain discrete matters such as electing directors, approving certain extraordinary transactions, cleansing interested party transactions, and voting on non-binding (so-called "precatory") proposals for management consideration. So, in the first instance, the corporation's managers, not its shareholders, determine a corporation's behavior. If its willing-to-sacrifice shareholders are to affect its behavior, the influence will need to be indirect, through

72 J. FIN. 2505 (2017) (using survey results and experimental data to show that investors' socially responsible investments are driven less by financial motives and more by social preferences and social signaling).

¹² For a discussion of what these financial considerations would be, see notes 74 & 75 & *infra* and accompanying text.

¹³ See, e.g., DGCL § 141(a) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation").

either ordinary director elections or through the workings of any of the multiple elements making up the incentive structure within which a firm's managers operate.

C. The Shareholder Franchise

In principle, if the holders of a majority of a corporation's shares prefer a share-value-decreasing change in its behavior in furtherance of some social end, the board, either to honor a pledge made to get elected or to enhance its chances of reelection, might cause the corporation to adopt the change. What evidence is there that this happens with any frequency? If, as we will find, there is little affirmative evidence that it does, what does theory, informed by what we do know about the real world, suggest as to its likelihood?

1. The likelihood that the holders of a majority of shares, if fully informed, would favor a share-value-diminishing change. A shareholder would be fully informed with respect to a socially oriented share-value-diminishing change in a corporation's behavior if she were given, and understood, the best available information on how much the change would advance the social end involved and how much it would reduce share value. For many corporations, the holders (directly or derivatively) of a majority of its shares, if fully informed, might well favor corporate behavior changes of this sort in furtherance of one or more such social ends.¹⁴ In a well-known example, DuPont is reported to have legally dumped toxic PFOA into the Ohio River, which resulted in social costs estimated at about \$350 million (reflecting, among other things, the resulting elevated rates of death and ill health and associated health care costs). By doing this, DuPont privately saved itself \$19 million, the cost of safely incinerating the chemical instead.¹⁵ In a paper with Eleonora

¹⁴ One piece of evidence that equity investors, if better informed, will be willing to accept lower returns for corporations reducing some negative externalities is an empirical study suggesting that privately held firms are likely to pollute less than comparable publicly held ones. See Sophie A. Shive & Margaret M. Forster, *Corporate Governance and Pollution Externalities of Public and Private Firms*, 33 REV. FIN. STUD. 1296 (2020). Their shareholders, because of their concentrated holdings, are likely to be better informed as a matter of course.

¹⁵ See Eleonora Broccardo, Oliver Hart & Luigi Zingales, *Exit versus Voice*, 130 J. POL. ECON. 3101, 3116-17 (2022).

Broccardo, Hart and Zingales take an investor with \$500,000 in an index fund diversified across the whole market and estimate that if DuPont had instead chosen incineration, it would have cost this investor \$0.19. They argue that a substantial portion of similarly positioned equity investors would have been willing to sacrifice the \$0.19 to prevent the dumping's significant social harm, a conclusion which, if the shareholders were fully informed, seems quite plausible.¹⁶

2. The lack of affirmative evidence that willing-to-sacrifice equity investors are influencing who is being elected as directors and their agendas. Compelling as this example might be, research does not reveal a single corporate director election in which a successful candidate pledged to implement a change for social ends and included the caveat that it would decrease share value.¹⁷

Perhaps, though, directors are divining socially oriented share-value-reducing behaviors that the holders of a majority of their company's shares prefer and acting on them without it being a campaign issue. There have been, after all, many recent examples, pursuant to the Exchange Act's Rule 14a-8, 17 CFR § 240.14a-8, of majority votes for precatory resolutions urging management to direct their corporations to behave in various socially-oriented ways.¹⁸ We are skeptical, however, that these votes provide evidence that managers sacrifice share value because of willing-to-sacrifice shareholders' preferences.

¹⁶ Survey data suggests that persons who invest in ESG oriented funds on average expect that they will receive inferior returns. See Stephon Giglio, et al., *Four Facts About ESG Beliefs and Investor Portfolios*, 164 J. FIN. ECON. 103 (2025).

¹⁷ In late 2020, the hedge fund Engine No. 1 acquired a stake in Exxon Mobil and subsequently mounted a successful proxy fight to replace some members of Exxon Mobil's board. The stated objective was to cause Exxon Mobil to forgo further exploration activities. This might be cited as a counterexample to the statement in the text, but that would not be correct. Ceasing exploration was not just claimed to reduce greenhouse gases, but also to be share-value-enhancing, by avoiding investments that would later become "stranded assets" as demand declines. See Engine No. 1's Letter to Exxon Mobile's Board of Directors (Feb. 22, 2021), <https://reenergizexom.com/materials/letter-to-the-board-of-directors-february-22>.

¹⁸ See, e.g., Sullivan & Cromwell LLP, *2023 Proxy Season Review: Part 1* (2023), https://www.sullcrom.com/SullivanCromwell/_Assets/PDFs/Memos/sc-publication-2023-proxy-season-review-part-1.pdf (43 proposals in the social or environmental area received a majority vote in 2022 and the first half of 2023).

First, promoters of these precatory resolutions do not suggest that achieving the social objective would sacrifice share value.¹⁹ Indeed, they often affirmatively suggest the proposed change would be financially positive or at least neutral.²⁰ Even if the change called for by the proposal would diminish share value, votes supporting the change cannot serve as evidence of directors responding to the informed preferences of willing-to-sacrifice investors when the sacrifice in share value is not even acknowledged. In any event, there is little evidence that these resolutions have led to share-value-diminishing changes in corporate behavior.

Second, some of the changes called for by successful precatory resolutions that their proponents claimed to be share-value-enhancing really may have been. Managers have a massive informational advantage over outsiders, and, as we will see, are incentivized to run the firm in a share-value-maximizing way. Still, they may fail to do so because they live in their own bubble that allows them to self-justify continuing to do what has been done in the past, or are overly focused on the short term.²¹ Accordingly, before the precatory resolution, such managers may have failed to perceive that the called for change in behavior would not just advance some social end,

¹⁹ See, e.g., <https://www.iccr.org/wp-content/uploads/2025/05/Amazon-shareholder-resolution-Climate-Commitments-and-Data-Center-Growth-1.pdf> (statement in support of 2025 14a-8 proposal at Amazon seeking a report on the climate implications of the company’s anticipated expansion of data centers, which makes no mention of the effect of the proposal on firm profitability or share value).

²⁰ See, e.g., https://www.iccr.org/wp-content/uploads/2025/05/25.AMZN_CE-Amazon-Resolution_FIN.pdf (preamble to 2025 14a-8 proposal at Amazon seeking a report on Amazon’s ability to reduce plastic pollution by using flexible plastic packaging, which would allow the company to “avoid regulatory, environmental, and competitive risk”).

²¹ It is a matter of scholarly debate whether there are many potential changes in corporate behavior that are “win-win” i.e. both pro-social and share-value enhancing. For arguments that there are, see ALEX EDMANS, GROW THE PIE: HOW GREAT COMPANIES DELIVER BOTH PURPOSE AND PROFIT (2020) and Robert P. Bartlett & Ryan Bubb, *Corporate Social Responsibility through Shareholder Governance*, 97 S. CAL. L. REV. 417, 458-59 (2024). Some scholars believe that hedge fund activism may in fact promote short-termism, see John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 1 ANNALS OF CORPORATE GOVERNANCE 1 (2016), which can lead to passing up “win-win” decisions if they require a short-term hit to net revenues. One study of a socially oriented investment fund’s engagements with issuers showed that when the issuers agreed to change, there was on average an increase in share value. See Elroy Dimson, Oğuzhan Karakaş & Xi Li, *Active Ownership*, 28 REV. FIN. STUD. 3225 (2015). For skepticism regarding how extensive these “win-win” situations are, see Mark J. Roe, *Stock Market Short-Termism’s Impact*, 167 U. PA. L. REV. 71 (2018) and Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Funds Activism*, 115 COLUM. L. REV. 1085 (2015).

but actually increase share value. A substantial vote in favor could be consciousness raising for them, puncturing the bubble or encouraging greater attention to what behaviors are truly share-value-maximizing in a complex world with changing demographics and socially-influenced brand reputation. The vote would not be an example of the influence of willing-to-sacrifice investors on directors, however, because no sacrifice was involved.

3. *Why it is unlikely that willing-to-sacrifice equity investors are influencing who is being elected as directors and their agendas.* A lack of affirmative evidence does not prove a negative, but it heightens the value of theory, informed by what we do know about the real world. Various factors suggest it is unlikely that investors with willing-to-sacrifice preferences are significantly influencing who is elected as corporate directors or their agendas.

a. *Incomplete information and rational apathy.* Recall that, in our terminology, an investor's preference is the corporate behavior that the investor would prefer if she were fully informed concerning how changes in this behavior would further her social aims and reduce share value. Typically, prior to a director election for directors, she starts out uninformed in these ways. Her preferences are in some sense hypothetical, or, in our terminology, "incipient." They become "manifest," and hence can potentially influence who gets her vote for director, if and only if the shareholder becomes fully informed by the time that she is to vote. Frequently, she does not become fully informed, and thus her share-value sacrificing preferences remain incipient and do not influence her vote for corporate directors.

The cost of acquiring and processing information is an important reason why specific business decisions are delegated to a corporation's directors and officers in the first place.²² Even a person whose only investment is a substantial block of shares in a single corporation is, if not

²² REINIER KRAAKMAN, ET AL., THE ANATOMY OF CORPORATE LAW 49 (2017).

also a manager, far from informed enough to make ordinary business decisions well. By extension, the investor would be similarly poorly informed as to whether a socially-oriented share-value-decreasing change is worthwhile in terms of his personal values. The situation is even worse for holders of most of the shares of the typical dispersed ownership corporation (whether they hold directly or derivatively through a fund). Each such holder, to reduce risk through diversification, typically splits her portfolio across many different firms. With so many firms in her portfolio, it is impractical, even if she is altruistic, to become sufficiently informed about each such firm to make her willing-to-sacrifice preferences manifest, or to cooperate with altruistic others in ways that would permit them to act together to further a shared goal.²³

There is also the problem of rational apathy. It is well established that ordinary retail shareholders have very little incentive to become informed even when all she wishes is for the corporation to maximize share value.²⁴ Any holder with less than 100% of the shares will not fully collect the rewards from the effort. This is true in the extreme if she owns only a small portion of the firm's equity, as is the case with the holders of most of the shares in a dispersed ownership corporation. Moreover, suppose such an investor nevertheless were to incur the cost to become well informed and that effort revealed that management was not maximizing share value. Her vote nonetheless is very unlikely to be determinative. That unlikelihood disincentivizes her from becoming informed in the first place. The bottom line is that an ordinary director election is

²³ Einer Elhauge argues persuasively that when an individual's equity interests in a firm are indirect through a fund, she is even more insulated from the social consequences of the firm's actions than where she made the decision on her own to acquire the interest through directly owning the shares. See Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 817 (2005).

²⁴See Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 2 J. L. & ECON. 395, 395-98 (1983).

generally not an effective channel for promoting even share-value-maximization, let alone other shareholder goals.²⁵

If rational apathy applies to voting on issues relating to a corporation's profitability, it applies in spades to voting on issues involving a corporation's social impact, which typically are not the primary reasons that the individual made the equity investment in the first place.²⁶

b. The vote is for who should be the directors, not on how the corporation should behave. Once a year shareholders vote for director candidates. Even if all the holders of a corporation's shares were—contrary to what we suggest above—fully informed, and the holders of a majority were willing to sacrifice share value to advance some social end, the resulting choice of directors would be unlikely to turn on these preferences. Despite these preferences actually being manifest, they would, for a number of reasons, likely just get lost in the noise or at least not be determinative.

To start, for most shareholders, the most critical consideration in deciding whether to vote for a particular director candidate will be whether the candidate would be good at supervising the productive running of the firm. Such a candidate serves their interests whether or not they are willing to sacrifice to advance some social end. Also, shareholders differ in their preferences with regard to sacrifice for any particular social end: some prefer no sacrifice, others are willing to make a modest sacrifice but not more, and yet others are willing to sacrifice more. This heterogeneity makes it hard for a director candidate to divine the range of shareholder preferences, and, relative

²⁵ KRAAKMAN ET AL., *supra* note 22, at 51-52. There is ample empirical evidence that ordinary retail investors are in fact apathetic when it comes to voting on ordinary matters. *See, e.g.,* Kobi Kastiel & Yaron Nili, *In Search of the "Absent" Shareholders: A New Solution to Retail Investors' Apathy*, 41 DEL. J. CORP. L. 55, 61-66 (2016).

²⁶ The increased retail ownership in meme stock issuers is accompanied by more, not less, retail shareholder apathy, in the use of the franchise. *See* Dhruv Aggarwal, Albert Choi & Yoon-Ho Alex Lee, *Meme Corporate Governance*, 97 S. CAL. L. REV. 1419, 1441-46 (2024). Although these added retail investors may not be fully representative of all retail investors, these findings are at least suggestive that any smart-phone-based renaissance in retail investing more generally will not increase the likelihood of willing-to-sacrifice directors being elected to corporate boards.

to share value maximization, what level of deviation, if any, would be preferred by the holders of a majority of shares. This difficulty makes it less likely that the candidate will find the issue one worth running on.²⁷

The problem, though, extends beyond differences in how much, if at all, equity investors want the firm to change its behavior to support any given social end. Consider some of the social issues that excite the most passion, such as birth control or abortion. Some shareholders will want the corporation to provide employees these services above what would be share value maximizing levels, compensating for what they believe are inadequate public services. Others want to prohibit the corporation from providing such services even if doing so decreases share value through negative effects on employee recruitment and retention.

For all these reasons, ordinary director elections are highly unlikely to be an effective channel by which willing-to-sacrifice shareholders can affect corporate behavior, even if they became fully informed and constituted a majority. This low likelihood compounds the rational apathy problem. It further reduces the chances that a social change agent would make the effort to inform and mobilize shareholders to vote, given that if they made this effort, the directors pledged to change still would probably not be elected. And if a change agent nevertheless did make the effort, it also reduces the chances that the shareholders would make the effort to listen.²⁸ In sum,

²⁷ Shareholder voting on 14a-8 precatory proposals can provide managers with only very selective information about shareholder preferences. *See, e.g.*, Doron Levit & Nadya Malenko, 66 J. FIN. 1579 (2011) (developing a model in which nonbinding votes fail to effectively convey shareholder views). *But see* James D. Cox & Randall S. Thomas, *Creating a Corporate Public Square*, 2021 COLUM. BUS. L. REV. 1147 (2021) (arguing that 14a-8 proposals should be more broadly envisioned as mechanisms that transmit information to the directors of all companies rather than just the directors of the target company). Some commentators suggest corporations should regularly poll their shareholders on their preferences with regard to social impact. *See, e.g.*, Hart & Zingales, *Shareholder Welfare*, *supra* note 7; Jill Fisch, *Purpose Proposals*, 1 U. CHI. BUS. L. REV. 113 (2022). Putting aside implementation costs, polling cannot cure the problems of it not being worth the effort for shareholders to become informed or of preferences for a deviation getting lost in the noise.

²⁸ These impediments have been recognized by others seeking to make firm managers more responsive to the preferences of their firm's socially-minded shareholders. *See, e.g.*, Adi Libson, *Taking Shareholders' Social Preferences Seriously: Confronting a New Agency Problem*, 9 UC IRVINE L. REV. 699, 719-22 (2019) (proposal to

even an informed shareholder electorate would be unlikely to elect such a director, and so why would any change agent try.

c. The analogy to the public sphere. One might respond to the foregoing by pointing to the process of electing public officials. Despite problems in the public sphere akin to the ones for director elections identified above, some combination of the media, political parties, advocacy groups, polls, focus groups, lobbyists, and voters' sense of civic duty assures that the preferences of citizen voters across a wide variety of issues do, to some extent, get recognized and acted upon. Informing and mobilizing voters in this public sphere, though, requires reformers to expend substantial energy and resources. We do not see a comparable political infrastructure replicated for each of the country's few thousand publicly traded dispersed ownership corporations. Those who might mobilize the shareholders of these corporations likely consider devoting the necessary energy and resources is not worthwhile. Corporate electoral pathways through which change could be accomplished are simply too fractured, rendering the payoff for any one corporation on any one issue too small. Also, to overcome rational apathy by voters in public elections, our educational institutions, opinion leaders, media, and political operatives all seek to inculcate a sense that voting is a civic duty and can provide a source of participatory satisfaction,²⁹ a notion reinforced by peer pressure.³⁰ Nothing comparable encourages shareholder voting. Tellingly, approximately 70% of eligible American voters participated in a federal election between 2018 and 2022,³¹ whereas estimates for retail shareholders hover around 30%.³²

establish board committees that would identify matters of significant social concern and solicit shareholder input on those matters).

²⁹ See André Blais & Carol Galais, *Measuring the Civic Duty to Vote: A Proposal*, 41 ELECTORAL STUD. 60, 61 (2016),

³⁰ Samuel Abrams, Torben Iversen & David Soskice, *Informal Social Networks and Rational Voting*, 41 BRITISH J. POL. SCI. 229 (2010).

³¹ Hannah Hartig, Andrew Daniller, Scott Keeter & Ted Van Green, *Voter Turnout, 2018-2022*, PEW RSCH. CNTR. (July 12, 2023), <https://www.pewresearch.org/politics/2023/07/12/voter-turnout-2018-2022>.

³² Gretchen Morgenson, *Small Investors Support the Boards. But Few of Them Vote*, N.Y. TIMES (Oct. 6, 2017).

d. Intermediaries and the franchise. A significant portion of equity investors invest derivatively through holding interests in mutual funds, ETFs, and pension funds.³³ The fund holds legal title to the corporation's shares and is usually the entity voting these shares.³⁴ This has one clear advantage: the fund, in determining how to vote, can spread across all the shares of each issuer in its portfolio the costs of determining what changes the issuer could make to advance any given social aim and the associated reductions in share value. So, on a per-share basis, these costs would be much lower than if each investor conducted the research herself. Indeed, some commentators recognize the rational apathy and other shortcomings of relying on voting by individual equity investors, but believe that funds' economies of scale, and of scope, can solve the problem.³⁵

³³ See, e.g., Sarah Holden & Michael Bogdan, *Main Street Owns Wall Street*, ICI Viewpoints (2021), https://www.ici.org/viewpoints/21_view_equityownership (reporting that in 2019, 56 percent of U.S. households' holdings of publicly traded stocks were held indirectly through funds and retirement accounts).

³⁴ Blackrock, State Street, and Vanguard, which dominate the market for broad-based index mutual funds and ETFs, have each adopted "pass-through voting" schemes that give their retail investors some say in the voting of the fund's shares. See, e.g., BLACKROCK, U.S. RETAIL PROGRAM FAQs (2025), <https://www.blackrock.com/corporate/literature/publication/voting-choice-usretailprogramfaqs.pdf>. These schemes allow a fund investor to have a proxy-soliciting firm vote her shares. She can choose among a small number of plans, each of which has an overall theme and associated voting guidelines. Among the seven plans made available by BlackRock, for example, three have social value aspects associated with them: the ISS "Catholic Faith-Based Policy," the ISS "Socially Responsible Investment (SRI) Policy," and the Glass Lewis "Climate Policy." So far, few fund investors have chosen one of these schemes rather than continuing to let the fund manager votes the shares, but the funds are committed to expanding the retail investor uptake. Alon Brav et al, *The Proxy Voting Choice Revolution* (2025), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5500098, at 3. Also, pension funds and some other institutional investors, in addition to their direct holdings of corporate equity, often hold equities derivatively by investing in mutual funds. In some of those instances, the mutual fund's manager might determine how the shares in which the pension fund has a derivate interest are voted, see Jill Fisch & Jeff Schwartz, *Corporate Democracy and the Intermediate Voting Dilemma*, 102 TEX. L. REV. 1, 27 (2023), but in others the pension fund may direct the voting of those derivative equity interests. See, e.g., Dorothy S. Lund, *Asset Managers as Regulators*, 171 U. PA. L. REV. 77, 83 n.29 (2022).

³⁵ See, e.g., Oliver Hart, Hélène Landemore & Luigi Zingales, *How to Implement Shareholder Democracy* (2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5039736; Other scholars argue that large institutional investors' broadly diversified portfolios incentivize them to cause the firms in which they are invested to reduce their negative externalities. See, e.g., Madison Condon, *Externalities and the Common Owner*, 95 WASH L. REV. 1 (2020); Jeffrey N. Gordon, *Systemic Stewardship*, 47 J. CORP. L. 627 (2022). They argue that because the costs of those externalities are borne by other firms in which the institutional investors are invested, the investors have a pecuniary interest in the externalities being curtailed. We are skeptical that this portfolio effect is having a significant effect on reducing firms' externalities, because, among many other reasons, the costs of a firm's negative externalities are ordinarily not borne in large measure by other firms, but instead directly by individuals in society.

To what extent, though, do these economies of scale solve the problems described above that prevent director elections from being an effective way for willing-to-sacrifice shareholders to affect firm behavior?

i. How big are the scale economies for acquiring information about issuers? At first glance, the economies-of-scale appear substantial. Institutional investors collectively hold 78% of the shares in the largest quintile of the economy's publicly traded firms.³⁶ Not all intermediaries enjoy such extensive scale economies, however. For example, an institution holding less than 1% of an issuer's shares can spread information acquisition costs over only a small fraction of a firm's total shareholder base. Interestingly, excluding such less-than-1% holders, institutions in aggregate hold on average only 47% of the shares of the S&P 500 firms.³⁷ Those firms' overall importance to the economy is shown by the fact that they employ close to two-thirds of the employees of all publicly traded firms.³⁸

In addition, although funds have economies of scale with regard to any given issuer, their portfolios typically contain hundreds of issuers or more. Determining what changes each issuer could make to advance various social concerns and what would be the resulting reductions in share value reductions is, in aggregate, a very large, expensive task.

³⁶ See Jonathan W. Lewellen & Katharina Lewellen, *The Ownership Structure of U.S. Corporations*, Table 3, p. 17 (January 2025), <https://ssrn.com/abstract=4173466> (institutional investors hold 78% of the shares of the largest quintile of publicly traded firms, where quintile demarcations are based on NYSE market capitalization).

³⁷ See *id.* (among the largest quintile of publicly traded firms, 47% of the firms' shares are held by institutional investors with greater than 1% equity interest). For publicly traded firms in the other four quintiles, from smallest to largest, 27%, 52%, 61%, and 59% of those firms' shares, respectively, are held by institutional investors with greater than 1% equity interest. See *id.*

³⁸ S&P 500 firms employ about 18% of the total U.S. workforce. See Torston Slok, *Most of the US Economy is in Private Markets* (April 30, 2024), <https://www.apolloacademy.com/most-of-the-us-economy-is-in-private-markets/>. All publicly traded firms employ about 30%. See Roe & Wang, *supra* note 4. Institutions with a greater than 5% equity interest in a firm are in a better position in this regard, but such institutions in aggregate on average less than 25% of the equity of the largest quintile of the economy's publicly traded firms. See Lewellen & Lewellen, *supra* note 36, at Table 3, p. 17. For publicly traded firms in the other four quintiles, from smallest to largest, institutions with greater than a 5% equity interest hold 14%, 27%, 32%, and 30% of their shares, respectively. See *id.*

ii. *Weak incentives to collect information about issuers.* Institutions with larger holdings can acquire the necessary information at a lower cost per share, but still how strongly do they wish to do so? Investors will not readily know whether fund managers are gathering such information. In contrast, fees are quite salient to investors. Thus, in a world of competing funds, managers of even larger funds are incentivized to skimp on information acquisition to keep their costs, and hence their fees, low.³⁹ This is especially true of broad-based index funds, all of which offer essentially the same product. These funds can only compete on fees, and, as a result, the fees are very low.

iii. *The need for information about investor preferences.* Once an intermediary is introduced into the equation, the information challenges are two-sided. Suppose an intermediary were fully informed about a change in issuer behavior that would advance some social aim. Having this information is just the first step. The fund must also know its investors' preferences. This is a huge problem because the preferences of willing-to-sacrifice investors are largely incipient. Investors cannot even articulate their preferences without knowing what can be accomplished and at what cost. If these preferences are not articulated and communicated, funds cannot vote in accordance with them.⁴⁰ As discussed later, we believe that no obvious workable mechanisms exist for accomplishing this task.⁴¹

³⁹ There is one way that competition among the large broad-based index funds, which are all offering essentially the same product, could lead the funds to be sensitive to equity investors' social concerns. John Coates suggests that, in order to attract customers, funds announce guidelines as to how they will vote on socially oriented precatory resolutions, and that their votes often decide the outcome. JOHN C. COATES, IV, *THE PROBLEM OF TWELVE: WHEN A FEW FINANCIAL INSTITUTIONS CONTROL EVERYTHING* 100 (2023). We discuss later why we are skeptical as to the strength of this effect. See III.B.5.e *infra*.

⁴⁰ There is always the possibility of a fund manager, without knowing the preferences of the funds' investors, voting the fund's shares based on her own personal social values. We do not explore that possibility here except to note that such behavior both severs the link between investor preferences and fund voting and implicates the larger social issue of the legitimacy of fund managers making these fundamental social choices. See COATES, *supra* note 39.

⁴¹ See notes 133 and 145 *infra* and associated text for a discussion of mechanisms some commentators have proposed and the reasons they are unlikely to work.

iv. Funds labelled as concerned with a social issue. What, though, about a mutual fund or ETF that labels itself as focused on a particular social issue? The very fact that an investor chose the fund provides its manager with some information about her socially-minded preferences. By itself, though, this information is much too coarse to meaningfully communicate investors' incipient preferences into specific changes in corporate behavior.⁴² For each of the social ends within a specialized fund's area of social concern, the fund would need to know how much its investors would be willing to sacrifice in return for the many different degrees of behavior change that could advance that end to one extent or another.⁴³

Suppose, hypothetically, a socially specialized fund overcame all the preceding problems and was fully informed both as to: (1) the negative social impacts and costs of correction for each firm in its portfolio and (2) to the varying extents to which each firm's investors are willing to sacrifice to correct these impacts. And suppose this information indicated that the firm's investors want the issuer to advance some social aim despite the decrease in share value. For competitive reasons, the fund may still be disinclined to vote in accordance with these preferences. Funds that claim to be dedicated to advancing a social concern generally do not suggest that they are doing so at a cost to their investors. Although these investors are willing to sacrifice a meaningful amount in returns to advance that concern, they would obviously prefer that cause be advanced at little or no cost to them. So, among competing funds, they would prefer the fund that claims it can advance the concern at little or no cost, when in fact the fund avoids the costs of advancing the concern by failing to do so, at least meaningfully. This tactic is likely to win

⁴² Moreover, the empirical evidence to date suggests that funds do not do a very good job at aligning their voting even with these crude indications of investor concerns. *See, e.g.,* Jonathon Zytneck, *Do Mutual Funds Represent Individual Investors?* (2021), <https://Articles.ssrn.com/abstract=3803690> (finding very little correlation between investor preferences and fund voting).

⁴³ *See* Bartlett & Bubb, *supra* note 21, at 472.

investors' favor because they will be able to detect a fund's poor financial performance relatively easily. Detecting its failure to vote in a way that results in a firm acting in a way that advances the fund's claimed social goals is much harder. Accordingly, the best way for such a fund to attract customers may be to claim that they will vote to advance some social concern, but in fact to vote in a way that instead maximizes financial return, i.e., to "greenwash."⁴⁴

v. *Fiduciary duties*. Finally, fiduciary duties would also exert a strong push for a fund to vote for share-value-maximizing directors even if most of its investors were willing to sacrifice. Consider first private pension funds. Their trustees are subject to ERISA, which requires them to act "solely in the interest of" and for the "exclusive purpose" of benefitting plan participants and beneficiaries.⁴⁵ The Supreme Court interprets this requirement as obligating these trustees to seek to exclusively maximize their beneficiaries' *financial* benefits.⁴⁶ That seemingly bars them from voting for directors who pledge to advance social aims despite the negative impact on share value. Public pension plan trustees are not subject to ERISA, but courts extensively rely on the statute when interpreting trustee fiduciary duties.⁴⁷ Moreover, we see no evidence that

⁴⁴ See, e.g., Markku Kaustia & Wenjia Yu, *Greenwashing in Mutual Funds* (2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3934004 (finding evidence of greenwashing); Lindsey Stewart, *Does Your Sustainable Fund Always Vote in Favor of ESG? Apparently Not*, Morningstar (2023), <https://www.morningstar.com/sustainable-investing/does-your-sustainable-fund-always-vote-favor-esg-apparently-not>. But see Quinn Curtis, Jill Fisch & Adriana Z. Robertson, *Do ESG Funds Deliver on Their Promises?*, 120 MICH. L. REV. 393 (2021) (finding that ESG funds offer investors increased ESG exposure and vote their shares differently than non-ESG funds).

⁴⁵ See 29 U.S.C. § 1104(a)(1)(A)(i).

⁴⁶ See *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 420-21 (2014). See also 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, 403-411 (2020) (discussing fiduciary duties under ERISA).

⁴⁷ See, e.g., David H. Webber, *The Use and Abuse of Labor's Capital*, 89 N.Y.U. L. REV. 2106 (2014) ("ERISA does not apply to public pension funds, but it is authoritatively cited to interpret the fiduciary duties embedded in state pension codes"); Paul Rose, *Public Wealth Maximization: A New Framework for Public Fund Fiduciary Duties* 2018 ILL. L. REV. 891, 893 ("For [public] pension fund trustees, a strict reading of their duty would require them to disregard worker and societal interests and focus solely on maximizing the value of the fund."). Some scholars have advocated for a broader understanding of the legal obligations of public pension fund trustees that would give the trustees greater latitude in their investment objectives than just the maximization of beneficiaries' financial gains. See, e.g., Jill E. Fisch & Jeff Schwartz, *The Singular Role of Public Pension Funds in Corporate Governance*, __ TEX. L. REV. __ (forthcoming 2025) (arguing that legal obligations of state and local pension fund managers should be understood as permitting them to make investment decisions based on both economic and societal considerations).

public pension funds expressly seek to advance social change at the expense of their pension beneficiaries' financial well-being, whether through the corporate franchise or otherwise.⁴⁸

The law gives mutual fund and ETF managers more latitude to pursue non-financial objectives at the expense of share value, including through the corporate franchise, but only if that is the fund's stated objective.⁴⁹ Though there are many socially-oriented mutual funds and ETFs, we are not aware of any whose articulated objective is to advance a social aim at the expense of share value. To the contrary, the stated investment objectives of socially conscious mutual funds and ETFs reference the promotion of returns.⁵⁰ Accordingly, and consistent with their fiduciary duties, mutual fund and ETF managers' voting guidelines, even those governing green or ESG

⁴⁸ For instance, California Public Employees' Retirement System ("CalPERS") is the country's largest state pension plan and is well known for its corporate activism, including with respect to social issues. *See, e.g.*, Stephen J. Choi & Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 VAND L. REV. 315, 315-16 (2019). But as CalPERS makes clear in its proxy voting guidelines, its "primary objective in exercising [its] ownership rights is to ensure that [its] portfolio companies are managed and governed in such a way as to generate long-term sustainable investment returns". CalPERS Proxy Voting Guidelines 1 (Jan. 2025), <https://www.calpers.ca.gov/documents/proxy-voting-guidelines/download>. *See also* CalPERS' Governance & Sustainability Principles 3 (Nov. 2023), <https://www.calpers.ca.gov/documents/governance-and-sustainability-principles/download> ("A vital part of [our mission] is ensuring that our investments, which fund around two-thirds of our pension payments every year, generate the highest possible returns at an acceptable level of risk."). There are arguments in the literature that public pension funds do not consistently seek to maximize the value of their portfolios, but the provided reasons do not concern the influence of investor preferences. *See, e.g.*, Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795 (1993).

⁴⁹ A manager of a mutual fund or ETFs will be considered an investment advisor under the Investment Advisers Act of 1940 ("IAA"). *See* 15 U.S. Code § 80b-2(a)(11) (definition of investment advisor). *See also, e.g.*, Fact Sheet, Fidelity Management & Research Company, <https://www.fidelity.com/myfidelity/InsideFidelity/NewsCenter/quickFacts/FMRCO.html> (Fidelity Management & Research Company ("FMR") serves as investment advisor to Fidelity's family of mutual funds.); SEC, Investment Advisor Public Disclosure, <https://adviserinfo.sec.gov/firm/summary/108281> (FMR registered as an investment advisor under the IAA). Under the IAA, an investment advisor owes fiduciary duties of care and loyalty to its mutual fund or ETF client, including a duty to act in accordance with the fund's desired objective. *See, e.g.*, SEC, Release No. IA-5248, 17 CFR Part 276 (2019) ("[An investment advisor's] fiduciary duty requires an adviser to adopt the principal's goals, objectives, or ends.").

⁵⁰ Consider, for instance, the BlackRock Sustainable Aware Advantage Large Cap Core Fund. *See* BlackRock, <https://www.blackrock.com/us/individual/products/279569/blackrock-sustainable-aware-advantage-large-cap-core-fund>. The stated investment objective of that actively managed fund is to "provide total return while seeking to maintain certain [ESG] characteristics and climate risk exposure relative to the Fund's benchmark." Prospectus, BlackRock Sustainable Aware Advantage Large Cap Core Fund at 1.

funds, predominantly explain that they exercise the corporate franchise to maximize investors' financial returns, not to prioritize social aims achievable only at the expense of returns.⁵¹

4. *Implementation.* Notwithstanding all the problems discussed here, suppose that, in an election reflecting the preferences of the holders of a majority of a firm's shares, the directors chosen are pledged to change firm behavior to advance a social end at the expense of share value. As we discuss later, a shareholder vote expressing this preference does not guarantee that the change will happen.⁵² Once elected, the directors and the officers they appoint will retain discretion on how to operate the firm. Indeed, the very reason for the existence of these directors and officers is the need for them to have this discretion: they are paid to gather all kinds of information that shareholders lack and to spend time analyzing and acting on it. Despite the mandate to deviate from share-value-maximization, these firm managers still operate within an incentive structure that

⁵¹ Consider Blackrock. Its voting guidelines for its passively managed mutual funds and ETFs explain that BlackRock's voting decisions are "focused solely on advancing clients' financial interest." See Blackrock, *Investment Stewardship, Proxy Voting Guidelines for Benchmark Policies - U.S. Securities* (Jan. 2026) at 3, n.1, <https://www.blackrock.com/corporate/literature/publication/blackrock-investment-stewardship-benchmark-guidelines-us.pdf>. A recent BlackRock stewardship report explains that BlackRock voted against environmentally-related shareholder proposals because they "sought outcomes that were unlikely to promote long-term shareholder value." See BlackRock, *Investment Stewardship Annual Report*, <https://www.blackrock.com/corporate/literature/publication/annual-stewardship-report-2024-summary.pdf>, at 11. Blackrock's voting guidelines for its actively managed mutual funds and ETFs, such as its BlackRock Sustainable Aware Advantage Large Cap Core Fund, see *supra* note 50, are similar. See BlackRock, *Active Investment Stewardship Global Engagement and Voting Guidelines* (Jan. 2026) at 16, <https://www.blackrock.com/corporate/literature/publication/blackrock-active-investment-stewardship-engagement-and-voting-guidelines.pdf>. There is no indication that the two BlackRock's U.S. managed ETFs with express climate and decarbonization objectives are different. See *id.* at 17; BlackRock, *Climate and Decarbonization Stewardship Program* (Dec. 2024), <https://www.blackrock.com/corporate/literature/publication/climate-and-decarbonization-active-stewardship-program-americas-product-list.pdf> (listing the two ETFs). Instead, both ETFs seek "long-term capital appreciation." See BlackRock, *U.S. Carbon Transition Readiness ETF*; <https://www.blackrock.com/us/individual/products/318215/blackrock-u-s-carbon-transition-readiness-etf>; BlackRock, *World ex U.S. Carbon Transition Readiness ETF*, <https://www.blackrock.com/us/individual/products/318216/blackrock-world-ex-u-s-carbon-transition-readiness-etf>. Fund managers such as BlackRock have made clear their belief that they would violate their fiduciary duties if they were to adopt an investment stewardship approach that would promote social objectives at the expense of share value. See, e.g., BlackRock, Inc., SEC No-Action Letter, 2022 WL 225966 (Apr. 4, 2022).

⁵² See III.B.3.b.iv *infra*.

exerts strong pressure on them to run the firm in a share-value-maximizing fashion, which is the next topic for discussion.

D. The Managerial Incentive Structure

Now, consider the second potential way that a firm's behavior could be changed where a portion of its shareholders have at least incipient preferences for it to sacrifice share value to advance some social end: the impact of these shareholders on the workings of the multiple elements that make up management's incentive structure.

1. Managerial interests. To understand how managers will respond to changes in their incentive structure, the starting point is identifying the interests that managers pursue while operating within this structure. Managers can use their positions to advance a variety of interests, some strictly self-regarding and others other-regarding.⁵³

a. Self-regarding interests. A manager's strictly self-regarding interests include compensation, perquisites, power, prestige, and the pleasure of benefiting her associates in the firm. On a period-by-period basis, decisions that use the firm's existing productive capacity to maximize the firm's residuals—the difference between the value of its output and the cost of producing that output – maximizes the capacity of the firm to satisfy these self-regarding interests because doing so maximizes its cashflow from operations.⁵⁴ In general, such decisions are also the ones necessary for the firm to operate in a share-value-maximizing fashion.⁵⁵ A deviation from

⁵³ See, e.g., MERRITT B. FOX, FINANCE AND INDUSTRIAL PERFORMANCE IN A DYNAMIC ECONOMY 121-23 (1987).

⁵⁴ This statement reflects the observation by Oliver Williamson that the shareholders are not the corporation's only residual claimant, implicitly management is a second one. See Oliver Williamson, *Corporate Governance*, 93 YALE L.J. 1197 (1984).

⁵⁵ Scholars long have recognized that these self-regarding interests of management can nevertheless diverge from share-value-maximization. See ADOLF BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932). See also MICHAEL C. JENSEN, A THEORY OF THE FIRM: GOVERNANCE, RESIDUAL CLAIMS, AND ORGANIZATIONAL FORMS 144-45 (2000) (summarizing the primary ways that managerial and shareholder incentives may diverge); FOX, *supra* note 53, at 121-23 (same). The reasons generally do not undermine the idea that these self-regarding interests motivate managers to act contrary to the preferences of willing-to-sacrifice investors. See note 58 *infra*. For the exception to this, see note 56 *infra*.

share value maximization in furtherance of some social aim will generally reduce these period-by-period residuals. Thus, the alignment between operating decisions that serve these self-regarding interests and those that maximize share value poses a very serious impediment to realizing the preferences of shareholders favoring such a deviation.⁵⁶

b. Other-regarding interests. Managers, just like investors, may have other-regarding values. These may include concerns with reputation and a sense of doing good. For some matters, these other-regarding interests may dominate a manager's self-regarding interests. In such cases, she may prefer that the firm deviate from maximizing period-by-period residuals and hence from share value maximization.

2. The elements of the managerial incentive structure. The incentive structure within which managers pursue their interests consists of both sticks and carrots. The sticks are the threat of a hostile takeover, an activist hedge fund campaign, a price-depressing sale of shares, and a suit charging breach of fiduciary duties. The carrots are the managers' compensation packages and their own shareholdings in the firm. The question regarding each of these elements is whether its workings would be affected in ways that would significantly change a firm's behavior if a

⁵⁶ This conclusion requires modest qualification. When it comes to managerial decisions concerning how to use of the firm's existing productive capacity, the decisions that maximize the firm's residuals – what provides the resources to satisfy all these self-regarding interests – are consistent with the decisions that maximize share value. The qualification relates to decisions concerning new investment in the firm's productive capacity in the situation where the current operation's cashflows exceed what would be needed to fund all the non-negative net present value (NPV) project ideas that the firm has generated. Share value maximization generally requires the return of this surplus to the firm's shareholders. However, the firm's ability over time to satisfy these self-regarding managerial interests can be enhanced by violating this rule and using the surplus instead to implement investment proposals that will yield a positive cashflow but will decrease share value because shareholders could be expected to earn a higher risk-adjusted return by simply investing the surplus in the market. See Michael C. Jensen, *Agency Costs of Free Cashflow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323 (1986). In this regard, aspects of the current corporate governance system that push *toward* share value maximization and against the preferences of managers to make certain negative NPV investments can act consistently with the preferences of shareholders who seek to reduce over time the size of an externality producing industry such as oil and gas exploration. See Bartlett & Bubb, *supra* note 17, at 459. In any event, such situations are the subject of the conventional agency cost theory of corporate governance, rather than the focus of this Article. See, note 3 *supra* and accompanying text.

meaningful portion of its shares were held by willing-to-sacrifice shareholders? With modest exceptions, we conclude no.

a. The hostile tender offer. A hostile tender offer occurs when a bidder seeks to purchase enough shares from the target's shareholders to replace the target's incumbent managers. The threat of a hostile tender offer disciplines firm managers from deviating too far from share value maximization for fear of losing their jobs.⁵⁷ The story works as follows. If managers fail to maximize share value, the share price reflects this. A hostile bidder can offer to purchase the firm's shares at a premium above this pre-offer price, but less than what the shares would be worth if the firm were run in a share-value-maximizing fashion. The premium prompts the holders of a majority of the shares to tender, allowing the takeover to succeed. The bidder then operates the firm in a share-value-maximizing way, making the acquired shares worth more than it paid for them.

i. Managers driven primarily by self-regarding interests. Where managers make decisions primarily motivated by self-regarding interests, they will already be trying to make operating decisions that maximize their firm's residuals on a period-by-period basis. The threat of a hostile takeover is irrelevant because it is a force pushing managers to change behavior when they are otherwise *not* trying to maximize the firm's residuals. Thus, any impact that willing-to-sacrifice shareholders might have on the workings of the threat is likewise irrelevant.⁵⁸

⁵⁷ See Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1174 (1981) (“[S]hareholders benefit even if their corporation never is the subject of a tender offer. The process of monitoring by outsiders poses a continuous threat of takeover if performance lags. Managers will attempt to reduce agency costs in order to reduce the chance of takeover, and the process of reducing agency costs leads to higher prices for shares.”); see also Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737, 756 (1997). (“Takeovers are widely interpreted as the critical corporate governance mechanism in the United States . . .”).

⁵⁸ This is not to say that these managers cannot be subject to a hostile takeover for some other reason. Trying to maximize residuals on a period-by-period basis, which managers' self-regarding interests prompt them to do, is only one component of share value maximization. If the managers are not competent or are shirking, or are taking for themselves more of the residuals than is needed to retain persons of their talent, they are not maximizing share value.

ii. Managers driven by other-regarding interests. Suppose managers' other-regarding interests are strong enough, relative to their self-regarding interests, that, they would prefer the firm to behave in some non-share-value-maximizing way that also happens to align with the preferences of willing-to-sacrifice shareholders. Would the presence of these shareholders weaken the hostile takeover threat and thus make it more likely that the managers would in fact cause the firm to behave in this fashion? Possibly, but only if these shareholders' preferences make them more reluctant to tender their shares, and this greater reluctance in turn increases the premium needed for a majority of the firm's shares to be tendered.⁵⁹ Otherwise, the deviation would make the firm just as attractive to an acquirer—and the takeover threat just as real—as if these shareholders did not exist. The reward would be just as great and the cost unchanged.

Should the company stay in incumbent hands, these shareholders, if fully informed, would, by definition, be willing to sacrifice a certain amount of share value to further the social end they favor. Therefore, they might also be willing to forego a tender offer premium of equal size from a bidder unwilling to further this end.

Nevertheless, for a couple of reasons, there is a good chance that these willing-to-sacrifice shareholders will not be significantly more reluctant to tender than shareholders unwilling to sacrifice, in which case their presence will not increase the needed premium. First, they are generally far from fully informed. In a tender offer, the premium they are being offered is something tangible, attractive, and easily knowable. In contrast, they may well not know that the acquisition they would facilitate by tendering would alter firm behavior in a way that would be

The same is true if the firm, instead of paying them out as dividends, is retaining a portion of its period-by-period residuals and reinvesting them in negative NPV projects. *See* note 60 *supra*. The likelihood of success of a hostile tender offer for any of these reasons, however, would not be weakened by the presence of willing-to-sacrifice shareholders because their concerns are unrelated to the issues prompting the takeover.

⁵⁹ To attract the needed majority of shares, a higher premium may be needed either to overcome the reluctance of the deviation-preferring shareholders or to attract a greater portion of the other shareholders.

damaging to their social concerns. Even if they do, they almost certainly lack sufficient information to determine whether avoiding the damage is worth foregoing the premium.

Second, even if the willing-to-sacrifice shareholders were fully informed, there is a subtle difference when the preference in question is whether to tender versus how a corporation in which they hold shares should behave. After all, it is not fully rational for an investor to be more concerned with the social impact of a firm in which she is a shareholder than with that of any other firm. A firm's impact on other people is the same whether the investor holds shares in it or not, and where she does, there is only an infinitesimal chance that the investor's purchase or vote will affect the firm's behavior. So why should she be especially concerned with the behavior of the firm in which she holds shares? This special concern appears to arise from a feeling of responsibility that arises from a particular *status*, that of being a share owner, rather than from a sense that there is a causal relationship between the unfortunate effects of the firm's behavior on other people and any *actions* she has undertaken – i.e., buying or voting the shares.. If it is the status of ownership that gives rise to her concern, that basis for concern is no longer present if, after she tenders her shares and so is no longer an owner, the company, to increase share value, changes behavior in a way that damages others.⁶⁰

b. The activist hedge fund. The activist hedge fund's standard business model involves four steps: (i) identify a firm where a change in how it is run would increase its share price, (ii) acquire a foothold stake in the target firm of perhaps 5-7% of its outstanding shares, (iii) persuade enough of the target's other shareholders of the change's desirability to constitute a majority vote to oust the incumbent managers in favor of the activist's nominees if the incumbents do not adopt the change, and (iv) sell the shares at a profit after the change is adopted and the share

⁶⁰ The same analysis would apply if the managers actually undertook the deviation driven by their own values and the hostile tender offer was not a threat, but an actual effort by an acquirer to reverse the situation.

price increases to reflect the improvement. The corporate governance literature generally argues that activist campaigns of this sort prevent firm managers from deviating too far from share value maximization because if they do, they will be forced to correct the situation or lose their jobs.

i. Managers driven primarily by self-regarding interests. Again, where managers' decisions are primarily motivated by self-regarding interests, they will try to maximize their firm's residuals on a period-by-period basis. Like the hostile tender offer, the threat of an activist campaign is a force pushing managers to change behavior when they are not maximizing share value. But if managers are already maximizing share value, the threat of an activist campaign is irrelevant. So, in this scenario, willing-to-sacrifice investors have no impact on this threat.

ii. Managers driven primarily by other-regarding interests. Suppose, though, that a firm's managers' other regarding interests are strong enough that they would prefer the firm to behave in some non-share-value-maximizing way that aligns with the way that some significant portion of its willing-to-sacrifice shareholders prefer? The central role of shareholder voting in activist campaigns means that the analysis here does not track so closely the hostile tender offer story. This is because the willing-to-sacrifice shareholders may vote against an activist's director candidates in order to preserve the firm's behavior. An activist who expects such negative votes would be less likely to launch a campaign, thereby weakening the activist threat and increasing the chance that the managers will act on other-regarding interests in the first place.

In this situation, for two reasons, the presence of the willing-to-sacrifice shareholders may modestly reduce the activist threat. One is the fact that the firm is furthering a social end will be at the heart of the activist's campaign. Although the activist will point to this behavior to persuade shareholders to vote for the activist director candidates, that effort will at the same time make the existence of this behavior, and the threat of its termination, more salient to willing-to-sacrifice

shareholders, increasing the chance they will vote against the activist director candidates. Second, the target firm's managers are materially interested in informing these willing-to-sacrifice holders, so as to prompt their vote against the activists, and corporate law allows managers to finance these efforts with firm resources.⁶¹

Even given these two factors, however, there are serious questions how often the willing-to-sacrifice shareholders, whose preferences likely start out as incipient, will become sufficiently informed for the preferences to become manifest and prompt a vote against the activist nominees. This is particularly so when it comes to retail investors, who hold their shares directly. It would require an effort by these shareholders that rational apathy suggests they will not make, and the expenditure of significant resources by the firm's managers.

Votes controlled by fund managers require a different analysis. Activist campaigns of all kinds owe much of their success to investment fund votes: for reasons of scale, fund managers are more likely to inform themselves about the merits of the campaign and their votes are much easier for the activist to solicit.⁶² Returning to the situation under consideration, suppose a meaningful portion of a firm's shares are held by funds claiming to be dedicated to furthering the social end in question. This might indeed weaken the activist threat. Still, there are the same information-asymmetry-based and fiduciary-duty-based doubts concerning fund manager willingness to vote against an activist as there are such doubts concerning voting for directors pledged to advance a fund's claimed social aim even when it reduces share value.⁶³

⁶¹ See John C. Coffee, Jr., *How Activist are Institutional Investors? A Closer Look at Proxy Contests and the Contemporary Balance of Power* 17-19 (2025), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=521ns. These corporate resources could be used both to mobilize retail investor votes and to make investment funds more likely to vote against the campaign in order not to offend the funds' willing-to-sacrifice investors.

⁶² See Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Reevaluation of Governance Rights*, 113 COLUM. L. REV. 863, 890 (2013).

⁶³ See Section I.C.3 *supra*.

In any event, whatever modest weakening of the activist threat does occur must be kept in perspective because it merely weakens what starts out as a very strong force pushing for share value maximization. Five to ten percent of all publicly traded firms are visited by an activist fund each year,⁶⁴ a phenomenon about which the rest of the firms are well aware and thus perceive it as a threat for them too.

c. Sale of share blocks. The sale of a large block of shares all at once often depresses their price. The holder of such a block can threaten a sale to prompt management to change course in the holder's preferred direction, knowing that the managers want to avoid a price drop.⁶⁵

Suppose a meaningful portion of a firm's shareholders would, if fully informed, prefer the company to sacrifice some profits to advance some social end. To take the strongest case, suppose also that these interests are derivative, with title to the shares held by one or more pension or investment funds who understand and are willing to pursue their investors' preferences. Could the threat of a sale by these institutions prompt managers to implement the change when they otherwise would not?

This sort of threat is very unlikely to work for two reasons. First, the managers would likely fear the price drop from advancing the social aim as much as they fear the price drop from the threatened sale itself. Second, microstructure economics teaches us that the reason why a block sale often depresses price is because it leads the market to infer that the seller has negative non-public information about the company that was not previously reflected in the price.⁶⁶ The institutions threatening sale have no nonpublic information. Even if the price drops initially after

⁶⁴ MARK J. ROE, MISSING THE TARGET 22 (2022).

⁶⁵ See, e.g., Anat R. Admati & Paul Pfleiderer, *The "Wall Street Walk" and Shareholder Activism: Exit as a Form of Voice*, 22 REV. FIN. STUD. 2645, 2647 (2009).

⁶⁶ See, e.g., Lawrence R. Glosten & Paul R. Milgrom, *Bid, Ask, and Transaction Prices in a Specialist Market with Heterogeneously Informed Traders*, 14 J. FIN. ECON. 71, 72 (1985); LARRY HARRIS, TRADING AND EXCHANGES: MARKET MICROSTRUCTURE FOR PRACTITIONERS 300 (2002).

the sale, when subsequently no negative news comes out, the price will quickly regain what it lost.⁶⁷ Because the price drop would be short-lived, it is unlikely to significantly hurt managers and is thus not a credible threat.

d. Fiduciary duties. The duty of care requires directors and officers to exercise reasonable care to ensure that their decisions are in the best interests of their corporation. The duty of loyalty requires a director or officer who has an interest in a proposed corporate action to behave fairly toward the corporation; in essence not to participate in authorizing the action unless she can affirmatively show that the action is in the corporation's best interest.

Understanding each duty thus depends on the concept of the "best interests of the corporation." A corporation is an artificial legal person. Its best interests are thus a legal construct as well, created out of a selection of the interests of several types of actual individuals that have a stake in its decisions. The ALI Corporate Governance Principles, for example, provides in part: "[A] corporation should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain."⁶⁸

One approach to this legal construct is to define the corporation's best interests as simply maximizing share value, since, all things equal, every shareholder prefers a higher risk-adjusted return to a lower one. Another approach is to recognize that all things are not equal, and ask which decisions maximize the combined financial and non-financial interests of the average shareholder. Suppose the holders of a majority of a firm's shares prefer firm behavior that furthers some social end even if it reduces share value, but management does not act accordingly. Under this second

⁶⁷ See Merritt B. Fox, Lawrence R. Glosten & Gabriel Rauterberg *Informed Trading and Its Regulation*, 43 J. CORP. L. 817, 827 (2018) (professional traders who find no new information to justify a price change trade in the opposite direction).

⁶⁸ PRINCIPLES OF THE LAW, CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(a) (AM. L. INST. 2005).

approach, disgruntled shareholders could initiate a derivative suit, arguing that the corporation's best interests require pursuing the social goal because that is what the average shareholder prefers.⁶⁹

No court so far has recognized this second approach as a valid theory, however. And even if one did, the derivative suit still would almost certainly fail. The claim by those bringing suit would be that management violated its duty of care by failing to advance the corporation's purposes. But, because of the business judgment rule, duty of care cases rarely succeed, even in cases where the assumed purpose of the corporation is to maximize profits and the claim is that managers failed to do so. Judges do not view themselves as business experts, and are therefore reluctant to second-guess management concerning what decisions best further the corporation's purposes.

e. Executive compensation and shareholdings. Executive pay packages have traditionally involved a mix of fixed salary and share-price-based components. The share-price-based component obviously incentivizes managers to maximize share value. This component's incentive does not weaken depending on whether some meaningful percentage of shareholders prefer for social reasons that the corporation maximize share value.

It is true that such pay packages today routinely also include a component tethered to ESG concerns. This does not meaningfully incentivize managers to undertake ESG activities that reduce share value, however. The ESG component represents only a very small portion of managers' overall compensation, typically around a couple of percentage points.⁷⁰ This component's very

⁶⁹ Resistance to going even this far is suggested by the recent case of *McRitchie v. Zuckerberg*, 315 A.3d 518 (Del. Ch. 2024) (a company's board did not violate their fiduciary duties by failing to reduce externalities that negatively affected the value of its diversified shareholders' holdings in other companies).

⁷⁰ See, e.g., Lucian Bebchuk & Roberto Tallarita, *The Perils and Questionable Promise of ESG-Based Compensation*, 40 J. CORP L. 37, 52 (2022) (for the S&P 100 firms, "in most cases, ESG metrics account for only 1.5%–3% of the total CEO pay"); David I. Walker, *The Economic (In)significance of Executive Pay ESG Incentives*, 27 STAN. J. L.

smallness testifies that whatever portion of the typical corporation's shareholders have at least incipient willing-to-sacrifice preferences, they have very little influence. Even more to the point, the ESG component is negligible relative to the share-price-based component. If the firm managers pursue an ESG-promoting activity that reduces share value, the resulting drop in their share-price-based compensation would overwhelm the ESG-based gain.⁷¹ Also, managers typically already have significant holdings in their firm's stock, further overwhelming the ESG component.⁷²

II. Investor Sorting and its Implications for Corporate Behavior

In Part I, we imagined a representative corporation whose shareholder body we took as given and that mirrored the aggregate preferences of the economy's equity investors as a whole regarding their willingness to sacrifice for any given social end. As we observed, all corporations' shareholder bodies would in fact roughly resemble that of the representative corporation if all the economy's willing-to-sacrifice equity investors constructed their portfolios solely based on ordinary financial considerations, and not on the social impact of an issuer's behavior, i.e. engaged in unconstrained investing. Any differences among corporations' shareholder bodies would then be largely due to chance, not to the company's social behavior.

This Part II constitutes the second stage in our overall positive analysis. It recognizes that some of the economy's willing-to-sacrifice equity investors *do* consider the behavior of firms in composing their portfolios. This investor sorting means that a corporation's shareholder base will not necessarily roughly resemble that of the representative corporation envisioned in Part I.

We address three questions. First, why does such sorting occur and how prevalent is it?

BUS. & FIN. 318, 334-39 (2022) (for thirteen leading companies, finding that the average ratio of ESG-based incentive dollars to total incentive dollars was 1.1%, with the median ratio just 0.2%).

⁷¹ *Id.* at 321. See also Adam B. Badawi & Robert P. Bartlett, *ESG Overperformance? Assessing the Use of ESG Targets in Executive Compensation Plans* (2024), https://Articles.ssrn.com/sol3/Articles.cfm?abstract_id=4941016 (evaluating the use of ESG targets in executive compensation).

⁷² See, e.g., Clifford G. Holderness, Randall S. Kroszner & Dennis P. Sheehan, *Were the Good Old Days That Good? Changes in Managerial Stock Ownership since the Great Depression*, 54 J. FIN. 435 (1999).

Second, does this sorting alter Part I’s conclusion that the willing-to-sacrifice equity investors are unlikely to meaningfully affect a corporation’s behavior through either the franchise or their effect on the workings of the managerial incentive structure? And third, does this sorting affect share prices in ways that affect firm behavior?

A. Taxonomy of Investor Types

In Part I, we assumed investors built their portfolios—whether they held stocks directly or derivatively through investment or pension funds—without considering the social impact of the companies they chose. Here, we add nuance by dividing equity investing into three types: “unconstrained,” “identity,” and “transformative.” The latter two types allow investors to sort themselves based on social preferences, which we ignored in Part I.

1. Unconstrained investing. The unconstrained investor conforms to the assumptions of Part I and constructs her portfolio based solely on ordinary financial considerations. Such an investor may well favor advancing certain social causes, but either she does not believe the way her portfolio is constructed helps achieve these ends, or she chooses not to advance pursue them through her portfolio’s composition.

2. Identity investing. Identity investors hold only shares in corporations whose behavior they approve of socially.⁷³ They may approve simply because the corporation is in a line of business that permits it to share-value-maximize without offending these concerns. Alternatively, the corporation may only be able to meet approval by deviating from share value maximization,

⁷³ One plausible explanation for this behavior is that many people are concerned about their self-image as caring individuals and engage in identity investing in order to signal to themselves that they have this trait. See George A. Akerlof & Rachel E. Kranton, *Economics and Identity*, 115 Q. J. ECON. 715 (2000); Arno Riedl & Paul Smeets, *Why Do Investors Hold Socially Responsible Mutual Funds?* 72 J. FIN. 2505 (2017).

but is in fact doing so.⁷⁴ Identity investing is sometimes referred to as socially responsible investing or ESG investing.

3. *Transformative Investing.* Transformative investing works as follows. Imagine an equity investor who is willing to sacrifice a certain amount of wealth to achieve some social end. She identifies a corporation that is currently not furthering this end. Changing its behavior to further this end would reduce its share value. The transformative investor takes any equity position in order to use the franchise to cause its managers to change its behavior in this way. Self-evidently, a rational investor would be unlikely to buy shares with this plan in mind unless she thought a like-minded majority could be formed out of other prospective purchasers, combined with existing shareholders whose manifest, or easy-to-make manifest, preferences favor the change.

B. The Prevalence of the Different Types of Equity Investors

Equity investors have traditionally been portrayed in the finance literature as uniformly being unconstrained investors, who simply seek to construct portfolios that maximize their risk-adjusted expected returns.⁷⁵ This portrayal covers active investors, who seek to achieve risk-adjusted results in excess of overall market returns by purchasing what they view as underpriced stocks and selling or selling short what they view as overpriced ones. It also covers passive investors, who do not seek to outguess the market and instead simply try to use diversification to minimize risk relative to an expected return that is a function of the overall market's return.⁷⁶

⁷⁴ More generally, identity investors underweight the shares of issuers they do not approve from a social perspective, relative to a circumstance in which they compose their portfolio on just financial considerations, *see, e.g.*, Zerbib, *infra* note 77 (modelling socially responsible investors as both avoiding the assets of certain issuers and underweighting others) but we streamline the analysis by considering the case in which identity investors fully underweight, and therefore exclude, the shares of disfavored issuers from their equity portfolios.

⁷⁵ *See, e.g.*, Harry Markowitz, *Portfolio Selection*, 7 J. FIN. 77 (1952) (the utility an investor derives from an investment assumed to be determined solely the investment's effect on the overall portfolio's value and standard deviation); William F. Sharpe, *Capital Asset Prices: A Theory of Market Equilibrium Under Conditions of Risk*, 19 J. FIN. 425 (1964) (same).

⁷⁶ This portrayal of pure unconstrained investing is obviously true of a broad-based index fund. A speculative investor will also use diversification to reduce risk. To try to beat the market, it will deviate from being fully diversified when

The discussion below suggests that as of today, the world has not changed so much that this modeling fails to accurately describe most equity investors. Still, identity investing is a real phenomenon practiced by a meaningful number of investors. Transformative investing is a conceptually possible third route, but research does not reveal any meaningful amount of it and theory suggests its future development faces long odds.

1. Identity investors. One way an identity investor can construct her portfolio is by screening out issuers whose social impact offends her values. Beyond this negative screening, the investor engages in unconstrained investing. The easiest places to spot entities engaging in this type of identity investing are among university and other nonprofit endowments, and public worker pension funds. Trustees of these entities, whether on their own accord or under pressure from some of their stakeholders, have divested shares of corporations viewed as acting in socially undesirable ways. However, this divestment has been largely confined to a few industries, such as oil, gas, coal, tobacco, and civilian firearms. Many retail investors likely construct their portfolios similarly.

Another approach to identity investing would be to hold shares only in issuers whose behavior affirmatively furthers a certain social end important to the investor. This could be an issuer that is able to further this social end while still maximizing share value. Or it could be one that, to further this end, needs to deviate from share value maximization but in fact does so. Green and ESG investment funds are the most prominent vehicles for this positive screening approach. A review of their prospectuses suggests that they confine themselves to investing in specified industries or in firms that meet certain positive criteria as measured by some kind of ESG index.

it finds the added risk worthwhile because, according to its assessments of share values, it is buying underpriced securities or selling, or selling short, overpriced securities, but then will correct for this deviation by reversing the transaction once the market price recognizes what the speculator has seen.

It is hard to get an empirical handle on the extent of identity investing, but observing the portion of all the money invested in mutual funds and ETFs that is in “green” or “ESG” funds provides a ballpark sense. Estimates in the literature vary significantly.⁷⁷ What is clear is that a substantial majority of dollars invested in investment funds do not come from investors who have signaled social concerns through their choice of funds. The estimates of the portion of total mutual fund and ETF investments represented by green or ESG funds almost certainly exaggerate the portion of dollars flowing into these funds from investors with *manifest* willing-to-sacrifice preferences because these funds suggest that they can attain risk-adjusted returns comparable to unconstrained funds. So, by choosing these funds, many investors are not signaling a willingness to sacrifice. At the same time, the estimates most certainly underestimate the percentage of investors with *incipient* willing-to-sacrifice preferences. Due to the tremendous information asymmetries previously discussed, there may be many mutual and ETF fund investors with incipient willing-to-sacrifice preferences who have chosen general rather than green or ESG-oriented funds. This is because they do not know of the ways that corporations in which they might otherwise invest could further some social aim at an acceptable cost to them, and so they just invest in a diversified portfolio. In sum, while it is clear that a subset of investors currently practice identity investing, the data cannot provide a precise estimate of its size.

2. *Transformative investors.* Pure transformative investing, while conceptually possible, seems unlikely to occur on any significant scale. For retail investors on their own to engage in effective transformative investing, enough of them would need to independently buy shares in the

⁷⁷ See, e.g., Jonathan Berk & Jules H. van Binsbergen, *The Impact of Impact Investing*, 164 J. FIN. ECON. 1, 6 (2025) (calculating that ESG mutual funds represent less than 1% of total mutual fund wealth in the United States in 2021 but assuming 2% to account for measurement error); Oliver Davis Zerbib, *A Sustainable Capital Asset Pricing Model (S-CAPM): Evidence from Environmental Integration and Sin Stock Exclusion*, REV. FIN. 1345, 1362 (2022) (calculating that stock in green mutual funds represented 12% of the total market value of all U.S. stock in 2019).

company at roughly the same time to end up holding a majority of its shares, and would then need to actively participate in the firm's governance. The information and coordination challenges make this nearly impossible.

In theory, socially oriented investment funds could overcome these coordination problems by banding together, perhaps with the help of university endowments, nonprofit endowments, and public pension funds. These investment funds, however, currently market themselves as achieving risk-adjusted rates of return comparable to ordinary funds. If a fund participated in a successful transformative investor campaign that caused a corporation to sacrifice share value, the resulting lower share price would reduce the fund's returns. Given how the fund markets itself, it could not last long if it regularly joined such campaigns.

University trustees, directors of endowed non-profits, and pension fund officials face less market pressure concerning how they compose their portfolios. They still recognize, however, that the capital loss from participating in a successful transformative investment would come at the expense of the entity's primary mission. It might also breach their fiduciary or other legal duties.⁷⁸ Moreover, to date, their reactions to stakeholder and political pressures with regard to socially responsible investing has been to divest in the fashion of an identity investor, not to acquire shares as a transformative investor.

In essence, any joint transformative effort would resemble a traditional proxy fight,⁷⁹ except that the desired change in firm behavior would make it less profitable, rather than more.

⁷⁸ The same fiduciary considerations that would counsel such entities from voting for directors pledged to share-value-reducing firm behavior to support some social end, *see* I.C.3.d.v *supra*, would counsel that these entities avoid transformative investing as well. *See, also*, Rose, *supra* note 47 ("For . . . pension fund trustees, a strict reading of their duty would require them to disregard worker and societal interests and focus solely on maximizing the value of the fund.").

⁷⁹ *See*, Lucian A. Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Towards Proxy Contests*, 78 CAL. L. REV. 1071, 1077-82 (1990) (discussing the contemporary relevance of traditional proxy fights in shaping managerial incentives).

Traditional proxy fights are very rare today, having been replaced by hostile takeovers and activist hedge fund campaigns. This is primarily because the costs of running proxy fights on the insurgent side are too great relative to the potential gain in the value of the instigator’s initial holdings, unless the insurgent holds a substantial portion of the all the firm’s shares. Here, the situation is even more forbidding: what instigator would be willing to bear these costs when the result would be a financial loss, not a gain? In any event, we are not aware of any such efforts to date. And even if there were such an instigator willing to take a loss, it is very unlikely that she would be able to acquire a majority of a firm’s shares on her own. That means she would need the help of institutional investors—green or ESG investment funds, university or non-profit endowments, or public pension funds—willing to trade off returns to further the social end being pursued by the instigator. We have seen that this is unlikely. Adding to the instigator’s problems, certain provisions of the Exchange Act impose obligations on “control groups,” and would discourage the needed coordination with and among such investors.⁸⁰

C. The Impact of Identity Investing on Director Elections and the Managerial Incentive Structure

When a portion of the economy’s equity investors engage in identity investing based on some social concern, they systematically exclude certain publicly traded corporations from their portfolios. These excluded corporations thus end up with proportionally fewer shareholders who care about this social concern. When an investor shows she is concerned about a social issue by excluding certain companies from her portfolio, that does not necessarily show that she is willing to sacrifice financial returns to further the cause. Still, the shareholders that a firm loses because of identity investing, those who would be willing to sacrifice will be disproportionately

⁸⁰ See, e.g., Section 13(d)(3) of the Exchange Act; Bernard Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1992).

represented. This means that the remaining shareholders include a smaller portion of willing-to-sacrifice investors than before.

For the disapproved of, excluded firms, this smaller portion of willing-to-sacrifice shareholders simply reinforces the conclusions from Part I. Relative to the representative corporation, their diminished numbers mean that they are even less likely to affect director elections. The same logic applies with regard to managerial incentives to maximize share value. We saw earlier that when managers are considering share-value-decreasing decisions motivated by their other-regarding interest, the managerial incentive structure pushes against this, but when these managerial other-regarding interests align with the ends pursued by the firm's willing-to-sacrifice shareholders, this push is modestly attenuated.⁸¹ When the willing-to-sacrifice portion of a firm's shareholders is reduced due to identity investing, that lessens this pressure's attenuation. Consequently, managers, despite their other-regarding interests, are that much more likely to stick to maximizing share value.

The flip side is that, with identity investing, the approved corporations will have proportionally more willing-to-sacrifice shareholders relative to Part I's representative corporation. Many of the corporations to which these investors turn are chosen simply because of the industries they are in. The nature of these industries means that the corporations can maximize share value without offending the identity investors' social values. For these corporations, the higher proportion of identity investors has no effect on their behavior.

What, though, about corporations that need to sacrifice share value to advance a social objective, but in fact make that sacrifice. Identity investors will turn to these firms also to the extent they can discern them. Will the higher proportion of identity investors increase the chances

⁸¹ See I.D.2.a.ii and I.D.2.b.ii, *supra*.

that these firms can maintain their share-value-sacrificing behavior? It will not do so through any impact on the choice of directors: all the obstacles to willing-to-sacrifice preferences affecting director elections still apply. It might, though, do so through this increased proportion's effect on the managerial incentive structure's pressure to maximize share value. The presence of these willing-to-sacrifice investors, because of their greater numbers relative to the Part I representative corporation, would diminish this pressure by more. That said, the incentive structure's pressure to maintain show value still starts as a powerful force, and its diminution, through greater, would still probably be modest. The number of firms that both deviate from share value maximization in furtherance of some social end and can be discerned as doing so by identity investors is probably low. Moreover, the reservoir of investors who might turn to such firms for identity investing reasons does not appear to be large. Indicative of this, as already discussed, only a relatively low percentage of dollars go to "green" and "ESG" funds, and only some of those come from investors with manifest willing-to-sacrifice preferences.⁸²

D. The Price Effect of Identity Investing

The third way willing-to-sacrifice investors might affect corporate behavior is through the effects on share prices from confining their stock portfolios to firms whose behavior they approve. What does theory suggest about the likelihood that r this kind of identity investor sorting is having price effects? What is the empirical evidence? And, if identity investing were to have a price effect, how might this change firm behavior?

1. The effects of identity investing on share prices: theory. If in fact identity investing has a meaningful share price effect, each expected future dollar of distributions from holding the share of an approved firm would be more expensive to purchase, and the opposite would be true for a

⁸² See note 77 and accompanying text.

disapproved firm. In other words, the shares of approved firms would have lower risk-adjusted expected rates of return. Identity investors would thus be making a monetary sacrifice by concentrating their holdings exclusively in approved firms.

Suppose a portion of all the firms in the economy (the “dirty firms”) engage in some socially disapproved activity, say they emit excessive carbon dioxide, while the rest (the “clean firms”) do not. We start with a world where all investors are unconstrained. Then identity investing commences, and the investors choosing this strategy refuse to include dirty firms in their portfolios. The remaining investors are still unconstrained and continue willing to hold shares of dirty firms. What does theory tell us about the price effect?

a. Theoretical backdrop. Modern finance theory’s twin pillars are the efficient market hypothesis and the capital asset pricing model (CAPM). Under the efficient market hypothesis, the price of each stock very quickly fully reflects all publicly available public information predictive of its future expected cashflow. Under CAPM, this expected cashflow is discounted to present value at a rate solely reflecting the expected return on the whole market portfolio plus a premium reflecting this cashflow’s systematic riskiness (its sensitivity to the ups and downs of the market as a whole, i.e., its beta). This systematic portion of a share’s total risk is the only part that a passive investor should care about because the rest of the security’s total risk can be eliminated with a sufficiently diversified portfolio.⁸³

Before identity investing begins, each passive investor would maximize her utility by holding a highly diversified portfolio drawn from all issuers. Speculative investors—the ones who make the market efficient by seeking out and analyzing newly available information—would

⁸³ See RICHARD BREALEY, STEWART MEYERS & FRANKLIN ALLEN, PRINCIPLES OF CORPORATE FINANCE __ (2023).

deviate from full diversification when acting on that information, but on average would also hold portfolios drawn from all issuers.

b. Simple arbitrage theory. One approach to the effect of identity investing's start suggests there would be essentially no price effect.⁸⁴ Before identity investing starts, each company's share price would equal its expected future cashflow discounted to present value at a rate reflecting its systematic riskiness.⁸⁵ When sorting begins, identity investors refuse to hold shares of dirty firms, reducing demand for their shares. That initially might lower their prices relative to the clean firms' share prices. This, however, would create a situation where a dollar of expected future cashflow from a clean firm costs more than one from a dirty firm with the same systematic riskiness. An unconstrained investor holding shares in a clean firm could sell these at their now higher price and buy shares of a dirty one at their now lower price. Doing so can result in a portfolio with the same expected cashflow and systematic risk, with extra cash left over, representing the difference between the sale and purchase prices.⁸⁶ This is an opportunity that many would seize. Professional arbitrageurs would add to this by selling clean firm shares short and buying dirty firm shares long and obtaining the same kind of gain. With continued trading, the gap in the cost of an expected future dollar keeps narrowing down ultimately to nothing, whereby an equilibrium is established, with prices of clean and dirty firms returned to their pre-identity investing levels.⁸⁷

⁸⁴ For more discussion of this arbitrage theory in the context of social investing, see Paul Brest, Ronald J. Gilson & Mark A. Wolfson, *How Investors Can (and Can't) Create Social Value*, 44 J. CORP. L. 205, 217 (2018).

⁸⁵ See BREALEY, MEYERS & ALLEN, *supra* note 83, at 85..

⁸⁶ For the classic exposition of the arbitrage story, see Myron S. Scholes, *The Market for Securities: Substitution versus Price Pressure and the Effects of Information on Share Price*, 45 J. OF BUS. 179, 182 (1972) (“[T]he market will price assets such that the expected rates of return on assets of similar risk are equal. If any particular asset should be selling to yield a higher expected return due solely to the increase in the quantity of shares outstanding . . . investors seeing these profit opportunities would soon arbitrage them away”).

⁸⁷ Of course, arbitrage may not operate so perfectly in actual markets. See, e.g., Jeffrey Wurgler & Ekaterina Zhuravskaya, *Does Arbitrage Flatten Demand Curves for Stocks?* 75 J. BUS. 583 (2002) (empirically showing that arbitrage can be hindered when stocks lack close substitutes).

c. Taking account of the reduced diversification. More nuanced financial models, however, predict that sorting would generate an enduring price impact, but leave open the empirical question of whether it is more than trivial. Consider the model developed by Jonathan Berk and Jules van Binsbergen.⁸⁸ Like our simple story, their model postulates two types of firms, clean and dirty, and two types of investors, identity investors (whom they call “ESG investors”), who refuse to hold the shares of dirty firms, and the other investors, whom we call unconstrained investors, and who are willing hold shares in either kind of firm.

Berk and Binsbergen’s model is based on the sensible notion that when identity investors confine themselves to clean firms, the unconstrained investors must hold more shares of the dirty firms than they otherwise would have. These absorbing unconstrained investors become less diversified because their portfolios are overweighted in shares of the dirty firms relative to the dirty firms’ proportion of total market capitalization. By absorbing these extra dirty firm shares, the most diversified portfolio that the unconstrained investors can construct reduces risk by less than holding a “market portfolio,” i.e., one where all firm’s stocks are held in proportion to their respective market capitalizations. For the unconstrained investors to be willing to hold this riskier portfolio, the shares of the dirty firms must be priced lower relative to their expected future cashflows than they otherwise would be.

3. The effects of sorting on share prices: empirical evidence. While there are strong theoretical reasons for believing that sorting affects prices, empirical studies of the question are mixed in their conclusions. First consider again Berk and Binsbergen. They parameterize their

⁸⁸ See Berk & Binsbergen, *supra* note 77. Other financial economic models similarly connect investors’ non-pecuniary preferences with asset prices. See, e.g., Zerbib, *supra* note 77; H. Arthur Luo & Ronald J. Balvers, *Social Screens and Systematic Investor Boycott Risk*, 52 J.FIN. & QUANT. ANALYSIS 365 (2017); Robert Heinkel, Alan Kraus & Josef Zechner, *The Effect of Green Investment on Corporate Behavior*, 36 J. FIN. & QUANT ANALYSIS 431 (2001). See also Lubos Pastor, Robert F. Stambaugh & Lucian A. Taylor, *Sustainable Investing* (2024), https://www.nber.org/system/files/working_papers/w33252/w33252.pdf, at 3-11 (providing model and surveying the literature).

model to empirically assess, relative to all investors having fully diversified portfolios, the effect of investor sorting on share prices from December 2015 to December 2020. They find a trivial effect: less than 1/200th of one percent in rate of return terms.⁸⁹ The primary reason is that the returns of Berk and Binsbergen’s clean bundle of stocks and those of the dirty ones are highly correlated, with a coefficient of 0.93.⁹⁰ So, when the unconstrained investors hold dirty firms’ shares disproportionately relative to the market portfolio, they lose very little in terms of the gains from diversification, and hence holding this higher proportion of dirty firm shares adds little to their risk. Thus, only a tiny discount in the price of dirty firms’ shares is needed to make unconstrained investors willing to hold these extra shares.⁹¹

Other researchers have developed and estimated asset pricing models that, in contrast to Berk and Binsbergen, show that identity investing has had a much more pronounced price effect, at least in certain time periods. Consider, for example, the work by Oliver Zerbib, who developed an asset pricing model that he uses to estimate the effect of investor sorting on equity prices between December 1999 and December 2019.⁹² Zerbib found that investors’ avoidance of disagreeable assets had an appreciable effect on those assets’ returns during a portion of his

⁸⁹ *Id.* at 6 (finding that ESG investors’ avoidance of the shares of dirty firms is causing the difference in the rates of the return of dirty firms’ stock and clean firms’ stock to increase by just 0.44 basis points).

⁹⁰ *Id.*

⁹¹ In addition to the correlation between dirty and clean stocks, the other parameters that determine the magnitude of the price effect in Berk and Binsbergen’s model are, using our terms (i) the percentage that the dirty shares represent as a proportion of the total capitalization of the market of both dirty and clean shares, estimated at 27%; (ii) the ratio of the equity invested wealth of identity investors relative to that of the unconstrained investors, estimated at well less than 1% but “conservatively” parametrized at 2%; and (iii) and the historical market risk premium over the safe asset, estimated at 6%. *See id.* at 13-15. They derive the first two values using data from 2015 to 2020 and the third value using data from 2021. *See id.* at 14-15. The price effect has a positive relationship with each these parameters. Berk and Binsbergen make reasonable assumptions to parameterize their model. *See id.* at 5-6. Berk and Binsbergen conduct three other parametrizations of their model but in none does the increase in the dirty firms’ costs of capital – and hence discount rate – caused by sorting exceed a still small 11 basis points. *See id.* at 16-17. Holding fixed all other parameters as in their baseline parameterization, identity investors would need to make up more than 80% of all investable wealth for the rate-of-return difference between dirty and clean firms to be 1%. *See id.* at 3, 19.

⁹² Zerbib, *supra* note 77. For any asset, Zerbib’s model calculates the exclusion effect, which is defined as the excess returns to the asset generated by socially-minded investors excluding a portion of investible assets from their portfolios. *See id.* at 1347.

evaluated period. In particular, Zerbib found that investors' avoidance of disagreeable assets had a large effect on those assets' returns during the 2008 to 2012 period, but had no meaningful effect in other years within the scope of his evaluated period, including those years overlapping with Berk and Binsbergen's relevant period.⁹³ Driven by the large price effect during the 2008 to 2012 period, Zerbib found that investor sorting had on average a non-trivial impact on divested firms' returns over the entire period he evaluated.⁹⁴ Because of Zerbib's conclusion concerning the full twenty-year period of his study is entirely driven by prices in this single four year sub-period, we find the Berk and Binsbergen conclusions more persuasive. Still, we note that yet other researchers have, like Zerbib, found non-trivial price effects caused by investor sorting.⁹⁵ So, in the end we think the jury is still out on the question.⁹⁶

3. *How any effect of sorting on share prices can affect firm behavior.* Assume for the purposes of discussion that identity investing has a non-negligible effect on share prices. How, if at all, might that affect firm behavior?

⁹³ *See id.* at 1377-78. As Zerbib explains, the emergence of a price effect in 2008 and extending through 2012 was caused by the particular nature of asset return correlations during that period. *See id.* at 1378. Between 2008 and 2012, the returns of the excluded assets in Zerbib's model became highly correlated with one another and also less correlated with the returns of the investible assets. *See id.* This increased the returns of the excluded assets during the 2008 to 2012 period, including because regular investors required the excluded assets to generate higher returns given that holding those assets imposed greater non-diversifiable risk on the regular investors, relative to the circumstance in which the excluded assets did not behave as a homogenous and separate group from the investible assets. *See id.* at 1347 & 1378. *See id.* at 1347 & 1378. After 2012, those particular correlations in asset prices dissipated, which eliminated the price effect caused by sustainable investors avoiding the excluded assets. *See id.* at Fig. 4 and Online Appendix pages 41-42.

⁹⁴ Zerbib finds an average yearly exclusion effect, *see supra* note 92, of 2.79% during his twenty-year evaluated period spanning December 1999 to December 2019. *See id.* at 1375. Recall, however, those aggregate results are not temporally uniform across the evaluated period and instead are driven by punctuated price effects occurring during the four-year subperiod spanning 2008 to 2012 when asset returns were correlated in a particular manner discussed above. *See supra* note 93. When asset return correlations did not behave in that way, there was no meaningful price effect from investors' avoidance of disagreeable assets. *See id.* So, one way to interpret Zerbib's findings, and to reconcile them with Berk and Binsbergen's, is that investor sorting is not having an appreciable price effect as general matter but can do so in select time periods when there is an abnormal correlation in asset returns.

⁹⁵ *See* Luo & Balvers, *supra* note 88, at 379; Heinkel, Kraus & Zechner, *supra* note 88, at 379.

⁹⁶ *See also* Gong Cheng et al., *The Impact of Green Investors on Stock Prices* (2024), https://www.nber.org/system/files/working_papers/w32317/w32317.pdf, at 5 ("The empirical literature presents a mixed panorama on the impact of divestment on stock price").

a. Changing the use of existing productive capacity. Consider a firm with productive capacity that could be used for either a dirty or a clean activity. Prior to sorting, it uses the capacity for a dirty activity because that yields a higher cashflow. Once the sorting occurs, the firm's share price declines because the market discounts at a higher rate than before the expected future cashflows from continuing the dirty activity. If the firm switches use of the capacity to the clean activity, the market will discount the firm's future cashflows from this productive capacity at a lower rate than before.

According to the standard mode of corporate finance, an issuer's share price reflects the market's best estimate of the firm's expected future net cashflow discounted to present value.⁹⁷ As we have seen, the managerial incentives structure pushes managers to maximize share value. Thus, management will switch the use of its current productive capacity to clean activities only if doing so favorably affects the calculation of the operation's future discounted expected cashflow. The switch will decrease expected future cashflow, which is why it did not happen before. The switch can nevertheless now increase share value, but only if the lower discount rate more than compensates for the decrease in expected future cash flow. In sum, only some existing capacity can serve dual uses, and only a portion of that will be switched.

b. New investment. Compared to switching existing productive capacity, a non-negligible impact on share prices from sorting will have a more certain, but slower acting, effect on the amount of clean versus dirty activity in the economy through its impact on new investment.

To maximize share value, managers will implement every proposed investment project that has a positive net present value. Sorting will increase the discount rate for projects facilitating dirty activities relative to ones facilitating clean activities. This means dirty projects are less likely

⁹⁷ See BREALEY, MEYERS & ALLEN, *supra* note 83, at 83.

to have a positive net present value than before, and clean projects are more likely to. Still, among the dirty project proposals, sorting will only eliminate those that would have had a positive net present value using the lower pre-sorting discount rate but have a negative net present value using the higher post-sorting rate. The reverse is true for clean project proposals. Depending on the industry, fully remaking its productive capacity to reflect sorting's differential discount rates for clean versus dirty activities could take decades.

There are also empirical studies showing that, compared to clean firms, dirty firms have lower prices relative to current earnings.⁹⁸ These studies do not establish that sorting has a pricing effect, even though they may sometimes be causally interpreted this way. Dirty firm prices, on average, may be affected by one or more other attributes unrelated to a sorting-induced higher discount rate on their future cash flows. Dirty firms, for example, may be concentrated in industries with lower expected future earnings relative to current earnings (think “smokestack” firms) than are clean firms (think of the lower pollution levels associated with high-tech “growth stock” firms).⁹⁹

4. The potentially self-reinforcing aspects of identity investing. We have suggested there is good reason to believe that a meaningful portion of equity investors have at least an incipient preference for sacrificing some return in furtherance of certain social ends.¹⁰⁰ Today, however, it appears that only a relatively small percentage of equity investors practice identity investing,¹⁰¹ and so it is likely not shaping corporate behavior much.

⁹⁸ See, e.g., Luo & Balvers, *supra* note 88, at 379; Heinkel, Kraus & Zechner, *supra* note 88, at 379.

⁹⁹ See, e.g., Paula Castro, Cristina Gutiérrez-López, María T. Tascón & Francisco J. Castaño, *The Impact of Environmental Performance on Stock Prices in the Green and Innovative Context*, 320 J. CLEANER PRODUCTION 1 (2021).

¹⁰⁰ See I.C.1 *supra*.

¹⁰¹ See *supra* note 77 and accompanying text.

The portion of investors engaging in identity investing might nevertheless grow substantially over time for reasons better explained by social psychology than informed economic rationality. Many investors appear to gain utility simply from being associated through share ownership with firms whose behavior they approve, and experience comparable disutility from association with firms they disapprove.¹⁰² These utility effects occur even when the investor does not think there is any causal linkage between her investment approach and changes in corporate behavior. Moreover, this attitude can be infectious, and so could result over time in a substantially higher percentage of investors engaging in identity investing for these simple associational reasons. At this point, the resulting sorting would begin to have a discernible effect on firm behavior. This more discernible causal link could sustain this higher level of identity investing by providing it a more durable, less faddish grounding. And it could stimulate yet more identity investing by attracting those previously skeptical of its effectiveness. As will be discussed in Part III, mandatory disclosure requirements about corporations' social impacts could facilitate this self-reinforcing process.

III. Should There Be Legal Reform That More Closely Aligns Corporate Behavior with the Preferences of Willing-to-Sacrifice Investors?

We now turn normative and consider the desirability of legal reforms intended to make firm behavior more sensitive to the preferences of willing-to-sacrifice equity investors. As we have seen, such investors are, under current law, unlikely to change corporate behavior significantly through the use of the shareholder franchise. While they might do so through the share price effects of identity investing, empirically, the effectiveness of this strategy is to date

¹⁰² See Nicolas P. B. Bollen, *Mutual Fund Attributes and Investor Behavior*, 42 J. FIN. AND QUANT. ANALYSIS 683 (2007). Consistent with this idea, the author presents empirical evidence that the pattern of cashflows in and out of funds labelled as socially responsible is less volatile than that of ordinary funds and that these funds suffer few withdrawals at times when they announce poor returns. *Id.* at 701,703. See also Akerlof & Kraton, note 73, *supra*.

far from clear. This Part assesses reforms that would arguably increase the influence of willing-to-sacrifice investors through each of these two potential pathways.¹⁰³

A. *Framing the Normative Inquiry*

We conduct our normative inquiry without any preconception that shareholders of dispersed ownership corporations have certain inherent rights to shape the behavior of the firms in which they invest. These firms are major players in society's fundamental decisions: what products and services are produced and in what quantity, how they are produced, who gets them, and how the gross revenues from their sale are split up among the firms' employees, investors, and suppliers of other factors of production. Firm behavior in these regards is shaped by a variety of forces: market incentives, government regulations, taxes and subsidies, and the threat of public and private lawsuits. Our inquiry concerning legal reforms that would potentially increase the influence of willing-to-sacrifice investors is a purely instrumental exercise. It seeks to determine whether any such reforms, when viewed as occurring within this larger context, can be expected to lead to social improvement.¹⁰⁴

¹⁰³ In Parts I and II, we also analyzed the effect of the presence of such investors on the managerial incentive structure. We do not consider here legal reforms that would weaken its push for share value maximization because, although they may be needed to assure that managers implement a share-value-reducing change voted by shareholders, *see* I.C.4 *supra* and III.3.b.iv, such reforms would not on their own make the presence of willing-to-sacrifice investors more likely to affect corporate behavior. Rather, these reforms make it more likely that the *managers'* preferences for the corporation to deviate from share value maximization to further some social end will affect corporate behavior. Whether or not that is desirable involves a dispute with a long history, but one quite different from the issues addressed here. *See* A. A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1073 (1931); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1147 (1932); Adolf A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932).

¹⁰⁴ This instrumental approach is standard in the corporate law literature on shareholder rights. *See, e.g.*, Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005) (arguing, based on corporate governance and firm value effects, for broadened shareholder rights); Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601 (2006) (arguing against broadened shareholder rights based on implementation and other concerns). We do not follow the approach of some other commentators who, reflecting democratic sensibilities, instead view shareholder rights akin to individual rights and use that proffered congruence as a basis for treating them as inherently worth promoting. *See, e.g.*, Colleen A. Dunlavy, *Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights*, 63 WASH & LEE. L. REV. 1347 (2006).

1. The variety of ways society's members shape corporate behavior. Our normative inquiry addresses the fundamental question of how various members of society participate in the decisions that shape corporate behavior. One way, through voting and other political activities, is as participants in the governmental political processes that determine applicable regulations, taxes and subsidies. A second is as consumers of the goods and services that corporations provide. A third is as suppliers of labor and other non-capital inputs to those corporations.¹⁰⁵ Finally, some members of society are equity investors and, in that role, represent yet another force in shaping corporate behavior. The normative question addressed here arises when some equity investors have a preference, at least in incipient form, to sacrifice returns to further some social end. Are there reforms that would give this particular subset of society greater weight than they currently have in the process of making society's fundamental economic decisions, and, if so, would adopting these reforms be socially desirable? Asking these questions makes clear how, at its core, this Article concerns political economy. Accordingly, we need to compare two pathways for changing corporate behavior to reflect social concerns, change induced by willing-to-sacrifice investors versus change induced by governmental regulation, and to explore the interaction between these two pathways.¹⁰⁶

2. The different types of social ends and their relationship to the pathways by which willing-to-sacrifice shareholders can affect corporate behavior. Our focus in this Part is on reforms designed to enhance the effectiveness of willing-to-sacrifice equity investors in shaping corporate behavior. Any changes in corporate behavior resulting from such a reform will create winners: indeed, the whole point of the willing-to-sacrifice investors' efforts is to produce a

¹⁰⁵ The potent role that suppliers and customers can play is discussed in Barzuzza, Curtis, and Webber, *supra* note 10.

¹⁰⁶ We say this in the same spirit as John Coates does in describing share voting by the large index funds as "political." See COATES *supra* note 39, at 99.

benefit for some people. Like most changes in corporate behavior, though, there will be losers as well, however. In considering a possible reform's desirability, we must pay attention to the patterns of winners and losers associated with the different kinds of social ends that can be advanced by share-value-diminishing changes in corporate behavior.

As discussed below, economics provides two very useful categories for characterizing social ends in terms of the pattern of winners and losers: (1) correcting market imperfections and (2) making the distribution of income and wealth more equal.¹⁰⁷ We must pay attention to how the particular pathway the reform promotes – franchise versus identity investing – can affect who are the winners and losers.

a. Social ends involving the correction of market imperfections. One category of social ends that changes in corporate behavior can promote is the correction of market imperfections, such as pollution or the exercise of market power. The starting point for understanding this category is the story of how, in the absence of such imperfections, operating a corporation to maximize the value of its shares is simultaneously the behavior that maximizes the corporation's contribution to society's total wealth, an idea related to what is often referred to as the first theorem of welfare economics.¹⁰⁸ This idea is that in the absence of any market imperfections, the amount the firm pays as expenses is the value, at the margin, of what the corporation takes from, or how it otherwise negatively impacts, the world in order to produce its output. And the amount it receives as revenue for this output is the value, at the margin, of what it gives back to the world. The difference—its residuals—is the firm's contribution to society's total wealth.¹⁰⁹ Shareholders are the residual claimants and so when, period by period over time,

¹⁰⁷ Some ends may, of course, fall into both categories. Some others may fall into neither, for example changing corporate behavior to correct for what the change's supporters feel is a past injustice.

¹⁰⁸ See MAS-COLELL, WHINSTON & GREEN, *supra* note 2, at 50.

¹⁰⁹ Louis Makowski & Joseph M. Ostroy, *Perfect Competition and the Creativity of the Market*, 39 J. ECON. LIT. 479

this difference, discounted to present value, is maximized, so is share value. Therefore, the behavior that maximizes share value is the same as what maximizes the corporation's contribution to society's total wealth.

The real world, however, has market imperfections that are not corrected by governmental regulation. Producing a corporation's output, for example, may release carbon into the atmosphere. The effects of this release on the climate has negative impacts on many members of society for which the corporation pays nothing.¹¹⁰ In deciding how, and how much, to produce, the share-value-maximizing corporation perfectly legally does not fully take into account these negative impacts. Similarly, when a corporation with market power maximizes share value, it produces at a level whereby its output's price exceeds its marginal cost, meaning it could contribute more to social welfare if it instead produced at a higher level with a commensurate lower price.¹¹¹ And, if a corporation knows something negative about its product that customers cannot detect at the time of purchase, failing to reveal the defect may be the more profitable strategy. Many customers will thus calculate that the purchase to be worthwhile when it is not.

Now imagine a corporation that is operating in the presence of such an imperfection, but that deviates from share-value-maximization by behaving as it would without the imperfection. Doing so is welfare enhancing in the sense that it will lead, in aggregate, to society's winners gaining more than its losers lose.¹¹² In the parlance of economics, correcting the market

(2001).

¹¹⁰ Symmetrically, a share value maximizing firm will, from a social point of view, underperform costly activities that have positive externalities. For example, a firm that trains new workers may be unable to fully capture much of the resulting lifetime improvement in their productivity.

¹¹¹ This is only true in terms of static efficiency, however. The prospect of being able to price above marginal cost is a major spur for innovation, which also leads to social benefits, making calculations of the tradeoff between the two a complex task.

¹¹² There are nuances. For instance, under the economic theory of second best, if an economic system has multiple market imperfections, then the correction of a single one in isolation may not necessarily be welfare improving. See R.G. Lipsey & Kelvin Lancaster, *The General Theory of Second Best*, 24 REV. ECON. STUD. 11 (1956). For example, consider a monopolist operating in some unregulated industry that generates an externality in the form of air pollution.

imperfection improves Kaldor-Hicks efficiency.¹¹³ The important point here, though, is that there will be losers.¹¹⁴

Critical to our discussion, a set of the economy's equity investors will be among the losers financially: whoever holds this company's shares will be holding the rights to a diminished stream of future residuals. For the firm's willing-to-sacrifice shareholders, this financial loss is worthwhile because they value more the aggregate improvement in the welfare of their fellow human beings than their losses from reduced share value. The rest of the firm's shareholders will not find the diminished future cash flows worthwhile, however. They may simply not care that a deviation would have this overall beneficial effect on others. Alternatively, they may be willing to sacrifice for these others to benefit, but only if the costs of the improvement can be spread more widely. That could be through mandatory regulation of the whole industry, bringing in the shareholders all industry's other firms too, or even spread over all members of society through a tax-financed subsidy to cover the firm's net revenue shortfall from making the change.¹¹⁵ Yet others may feel that the seriousness of a corporation's negative impact is not self-evident, and so the costs of changing its behavior should not be imposed on the firm (and ultimately its

A policy intervention that corrects the monopoly problem would improve aggregate social welfare by bringing prices and output back to their competitive levels, but the increase in output would generate more pollution, where the cost of that additional pollution might overwhelm the efficiency gains associated with elimination of the monopoly. In contrast, the simultaneous correction of the monopoly problem and the externality would increase social welfare.

¹¹³ A change, X, is said to be Kaldor-Hicks efficient relative to the status quo, or a Kaldor-Hicks improvement, if those made better off by X could, in a hypothetical bargain, fully compensate those made worse off by X and still be better off themselves, but does not require that the compensation actually occur. See, e.g., Anthony T. Kronman, *Wealth Maximization as a Normative Principle*, 9 J. LEG. STUDS. 227, 235-36 (1980). This social welfare criterion is standard in most law and economics scholarship.

¹¹⁴ For instance, consider a firm that generates a negative externality in the form of pollution. If the firm were to mitigate this pollution by producing less, the wellbeing of those harmed by the pollution would improve. Simultaneously, the output reduction would increase prices for its product, hurt customers, and decrease the firm's profits and hence share value, hurting its shareholders (assuming away any share price effects associated with any resulting investor sorting).

¹¹⁵ Economic experiments show that people are more willing to act pro-socially if they think others will as well. See, e.g., Ernst Fehr & Simon Gächter, *Cooperation and Punishment in Public Goods Experiments*, 90 AM. ECON. REV. 980 (2000). The potential for people to act this way has been a particular matter of attention in the literature on tax evasion. See, e.g., Joel Slemrod, *Cheating Ourselves, the Economics of Tax Evasion*, 21 J. ECON. PERSP. 25 (2007).

shareholders) unless some authoritative determination has been made that the social benefits are greater than the cost to the company. Shareholders falling into these last two categories are willing to sacrifice to further the social end in question, but only if a decision is made by the government rather a shareholder vote.

When the company we are considering deviates from share-value-maximization to correct the market imperfection, its non-share-value-sacrificing shareholders will likely not be the only losers. Any given change in corporate behavior, whatever the reason, affects many members of society besides its shareholders. Whatever the balance between the winners and losers, there likely will be some losers. In this sense, a change to correct a market imperfection is no different than a change in corporate behavior for any other reason, such as a change to take advantage of a new technology, a change in the costs of its inputs, or a change in the demand for its outputs. What matters for social welfare is that with the imperfection corrected, the aggregate gains outweigh the aggregate losses when both the equity investors and the losing other members of society are taken into account.

b. Social ends involving the reduction in inequality. A second category of social ends that can be advanced by changes in corporate behavior involves reducing inequality in income or wealth. For example, a firm may have willing-to-sacrifice shareholders who prefer that it pay lower-level workers more than the competitive wage, or that it sell a vital drug to the poor for less than its marginal cost.

As with correcting market imperfections, the rest of its shareholders prefer not to sacrifice share value to further this redistributive end. They may not feel that society's income or wealth needs to be distributed more evenly. Alternatively, they may feel that such redistribution is needed, but explicitly or implicitly believe that redistribution should be the province of

government tax and benefit policies, where the pie being divided is maximized through actions that promote Kaldor-Hicks efficiency. They may have the same view about “predistribution” efforts at enhancing the income-earning potential of marginalized communities through education, healthcare and other social services. The view favoring reliance on governmental redistribution and predistribution can also reflect an investor’s aversion to sacrifice for these purposes unless other similarly situated persons, wealth or income-wise, sacrifice as well.¹¹⁶

3. *Reasons for primary focus on market imperfection corrections.* Although reducing inequality can be a worthy social goal, our focus, for a number of reasons, will be on the correction of market imperfections. First, correcting market imperfections appears to be a significant, perhaps dominant, motivator for willing-to-sacrifice equity investors, particularly given the central concern with reducing carbon emissions to ameliorate climate change. Second, Kaldor-Hicks efficiency is used as the normative guide by the proponents of the franchise reforms considered here, and so using it as our guide permits us to better engage with that literature.¹¹⁷ In the absence of efficiency effects, a pure redistribution of income or wealth only relocates existing societal wealth, rather than also increasing it. Consequently, such a redistribution would not constitute a Kaldor-Hicks improvement, although, of course, it might be normatively supported on other grounds such as equality or fairness.¹¹⁸ Third, although each individual instance of a firm sacrificing profits to correct for a market imperfection creates losers as well as gainers, a

¹¹⁶ See *infra* B.3.b.vii.

¹¹⁷ See, e.g., Hart & Zingales, *Corporate Governance*, *supra* note 7.

¹¹⁸ To see this, suppose that there are no market imperfections and there is a contemplated redistribution of income that would take \$100 from person A and transmit it to person B. After the transfer, the only way that person B could make person A as well off as they were pre-transfer would be to remit \$100 back to person A, but that would leave person B in the same position as they were pre-transfer. Thus, the redistribution did not constitute a Kaldor-Hicks improvement. The redistribution might still be normatively justified, for instance, if person A had significant wealth and person B had little. Finally, if the redistribution were to somehow alleviate a market failure, then it would generally constitute a Kaldor-Hicks improvement. See *supra* note 112 and associated text. However, this circumstance is not an example of a pure income redistribution.

legal regime regulating private sector activities that overall seeks to promote Kaldor-Hicks efficiency will likely leave everyone better off. The losers from an arrangement that promotes efficiency in any given instance are still likely to be net gainers over a lifetime of interactions in a private sector structured to maximize efficiency.¹¹⁹ This is why Kaldor-Hicks efficiency as a normative guide receives such prominent attention in the legal literature more generally.¹²⁰ Consider the following comparison. One situation is where a private person's decision creates a loser as the result of an act occurring within the context of a private market that is structured to try to enhance efficiency. The other is where a private person's decision leads someone else's involuntarily loss where the aim is a redistribution as an end in itself. As we will discuss in more detail below, the loss resulting from the first person's decision would, to most people, be less concerning to than the loss resulting from the second person's decision. Most people, though, would be much less concerned if the loss associated with the second person's decision had instead been a redistribution decided upon through governmental process.¹²¹

B. Reforming the Shareholder Franchise

¹¹⁹ Any given instance of a Kaldor-Hicks improvement might be normatively unappealing because the resulting distribution of benefits and costs is socially undesirable, such as when it aggravates income inequality. *See, e.g.*, Matthew D. Adler & Eric A. Posner, *Implementing Cost-Benefit Analysis When Preferences Are Distorted*, 29 J. LEG. STUDS. 1105, 1109-1110 (2000). However, this is not likely to be a good reason for opposing market-imperfection-correcting corporate changes preferred by willing-to-sacrifice equity investors. Here, the costs imposed by share value maximization are likely disproportionately borne by the poor, which, for example, is true with negative externalities in the form of pollution. *See* Daniel A. Farber, INEQUALITY AND REGULATION, *Designing Rules to Address Race, Poverty, and Environmental Justice*, 3 AM. J. L. & EQUAL. 2, 4, 17 (2023). Also, imperfect competition and market power have been shown empirically to contribute to income inequality. *See, e.g.*, Joshua Gans *et al.*, *Inequality and Market Concentration, When Shareholding is more Skewed Than Consumption*, 35 OXFORD REVIEW OF ECONOMIC POLICY 550 (2019). All this said, we recognize that Kaldor-Hicks efficiency has been critiqued in the literature on other grounds. *See, e.g.*, Jules L. Coleman, *Economics and the Law: A Critical Review of the Foundations of the Economic Approach to Law*, 94 ETHICS 649 (1992).

¹²⁰ *See also* Zachary Liscow, *Is Efficiency Biased?*, 85 U. CHI. L. REV. 1649, 1659 (2018) (“Adopting [a policy that improves Kaldor-Hicks efficiency] ensures the total amount that people are willing to pay in aggregate for policies has increased. As Judge Posner famously put it, in a sense, “wealth” has increased—not in that people have more money in their bank accounts, but rather in the sense of total surplus (willingness to pay for social arrangements) increasing. Adopting such efficient policies then respects people’s preferences by adopting the policies that they value most”).

¹²¹ *See* B.3.b.vii *infra*.

One potential way to make corporate behavior more sensitive to the preferences of willing-to-sacrifice equity investors is to reform the corporate franchise. This would involve allowing shareholder votes on specific business decisions, and possibly also changes in who decides how these votes should be cast.

1. The plausibility that majority holders of a firm's shares would favor a market-imperfection-correcting change in firm behavior. Reforming the shareholder franchise to make corporations more sensitive to the preferences of willing-to-sacrifice investors only makes sense if there is reason to believe a significant body of such investors exists. We asserted at the start of this Article that it is easy to imagine that it does, should they be fully informed, because equity investors are full human beings with values beyond maximizing returns on their investments. The proposition gains more credibility, though, when worked out in a more formal way. The economists Oliver Hart and Luigi Zingales do just that in a simple, elegant model that they developed as part of a larger project advocating for reform of the corporate franchise of the very kind being assessed here. Hart and Zingales show that the holders of a majority of shares might plausibly prefer that a firm deviate from share value maximization to correct for a broad range of market imperfections.¹²² In their model of investor preferences, a corporation must decide whether to end some activity that generates a negative externality. Recall their example where DuPont legally dumped toxic wastes into the Ohio River. Incinerating the chemicals instead would have produced no environmental harm, but would have been costly for the firm. If DuPont had chosen incineration and incurred those extra costs, the typical DuPont shareholder's wealth would have been diminished by \$0.19. Aggregated across all shareholders, these extra costs would have represented about 1/16th of the dumping's \$350 million damage in the form of death, injury, and

¹²² This model is developed in Hart & Zingales, *Corporate Governance*, *supra* note 7. A more comprehensive model appears in Broccardo, Hart & Zingales, *supra* note 15, at 3113-3117.

health care costs. Hart and Zingales persuasively argue that the holders of a majority of DuPont's shares, if aware of the situation, would almost certainly have preferred incineration. In essence, they are suggesting these holders would have been sufficiently empathetic with their fellow human beings that where, as here, the gainers' gains so outweigh the losers' losses, they would be willing to incur the financial loss needed to correct the market imperfection.

In the Appendix to this Article, we reorient Hart and Zingales' shareholder preferences model to support two propositions that are of interest to our inquiry here:

- (I) All else equal, a socially-minded shareholder's willingness to support a social welfare improving deviation increases as the shareholder's fractional equity interest decreases.¹²³
- (II) All else equal, a socially-minded shareholder's willingness to support a social welfare improving deviation increases as the deviation's social welfare improvement relative to its cost increases.¹²⁴

In the Appendix, we also provide a stylized example in which we imagine that a shareholder has an equity interest in a public company representing 1/10,000,000th of its total outstanding stock, a portion that Hart and Zingales use in their example of a typical highly diversified investor.¹²⁵ The net social benefit from eliminating the externality generating behavior is 1.2 times the cost to the company and hence to its shareholders.¹²⁶ In that case, despite the cost

¹²³ See Appendix, Proposition 3.

¹²⁴ See Appendix, Proposition 5.

¹²⁵ This is the same proportion as Broccardo, Hart, and Zingales use in their DuPont example concerning an investor with \$500,000 invested in a broad-based index fund. See note 15 *supra* and accompanying text.

¹²⁶ This may seem like a modest benefit-to-cost ratio from eliminating an externality, thereby suggesting the shareholder could have an even smaller empathy factor and still favor the deviation. It should be noted, however, that the more glaring externalities are likely to already be the targets of government regulation, since on average the most political energy would be devoted to correcting them.

to her, a shareholder would favor the deviation if the empathetic pleasure she would obtain, i.e., her empathy factor, was anything more than about one two millionth of the rest of society's net benefit (i.e., the net gain from eliminating the externality to everyone but the shareholders minus the cost to all the company's other shareholders). In other words, if the corporation's total market capitalization was \$10 billion (so that the shareholder's equity interest would be worth \$1,000) and society's net benefit from the deviation is \$200 million, she would vote to approve it if the pleasure she received from the rest of society enjoying this net benefit exceeded the pleasure she would enjoy from receiving \$10.¹²⁷

The Hart and Zingales model's key idea is that where a shareholder holds only a small portion of the corporation's shares, she is empathetically weighing the total society-wide net gain from the corporation changing behavior, against her own small fraction of the total losses. So, even if the shareholder is only a little bit empathetic, where society's net gains are substantial, she will prefer the socially beneficial outcome. She prefers this even though it diminishes share value and hence is personally costly. The vicarious pleasure that people obtain from the elimination of an externality is like a public good. Its cost is fixed, however many people enjoy it. The larger the group across which the fixed cost can be spread, the smaller the burden each member must shoulder, and thus the more likely the holders of a majority of the firm's shares will favor correcting the imperfection. In their model, you get this pleasure only by being a shareholder (apparently

¹²⁷ Note that as a shareholder's equity interest increases, she needs to receive higher empathetic pleasure from elimination of the externality to support its elimination, all else equal. See Appendix, Equation 14. In the example above, it is therefore much less likely that a controlling shareholder or a shareholder of a closely held corporation will want to eliminate the externality. This point is the basis of Kahan and Rock's observation that even if society somehow were able to rely on dispersed ownership firms to rectify social ills by leveraging their shareholders' preferences to affect social change, that would at best be a partial solution because the shareholders of other important corporation types would not as readily follow suit. See Marcel Kahan & Edward Rock, *Corporate Governance Welfarism*, 15 J. LEGAL ANALYSIS 108, 122-23 (2023).

through some sense of responsibility), and you pay a portion of the cost only by being a shareholder. The more shareholders there are to share the burden, the lower the cost to each.

2. *The idea of harnessing willing-to-sacrifice shareholders' preferences to correct market imperfections left uncorrected by the government.* Viewed through the normative lens of Kaldor-Hicks efficiency, an important function of government is to increase social welfare by correcting market imperfections. The government does so by prohibiting, taxing, or subjecting to civil liability negative externalities, mandating or subsidizing positive externalities, outlawing anti-competitive practices or requiring marginal cost pricing, and requiring disclosures or imposing quality standards on goods and services. The corresponding laws and regulations are the products of a governmental political system in which every adult citizen in a jurisdiction has the right to vote. By definition, when a market imperfection is corrected, the gainers' gains outweigh the losers' losses. Thus, in theory, through some kind of log rolling or wealth transfer, a majority of voters could always be assembled to favor the correction. In reality, of course, the political system falls far short of working this way, and so many imperfections continue to exist, including ones that cause share-value-maximizing corporations to act in ways that are not social value maximizing.¹²⁸

From this perspective, any imperfection that continues to exist represents a governmental failure. Hart and Zingales look to shareholders with these willing-to-sacrifice preferences to step into the breach and help alleviate such failures. At its most foundational level, Hart and Zingales' model envisions that a firm's shareholder base includes a subset of shareholders who serve as essentially Kaldor-Hicks-efficiency police. These shareholders would act when a corporation's

¹²⁸ ANTHONY DOWNS, *AN ECONOMIC THEORY OF DEMOCRACY* (1957) is a pioneering study in political economy, using the assumption that political parties act rationally to maximize their chances of winning office. This analysis shows that the system will not likely maximize social welfare. *Id.* at 52.

share-value-maximizing behavior is associated with some market imperfection, such as DuPont's toxic dumping. In such a situation, a change in corporate behavior, though diminishing share value and hence the wealth of each of its shareholders, would, wealth-wise, leave society's gainers ahead by more than it would leave behind its losers, a group who, financially, would include the firm's shareholders. Hart and Zingales imagine that any given shareholder would prefer the change in behavior where the cost to her individually is less than the empathetic pleasure she receives as a result of the net gain that the behavior change would yield to the rest of the world. Her calculation would include both the cost to the other shareholders and the gains and losses of everyone else in society.¹²⁹

3. *Reviewing why, so far, shareholders have not played this role.* Consider a situation in which a corporation's shareholders are fully informed concerning both (1) the extent to which a deviation from share-value-maximizing behavior would advance some widely shared social aim, and (2) the amount by which the deviation would diminish share value. As the Hart and Zingales model suggests, when shareholders are so informed, it is easy to imagine many cases where the holders of a majority of the company's shares would prefer the deviation. The cost to each

¹²⁹ In the Hart and Zingales' model, the shareholder is voting shares in a corporation that, if it behaves in a way that maximizes share value, it will not, because of the presence of a market imperfection, be acting in a social welfare maximizing way, i.e., its behavior will not be Kaldor-Hicks efficient. It is assumed that she will feel a sense of responsibility for the firm's behavior. To the extent that she is an empathetic person, if the corporation deviates from share-value-maximizing behavior so as to behave in a fashion that was less profitable but was Kaldor-Hicks efficient, she would enjoy some net pleasure, since by definition the gainers' gains would exceed losers' losses. In deciding how to vote, she would weigh that net pleasure against her pro-rata share of the decline in share value. We find this sense-of-responsibility concept a little questionable since the likelihood that her vote will change anything is vanishingly small. Perhaps Hart and Zingales adopt it because the very existence of the vote would tweak each shareholder's conscience. That though, raises the interesting question of who would call for this conscience-tweaking vote in the first place. We think it is more realistic to assume that when an investor wants the corporation to change behavior, it is not because she is a shareholder. She would want it to change even if she were *not* a shareholder, indeed even more intensely since it would involve no cost to her. She is an empathetic person who, if she were not a shareholder, would unambiguously enjoy net pleasure if the corporation were to change: the fact that the deviation results in a net gain to society means that the joy she would receive from the gainers' gains would exceed the sadness she would feel for the losers' losses. She *is* a shareholder, however. This means, on the one hand, that under the subject-broadening reform, she would be able to vote to have the corporation change, but, on the other hand, she will suffer the loss in terms of share value if the proposal to change wins the election. This change in assumption would not alter the core of their results.

shareholder in terms of foregone share value might be slight, and many of them might empathetically gain utility from the corporation advancing the social aim. The classic example, again, is DuPont's choice between dumping toxic chemicals into the Ohio River versus safely incinerating them at a higher cost.¹³⁰ This all makes sense, but yet, as discussed in Part I, the cold reality is that research fails to reveal a single instance where a director election ever turned on such an issue.

We suggested two primary reasons why. First, a firm's shareholders in fact start out far from being fully informed about issues of this sort. What they would prefer if fully informed is irrelevant should they in fact never become informed. For these incipient preferences to become manifest, a social change agent would need to expend substantial political energy and material resources to inform these shareholders. The shareholders themselves would then need to make the effort to absorb and reflect on the information and to vote accordingly. Rational apathy suggests they are unlikely to do these things.

Second, even if these shareholders' preferences became manifest, under current corporate governance arrangements, shareholders can only vote for directors, not on specific business decisions. The election of directors is about much more than this one issue, and so willing-to-sacrifice preferences are at high risk of getting lost in the noise of other considerations. In particular, the most critical consideration in a director election is usually whether the candidate would be good at supervising the productive running of the firm as a more general matter. This second lost-in-the-noise reason why we have never seen a director election turn on a willing-to-sacrifice issue reinforces the first reason: neither the change agent nor the shareholders will expend

¹³⁰ See note 15 and accompanying text.

the resources and effort needed to make preferences manifest if doing so will have very little prospect of affecting who is elected as director.

4. *A possible way to make the shareholder franchise more effective: allow a shareholder vote on specific business decisions.* A leading potential reform, discussed more in the next subsection, is to allow shareholders, by binding vote, to make specific business decisions for the corporation. This reform would be an antidote to the second, lost-in-the-noise reason for the current franchise ineffectiveness discussed above. Enacting it would also eliminate this second reason's reinforcement of the first, not-worth-the-effort, reason

How the reform would work can be illustrated yet again by the DuPont story. Assume, quite plausibly, that the holders of a majority of its shares have an incipient willingness to sacrifice the cost of incineration, \$0.19 for the typical investor, to avoid the social damage of the dumping. It is nevertheless hard to imagine that these preferences would become manifest and then determinative in the process of a *director* election. Suppose, though, that the dumping could be stopped by a shareholder vote specifically aimed at that issue. A social change agent aware of the issue might easily calculate that a vote to ban the dumping as quite likely to succeed if she could make manifest the shareholders' incipient preferences. This higher likelihood of success, relative to the matter being simply one of many issues in a director election, increases the likelihood that the change agent would make the attempt.

The internal governance arrangements of today's corporations, however, do not allow such a vote.¹³¹ Part of the reform would thus be amending each state's corporate code to either require,

¹³¹ The typical state corporation code only provides for a shareholder vote with respect to certain discrete matters, including director elections and approval of major transactions, such as a merger or sale of substantially all the firm's assets, *see, e.g.*, DGCL § 211(b) (shareholder election of directors) & 251(c) (shareholder voting for a merger with another Delaware corporation). These codes do not provide for a binding vote on specific business decisions. In the various states, this is, at a minimum, the default arrangement, *see, e.g.*, DGCL § 141(a). Research does not reveal any dispersed ownership publicly traded corporation where this is not currently the arrangement.

or at least provide as the default, an arrangement by which shareholder proposals relating to specific business decisions could be put to a binding shareholder vote. In addition, the reform would require rescinding the federal proxy regulation that allows management to exclude from a company's proxy materials any shareholder-initiated resolution relating to an ordinary business operation.¹³²

5. *Hart & Zingales and market-imperfection-correcting deviations: the promises and the problems.* The leading proponents of this reform allowing shareholder voting on specific business decisions are again Hart and Zingales. In multiple well-known papers building on their model of shareholder voting preferences, they argue in favor this reform as a way to correct market imperfections left uncorrected by government.¹³³ As just noted, the reform would likely lead in at least some instances to shareholder approval of resolutions that would result in market-imperfection-correcting changes in corporate behavior. This is because it would eliminate the “lost-in-the-noise” problem associated with director elections. It would allow proponents of a change in corporate behavior to conduct a focused campaign on a specific issue. Any such change in corporate behavior, though share-value-diminishing, would increase social welfare in the Kaldor-Hicks sense.

¹³² Exchange Act Rule 14a-8(i)(7). The exclusion provision's entire rationale is to avoid clutter in the proxy materials relating to matters outside the province of shareholders. *See* Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 40018, 63 Fed. Reg. 29106, 29108 (1998). This rationale would be lost if a corporation's shareholders had the right to a binding vote concerning business decisions. *See also* Libson, *supra* note 28, at 714-18 (discussing how the ordinary business exclusion impedes the use of shareholder proposals on social issues and arguing for the exclusion's elimination).

¹³³ *See* note 7 *supra*. There have been other proposals to reform the shareholder franchise; *see, e.g.*, Bebchuk, *supra* note 104 (arguing in favor of permitting shareholders to set business decisions relating to sales, dissolutions, distributions, and management remuneration); Eric A. Posner & E. Glen Weyl, *Quadratic Voting as Efficient Corporate Governance*, 81 U. CHI. L. REV. 251 (2014); Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 127, 166-73 (2009). However, unlike Hart and Zingales, these proposals have not been specifically focused on increasing the influence of willing-to-sacrifice shareholders. There are also scholars arguing against broadening the shareholder franchise for any reason *See, e.g.*, Bainbridge, *supra* note 104, at 622-23. Other scholars have advanced proposals that would increase the scope of the precatory 14a-8 process. *See, e.g.*, Geeyoung Min, *Shareholder Direct Democracy*, 74 EMORY L.J. 381 (2004).

That said, in our view, allowing votes on specific business decisions will not, by itself, go far toward eliminating the other reason the shareholder franchise has been such an ineffective tool for aligning corporate behavior with willing-to-sacrifice shareholder preferences: shareholder ignorance and rational apathy. In an effort to ameliorate this second reason, Hart and Zingales suggest multiple ways of changing *who decides* how a firm's shares are voted. As discussed below, we are skeptical about how well each would work. Success in changing corporate behavior would also be hindered by managerial resistance to whatever business decision resolutions actually are adopted.

Assessing the likely effectiveness of the reform and its overall social desirability requires consideration of three sets of factors: (i) what would be the social costs associated with efforts to mobilize willing-to-sacrifice shareholders that would not have been incurred absent the reform; (ii) when business specific resolutions are adopted, how reliably would they be implemented, and, to the extent they were, would there be any significant costs to the shareholders beyond the loss in share value from the change in behavior; and (iii) would the shareholder preferences that are made manifest be based on accurately identified market imperfections. Our overall conclusion is that a reform allowing votes on specific business decisions, even combined with one or more of the suggested changes in who decides how shares are voted, would probably not result in many such resolutions being adopted. And even if the reform were to result in more resolutions being adopted than we forecast, it still might well not be socially beneficial from an overall point of view.

a. Voting by individual investors. Let us start by considering how things would work if individual investors did the voting, either directly, if they were retail investors, or through full pass-through voting, if they were investment fund investors.¹³⁴ In other words, we are

¹³⁴ A retail investor has a direct beneficial interest in the shares she holds and votes them herself (or leaves the voting to her broker's nominee). Currently, no investment fund offers its investors a way to vote the fund's shares without

contemplating that the voters are the persons whose money was the ultimate source of the funds to purchase the shares being voted.

When it comes to voting on social issues, the typical such investor starts out uninformed concerning each of the firms in which she is directly or indirectly invested. Unlike in the Hart and Zingales model discussed above, the investor will know little about each firm's potential for social-welfare-increasing deviations from share-value-maximization, let alone the extent of each such potential deviation's welfare improvement versus its associated decrease in share value.

Obtaining this information, providing it to investors, and mobilizing their votes would consume substantial resources and require the energy of public-spirited social change agents. And it would need to be done on a firm-by-firm basis. Let us start with obtaining the information. Consider the social change agent's task with regard to just a single firm with single activity that impacts on a single social concern. Management would often be in exclusive possession of the information relating to the level of activity, and would almost certainly be better informed than anyone else about the cost of any alternative course of action that would better advance this social concern. It is likely to resist disclosing both kinds of information. Providing this information would often be expensive and useful to competitors. Providing it would also increase the chance that shareholders would approve a resolution. Approval, in turn, would tend to be contrary to managerial interests, because, as discussed earlier, these interests are usually best served by operating decisions that maximize share value. If the change agent nevertheless did obtain the information, outside expertise would then be needed to assess the extent to which that alternative course of action in fact furthers the social concern and how much it would reduce share value. The

some kind of intermediation what the major funds offer is the option of having a proxy-soliciting firm vote her shares in accordance with one of a small number of plans, each of which has an overall theme and associated voting guidelines, see note 34 *supra*. For completeness, however, we consider here the possibility of full pass through voting, whereby the fund investor herself deciding how her pro rata portion of the fund's investment in each firm that it holds.

social change agent would then need to identify the firm's shareholders, put this information into their hands, credibly explain its implications in terms of the shareholders' social concerns, and mobilize the shareholders to actually vote.

The shareholders themselves would need to devote time and energy as well, absorbing and considering the information being provided and acting upon it by voting. As discussed earlier with respect to director elections, the ordinary shareholder will be rationally apathetic in these regards because it is highly unlikely that her vote will make the difference in the outcome. She is thus unlikely to absorb and process the needed information and to then vote accordingly unless mobilized to do so. Moreover, it is often a matter of debate which situations constitute serious market imperfections and what changes in firm behavior would be effective corrections. Thus, making incipient preferences manifest is often not a matter of simply providing equity investors with information. Each shareholder would need to be involved in weighing the arguments in the debate to ensure her vote reflects her true preferences. She would need to either weigh these arguments on her own, or seek out the views of others whom she has assessed as competent and trustworthy. Otherwise, she could vote for a change in firm behavior described by proponents as furthering a social end she supports at a cost low enough to make it worthwhile to her, but where a full examination would reveal this not to be the case.

In essence, if individual equity investors are the voters, success would require establishing a firm-by-firm set of mini-political systems. This is an expensive proposition: in governmental elections, think of the large sums spent informing, persuading, and mobilizing voters, and the time and effort voters put into deciding how to vote and then actually voting and this would be no different. Take a situation where a deviation from share value maximization would correct some market imperfection at a cost that the holders of a majority of the firm's shares would, if fully

informed, find worth incurring. It will not be easy for a social change agent to ascertain this, but sometimes one will. Even then, the prospect of expending the energy and resources necessary for a successful campaign will, in most cases, deter the change agent from moving forward. Suppose, though, that because of the reform, some change agents still do move forward and their resolutions are adopted, but require the votes of individual investors to pass. Assessing the social desirability of the reform to allow specific-business-decision voting would require considering not just the net social gains from the resulting changes in firm behavior when the resolution passes, but also, for both successful and unsuccessful campaigns to persuade individual voters, the campaigns' costs and the costs to the shareholders in terms of processing information and voting.¹³⁵

This analysis is subject to one refinement. As used throughout this Article, the idea that the individual investor only votes in accordance with her preferences when she is “fully informed” is a simplification. A more precise formulation would be that for one to vote in accordance with what would be her preferences if fully informed requires her to be provided with, process and act upon messages that would prompt her to come to the same vote, even if these messages do not render her fully informed. This more precise formulation does not change anything, however, other than, as discussed below, introducing the idea that shareholders could be mobilized to vote in favor of, or against, resolutions where, if fully informed, they would have voted the opposite way.

b. Voting services. One approach to ameliorating the problems arising from investor ignorance and rational apathy is for each individual investor to delegate to a proxy advising firm, such as ISS, the task of voting her equity interests in accordance with her particular

¹³⁵ These shareholder costs also include those incurred by the shareholders who eventually vote against the resolutions calling for share-value-decreasing changes. For each such resolution, these are investors who are at least incipiently opposed, i.e., investors who if fully informed would vote no either because they do not wish to sacrifice to the extent (if at all) required by the resolution, or do not believe it will effectively promote its purported end. They may need to gather and analyze information to determine that the resolution is in fact inconsistent with their preferences, and will need to mobilize in order to maximize the chance that their position prevails.

values. This idea has been suggested by Hart and Zingales, who point to the detailed criteria used by ISS and others in advising socially oriented investment funds how to vote their shares.¹³⁶

We are skeptical that such voting services would be much help. To start, a voting service of the kind proposed would be performing a distinctly different task from the one currently performed by proxy advisory firms for socially oriented funds. These funds do not suggest they are willing to sacrifice returns in order to further the social cause they claim to advance.¹³⁷ And the Rule 14a-8 proposals on which the proxy firms are being asked to advise are purely precatory. Not surprisingly, therefore, the criteria used by proxy advisory firms do not address the degree of sacrifice, if any, that a proposal would entail. The voting service, in contrast, would be deciding on resolutions requiring changes in firm behavior that *would* involve a reduction in share value.

Consider the three tasks the voting service would need to undertake for its vote on such a resolution to be in accordance with the preferences of any given individual willing-to-sacrifice equity investor:

First, it must assess how much the change in firm behavior would reduce firm value.

Second, it must assess how much the change would advance the social cause that the change is intended to advance.

Third, the service must determine whether this particular individual investor values this social advance more than her diminution in wealth from the drop in share value caused by the change.

For any socially-oriented resolution up for a vote, undertaking the first two tasks would be a difficult and expensive effort for the same reasons, discussed just above, that undertaking them

¹³⁶ Hart & Zingales, *Corporate Governance*, *supra* note 7, at 213.

¹³⁷ See, e.g., *supra* note 50.

would be for a social change agent.¹³⁸ As for the third task, willing-to-sacrifice investors vary from each other as to their willingness to sacrifice, and hence as to whether an affirmative or negative vote is more in line with their preferences.

In accordance with the extension of the Hart and Zingales model developed in the Appendix, a given shareholder's willingness to prefer a share-value-deviating change in corporate behavior is related: (i) positively to the change's externality improvement ratio (the net benefits to persons other than the shareholders divided by the cost of the change to the firm), (ii) negatively to the fraction of the firm that she owns, and (iii) positively to her empathy factor (her willingness to sacrifice wealth to improve the position of others).¹³⁹ The externality improvement ratio can be calculated from the results of the first two tasks and voting service will know the number of shares it is voting for any given shareholder and hence the fraction of the firm that she owns. However, it is difficult to figure out how an investor can communicate to the voting service her empathy factor. This is further complicated by the fact that an investor may not even have a consistent single empathy factor applicable across the range of social concerns that could be advanced by market imperfection corrections. Also, for competitive reasons, a voting service will be concerned with its costs, and the most economical approach for a voting service would be to adopt a single position—either for or against—any given proposal. The fact that the fraction of the firm held by each voting service subscriber and her empathy factor both vary from one subscriber to another means that

¹³⁸ Nor can the voting service simply rely on the work of a proposal's change agent. The discussion above concerning change agents describes the difficulty and expense that an ideal agent would incur in obtaining what she would need to know to determine whether a share value reducing change in a firm's behavior would in fact increase social welfare and to inform share voters how great the social gain will be relative to the decline in share value. An actual change agent might, though, put a particularly high value on how the change would advance the social cause involved, and, in her desire for the resolution calling for the change to pass, make public statements that overstate the gains the change would bring or understate its cost to share value. Thus, the voting service would need to make its own determinations to do due diligence on these public statements.

¹³⁹ See Appendix, Propositions 3-5.

doing the single position would be contrary to what many subscribers would prefer if they were fully informed.

The challenge faced by the voting service is compounded by the fact that the typical individual investor today is likely to be highly diversified. This means she will have equity interests in hundreds, possibly even a few thousand, firms. For a substantial portion of these firms, the presence of market imperfections means that operating in a share-value-maximizing way is operating in a socially suboptimal way. Each such firm would thus be a candidate for one or more imperfection-correcting, share-value-reducing resolution dictating changes in the firm's behavior. To properly serve this typical investor, the voting service would need to undertake the three tasks set above with regard to every such proposal. If the reform allowing votes on specific business decisions were adopted and succeeded in generating proposals to correct a substantial number of imperfections each year, the voting service's very substantial cost of doing its work, even if spread over a large number of users, appears to us likely to be more than what most investors would be willing to pay. In other words, we are skeptical that a viable business model exists for voting services to serve as a solution to the problems raised by individual voting. It is telling that no such voting service exists today.¹⁴⁰ The fact that no one finds it profitable to provide a voting service for the current matters on which shareholders can vote – such as directors, major corporate

¹⁴⁰ For retail investors, research has not revealed any voting service of the kind described here. The closest thing we found, Tulipshare, was described by its CEO as “the first broker to combine shareholder activism with online brokerage.” <https://www.forbes.com/sites/afdhelaziz/2021/08/18/how-revolutionary-new-activist-investment-platform-tulipshare-is-letting-people-vote-with-their-money-to-take-action-at-apple-amazon-coca-cola-and-more/>. Tulipshare, though, closed the trading platform in 2023. *See* <https://tulipshare.com/faq>. The pass-through voting schemes offered by the managers of the major investment funds involve delegating voting to a proxy soliciting firm. In that sense, these schemes involve something resembling a voting service of the kind discussed here. *See* note 34 *supra*. The funds, rather than the individual investors, are the ones paying for these services. For reasons of competition, the funds are very conscious of their costs. They therefore do not have the incentives to provide well the three tasks discussed here. *See* Brav et al., *Proxy Voting Choice*, *supra* note 34, at 27-30.

transactions and precatory resolutions -- leads us to doubt that they would suddenly materialize just because specific business decisions were added to the list.

One final problem. Even if some voting service firms did materialize with the adoption of voting on specific business decisions, it is unclear how individual investors would be able to monitor the quality with which the firms were performing their three tasks, on which, to save costs, the voting services will be tempted to shirk.

c. Investment funds with specified voting strategies. A second approach for ameliorating the problems associated with individual voting is for investment management firms to offer to investors funds with a clearly identified voting strategy. Hart and Zingales suggest this approach as well, giving as an example a fund committed to vote for any proposal that would cause a firm to reduce carbon emissions as long as the cost is no more than \$100 per ton.¹⁴¹ In essence, the fund would be committed to vote in a way that commands every firm in its portfolio to act as though, as a share-value-maximizer, it was under the constraint of paying a \$100 per ton tax on all the carbon it was emitting, even though it in fact was not required to pay the tax.

The specialized voting funds approach has the advantage that the funds could substitute for social change agents and introduce shareholder proposals themselves. To do its job properly, however, the task before such a fund appears monumental. To illustrate, we will use the Hart and Zingales example. Determining how a firm would be run as a profit maximizer if it were paying a hypothetical \$100 per ton carbon tax would appear to require the fund to have as much information as the firm's management itself would require to operate the firm efficiently, with or without that constraint. That is certainly the case if the resolution being voted upon by the fund specifies the changes the firm must undertake. If, instead, the resolution simply commands the

¹⁴¹ Hart & Zingales, *Corporate Governance*, *supra* note 7, at 213-14.

firm to act as though it were paying a \$100 per ton carbon tax, the same detailed information would instead be needed to monitor compliance. Such monitoring would be necessary because compliance would diminish share value and so would be likely contrary to managerial interests. Moreover, if the fund is responsible for putting forward the resolution, it would need to be making these determinations on an ongoing basis for every firm in its portfolio.¹⁴² It is very doubtful that a fund could incur the costs of making these determinations and keep its fees competitive enough to attract significant investment.

The specified-voting-pattern-fund idea has other problems as well. First, the idea of a fund dedicated to making the firms in its portfolio act as if they were paying a \$100 per ton carbon tax runs contrary to Hart and Zingales' underlying model. As discussed above and elaborated more formally in the Appendix, whether an investor in a firm would prefer it to change and operate this way would depend on the investor's empathy factor, the fraction of the firm owned by the investor, and the externality improvement ratio associated with the change.¹⁴³ Assuming the fund holds the same fraction of each firm in its portfolio, this implies the following. For some firms, operating as though it were paying a carbon tax of \$100 per ton will reduce their carbon output a great deal relative to the cost of making the change, and for others, much less so. Thus, the change's externality improvement ratio will vary from one firm in the fund's portfolio to another. This means that the implied carbon tax rate that would optimally suit a given investor's preferences would also vary from one firm in the portfolio to another, some being perhaps above \$100 and others below.

¹⁴² Presumably almost every firm in a fund's portfolio would, if run in a share value maximizing way unconstrained by a shareholder resolution, would emit some carbon. A large portion of them would be run in an at least somewhat different fashion if it had to pay a \$100 tax per ton of carbon.

¹⁴³ See Appendix, Propositions 3-5.

This concern could perhaps be set aside on the theory that an investor could communicate a rough approximation of her voting preference with regard to each firm in the fund's portfolio by whether she chooses a fund with a higher or lower implied tax. That would suggest how much value she puts on reducing carbon emissions as a general matter. Still, to satisfy a set of investors with varying preferred overall implied tax rates, a fund manager would need to offer a collection of funds, spanning a range of different implied tax rates. The hope would be that there was some implied carbon tax rate low enough that a resolution calling for an issuer to act as though it were subject to that implied rate would attract the votes of a majority of an issuer's shares. The idea would be that investors in funds with higher implied carbon tax rates would want their funds to vote positively for the resolution with this lower implied tax rate because they would prefer the issuer to reduce its carbon emissions partway down to the level they would regard as optimal, as opposed to not reducing them at all. Voting as a way of aggregating individual preferences in a coherent, consistent, and unmanipulable way is famously vulnerable to a number of maladies, however, and the more complicated the set of choices, the greater these problems.¹⁴⁴ So, whether, in reality, the corporate franchise—what is essentially a political system that needs to generate a single course of action from the votes of persons with varied preferences—could work this way is an open question.

Finally, Hart and Zingales' specialized voting fund idea appears to contemplate that each kind of investment fund would be dedicated to advancing its own specific social end. Each individual investor will often be willing to sacrifice returns to advance multiple social ends. Any

¹⁴⁴ These maladies include the Condorcet Paradox, whereby three or more choices being subject to pairwise votes can yield logically inconsistent results. The maladies include, as well, the result's sensitivity to whoever controls the agenda and to insincere, strategic voting. For a good overview of these maladies and the less-than-perfect approaches to their cure, see Jonathan Levin & Barry Nalebuff, *An Introduction to Vote-Counting Schemes*, 9 J. ECON. PERSP. 3 (1995).

investment dollar can only go into one fund, meaning that the willing-to-sacrifice investor with multiple social concerns will either need to split her total savings across multiple funds or leave some of her social concerns unaddressed. This dispersion of willing-to-sacrifice investor savings among multiple funds may leave each such fund without sufficient resources to buy shares with enough votes to pass the proposals that she and like-minded investors favor.

d. Investor assemblies. In a more recent working paper, Hart and Zingales, in collaboration with H el ene Landemore, have more explicitly recognized the investor ignorance and rational apathy problems associated with individual investor voting on specific business decisions.¹⁴⁵ They have proposed yet a third possible way to ameliorate these problems: an assembly drawn from an investment fund’s investors to provide the fund’s managers with guidelines concerning how to vote the fund’s shares on matters of social concern. Members of the assembly would be randomly drawn from the fund’s investors, with the odds of being drawn in proportion to the size of the investor’s holdings in the fund.

The proposal has three attractive features. First, it takes the very considerable voting power currently in the hands of each of the large broad-based index investment funds and puts that power to work advancing various social ends of concern to its investors.¹⁴⁶ Second, using these large investment funds to do this work spreads the associated costs across very large investment pools,

¹⁴⁵ See Hart, Landemore & Zingales, *supra* note 35.

¹⁴⁶ The large management companies that manage the bulk of all such index fund money also manage managed funds, an activity that earns them much higher fees per dollar invested. They will be reluctant to subject these managed funds to the assembly process because, unlike broad-based index funds, they compete on the basis of risk-adjusted returns, and implementing assembly guidelines would involve a sacrifice in returns. One could argue that many managed fund investors also would be willing to trade off returns for advancing various social causes and so managed funds could compete on the combination of the returns they achieve plus the causes they advance. One problem with this argument is that relative to returns, the social-cause-advancement feature will be less salient and a harder to verify component of any competition. Another is that this kind of competition is likely to lead to a separating equilibrium, whereby investors who seek share value maximization will abandon funds that advance social causes, reducing their number of votes.

reducing these costs greatly in per-dollar-invested terms.¹⁴⁷ Third, because the assemblies would be working with broad index funds, the proposal is unlikely to contribute to a separating equilibrium in which willing-to-sacrifice investors are invested in one group of firms, and investors who wish to maximize share value are invested in another group of firms (as likely would happen if the assemblies advised managed funds).

Because of these features, the proposal avoids some of the pitfalls associated with the voting services and specialized voting funds approaches for ameliorating the rational apathy problems associated with voting by individual investors. As a result, it may be worth a try; indeed, we offer suggestions below on how it might be implemented. Still, in the end, we are skeptical that it will be sufficiently effective. We see two primary problems: a lack of representativeness in the composition of the assembly members, and a low likelihood that the voting guidelines developed by the assemblies will result in meaningful changes in firm behavior that better reflect underlying investor preferences.¹⁴⁸

i. Representativeness. Regarding the representativeness of the assembly's composition, the proposal contemplates that the chance of receiving the opportunity to serve in a fund's assembly will be allocated randomly in proportion to the size of an investor's holdings. This is appropriate because any sacrifice in returns to further some social cause will be in proportion to

¹⁴⁷ Three management companies—Vanguard, BlackRock, and State Street (the “Big Three”)—manage funds holding in aggregate approximately 21% of the shares of a typical S&P 500 firm. Matthew Backus, Christopher Conlon & Michael Sinkinson, *Common Ownership in America: 1980-2017*, 13 AM. ECON. J.: MICROECONOMICS 273, 285 (2021). By dollar volume, the bulk of the funds managed by the Big Three are broad-based index funds and, in turn, the Big Three's broad-based index funds dominate this market.

¹⁴⁸ It should also be noted, that to the extent that the proposal is effective in requiring deviations from share-value-maximization preferred by the persons contributing a majority of the country's equity capital, those who are opposed to these deviations will, for good or for bad, be forced to go along. Arguably, this fact should not be a concern as long as the deviations genuinely correct market imperfections. See notes [] and accompany text. There is the question, though, of whether all resolutions would correct market imperfections. See []. In any event, the existence of investors who do not agree raises the same fiduciary duty questions for fund managers as are raised by all voting for share-value-diminishing proposals. See notes 46 & 47 and associated text, *supra*. Thus, the assemblies proposal would be effective only if there were legislation, rulemaking, or court rulings that would find that adhering to the assembly's guidelines would not to be a fiduciary duty violation.

these holdings. The problem, though, is that anyone who receives the opportunity to serve has the right to refuse. The pattern of acceptances and refusals can bias the composition of the assembly in ways that can cause multiple problems.

One problem relates to the fact that a critical function of the assembly will be to assess how much a given guideline would reduce the share value of the firms to which it is applied, and how much it would advance the social cause it is supposed to advance. These are tasks that take considerable time and effort. Refusals to serve will lead to a bias against inclusion in the assembly of those among the fund's investors whose backgrounds and skills would be the most valuable in making these assessments. These are the persons for whom the time and effort serving in the assembly involve the highest opportunity costs, and hence they are most likely to refuse serving. Trying to solve this problem by paying all the representatives the same very high fee equal to these persons' opportunity costs might overcome the problem. Such a high fee, however, will also attract acceptances from lower opportunity cost investors who are more interested in the fee than in the work of the assembly.

A second problem arises because the people most motivated to accept the opportunity to serve are persons especially interested in the social impacts of corporate behavior. In the language of the model in the Appendix, this means that the assembly members are likely to have significantly higher empathy factors than the average investor in the fund.

ii. Effectiveness. Regarding the effectiveness of the voting guidelines generated by the assembly, Hart, Landemore, and Zingales lay out a procedure by which an assembly would coalesce around a couple of areas of concern for each year, and then lay out voting guidelines for the fund to follow. They do not say, however, how these guidelines would be articulated.

One approach to articulating the guidelines might resemble what Hart and Zingales contemplated for the specialized voting funds. Their example, recall, was a guideline calling for approval of any shareholder resolution that requires the firm to reduce carbon emissions to the extent that it can do so for no more than some maximum threshold number of dollars per ton. Using this example, the question is how the assembly would decide on what the maximum implied carbon tax should be. Consider again their model of shareholder preferences, as extended in the Appendix. Any given assembly member has his particular empathy factor and owns his particular fraction of the fund. Based on these, he would be in favor of any change in firm behavior that results in an externality improvement ratio greater than some given minimum.¹⁴⁹ This, though, creates a problem for that assembly member in developing a guideline to be applied to all the firms in the fund's portfolio: the implied carbon tax associated with that minimum externality improvement ratio differs from one firm to the next. Moreover, each member's implied tax rate for any given firm will depend on his particular empathy factor, and that will differ from one assembly member to the next. So, for an assembly of such members to agree on a single implied tax rate to be applied to all these firms, the implied rate would need to reflect some kind of average empathy factor, average fraction of ownership, and some sense that the chosen implied tax rate would, on average across firms in the fund's portfolio, result in externality improvement ratios that would reflect the average of the assembly members' respective individual externality improvement ratio minimums.

One can imagine the democratic processes followed by the assembly leading to some kind of consensus on the empathy factor, the fraction of ownership, and the externality improvement ratio minimum for use in computing this single implied carbon tax. Again, though, using a

¹⁴⁹ See Appendix, Proposition 2.

electoral process to come to such a number in a consistent, unmanipulated way is vulnerable to voting's famous maladies, discussed above. Moreover, it would require developing a sense of the average externality improvement ratio for all of the fund's firms associated with different implied carbon taxes, which would be a difficult and expensive task for the assembly to undertake.

There is an alternative approach for assembly articulation of its carbon cleanup cost guidelines that would at least avoid the last of these problems. This would be to simply call for approval of all shareholder resolutions that require reducing carbon emissions to the extent that it can be done with an externality improvement ratio no less than the average of each member's minimum improvement ratio implied by his empathy factor and fraction of ownership. This approach would simplify the work of the assembly but add to the work of the fund in terms of using the guidelines in deciding how to vote resolution by resolution.

Either way, the assembly would be tossing the fund a "hot potato" in terms of collecting and analyzing an enormous amount of information for every single firm in the fund's portfolio. Whether the guideline is articulated as requiring carbon reductions costing less than some minimum threshold per ton, or requiring as much reduction as can be achieved given some minimum externality improvement ratio, the fund would need to know how the firm should be run as a profit maximizer under that constraint when the government is in fact not imposing that constraint on it. We suspect that competitive concerns will lead the managers of even the largest funds to be unwilling to incur anything like the expense required to even begin to approach acquiring the information needed. They might, though, identify the extreme cases of firms that have the most room for improvement relative to the sacrifice in return.

The other challenge to effectiveness is simply the proposal's limits in terms of the equity dollars involved. Massive as the large broad-based index funds are, they probably represent no

more than 20%-25% of all equity investment in publicly traded U.S. firms.¹⁵⁰ Suppose that, despite our doubts, the assemblies approach is very successful at prompting index fund managers to vote in accordance with the willing-to-sacrifice preferences of their investors. For any resolution to pass, a substantial number of favorable votes would still be needed from the typically very large number of non-index-fund shareholders, including from individual retail investors and managed investment funds. Thus passage can still be stymied by the already analyzed rational apathy problems associated with individual retail customers, and by the reluctance of managed funds' managers to vote for resolutions resulting in lower portfolio returns due to competitive concerns.

e. Index funds competing on the basis of socially-oriented guidelines. Is it possible that even without assemblies, each of the large, broad-based index funds, to gain market share, would be motivated to vote in favor of socially oriented, specific business decision proposals that reflect what the majority of equity investors would prefer if fully informed? John Coates suggests that, to attract customers, these funds already announce guidelines as to how they will vote on socially oriented precatory resolutions, and that their votes often decide the outcome.¹⁵¹ Broad based index funds compete in offering essentially the same product. Any given fund's market share will not depend on the performance of the firms in its portfolio because all the funds hold essentially the same portfolio. So, each fund will not be disinclined to vote for a share-value-diminishing proposal just because it will reduce the value of its portfolio. Still, in composing their guidelines, the funds will not have the advantage of the work that an assembly can do in providing information about investor preferences. Consumer behavior will not be a substitute. Because the preferences of equity investors themselves are largely incipient, the guidelines are not likely to

¹⁵⁰ See note 147, *supra*.

¹⁵¹ COATES, *supra* note 39, at 100.

play a large role in their choice of funds, and to the extent they do, the choices may not resemble what they would choose if fully informed. Moreover, even if the guidelines did reflect the willing-to-sacrifice preferences of equity investors, the likelihood that they would result in any significant change in corporate behavior is low for the same reasons, discussed just above, as to why the guidelines composed by assemblies are unlikely to be effective.¹⁵²

f. Fiduciary duties of fund managers. As we discussed earlier in Part I concerning the choice of directors, even if a majority of an investment fund's investors were in support of doing so, an investment fund's manager would risk a fiduciary duty lawsuit should it vote for a director candidate that pledged a share-value-diminishing change in furtherance of some social end.¹⁵³ If the vote instead were for a binding resolution calling for the same change, the managers would even more clearly face this risk. This risk is a major obstacle to the proposed franchise reform accomplishing its purposes because a substantial portion of equity investor wealth is invested through such funds and the funds typically vote the shares they hold. This obstacle could be avoided if the fund passed voting through firm-by-firm voting to its investors.¹⁵⁴ Doing so, however, simply returns us to the preceding discussions concerning the investor ignorance and rational apathy problems associated with individual investor voting and the shortcomings of various arrangements by which these investors could ameliorate these problems by delegating voting to others.

g. Conclusion. Many equity investors may start with incipient willingness-to-sacrifice preferences. We have argued, though, that even with the reform of allowing shareholder

¹⁵² See III.B.5.d *supra*.

¹⁵³ See I.C.d.v., *supra*.

¹⁵⁴ In recent years, a number of funds have adopted pass-through voting schemes, but these schemes usually provide only very limited voting choice to fund investors. See note 34 *supra*. Some scholars have argued for an expansion of such pass-through voting if it is structured in a way that can avoid some of its problems. See, e.g., Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493, 529-532 (2018); Brav et al., *Proxy Voting Choice*, note 34 *supra*.

votes on specific business decisions, these preferences will not become manifest without the investors becoming informed and motivated to vote. Rational apathy means that it is unlikely they will do so in significant numbers on their own. Voting services and specialized voting funds are unlikely to help to any meaningful extent. Fund assemblies might generate affirmative votes for some market-imperfection-correcting shareholder resolutions, but by themselves, these votes will be well less than a majority. Thus, changing corporate behavior through the franchise cannot avoid the need to develop firm-by-firm political systems where change agents inform individual investors and motivate them to vote, with all such a systems' attendant costs.

6. *The hidden cost allowing shareholder votes on specific business decisions: diminished public sector political vitality.* Notwithstanding the costs associated with shareholders becoming informed and their votes mobilized, there is a good chance that the reform allowing votes on specific business decisions could occasionally spur socially positive changes in corporate behavior. This is because it would mitigate the problem, discussed above, of willing-to-sacrifice preferences getting lost in the noise of the many other considerations that dominate director elections.¹⁵⁵ We are skeptical that such behavior changing votes will occur often, but we could be wrong, and it is even possible that they would occur with considerable frequency.

Whatever the reform's level of success, however, there would be a proportionate, under-recognized additional cost to society as a whole. The development of the alternative firm-by-firm political systems needed to make the reform work would not occur in a vacuum. The energies of persons seeking to reform corporate behavior are finite, as are the material resources at their disposal.¹⁵⁶ Consequently, they will need to decide where to dedicate their efforts. Energies and

¹⁵⁵ See III.B.3 *supra*.

¹⁵⁶ The costs of mobilizing votes in an activist campaign provide at least a crude, order-of-magnitude measure of what the costs would be to mobilize votes for the kind of shareholder proposals discussed here. As an example, the two sides in the Triam activist campaign to elect a short slate of directors for Proctor & Gamble expended about \$60 million.

resources devoted to corporate elections would thus come at the expense of efforts to reform the governmental political system and to further the same social ends.

Despite current frustrations, political energy and resources can more efficiently correct market imperfections if channeled into the public sphere, rather than the private one. There they can be concentrated to affect the behaviors of a broad swath of firms, rather than being spread piecemeal across hundreds, conceivably even thousands, of battles, each involving an individual firm. Government imposed rules that apply to all firms in an industry also avoid the prisoner's dilemma fear that each individual firm's willing-to-sacrifice shareholders would face. This fear is that if the firm changes to advance the social end they support, its competitors, rather than also changing, will see an opportunity to increase profits by increasing market share, thereby increasing the changed firm's share value loss and diminishing how much its change furthers the relevant social end.¹⁵⁷

7. *Why public sector efforts are warranted despite current political dysfunction.* This moment of political polarization and extreme assertions of presidential power by an anti-regulatory incumbent may seem like an odd time to insist that political energy and resources are better devoted to the public sphere than to the corporate one. One retort would be that this is also not a propitious moment for the changes in law that would be necessary for shareholders to be able to vote directly on matters of corporate behavior. More importantly, though, both history and political science provide grounds for optimism regarding the eventual effectiveness of efforts to achieve political reform and the government's ability to address our environmental and social problems.

See Edward B. Rock, *Institutional Investor in Corporate Governance*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE, 363-372 (Jeffrey N. Gordon & Wolf-Georg Ringe eds. 2025).

¹⁵⁷ This is an especially big problem if a competing firm is privately held, has a controlling shareholder, or has major block holders. According to the Hart and Zingales model, concentrated holders are much less likely to vote for a market-imperfection-correcting deviation from share value maximization. See Marcel Kahan & Edward Rock, *Corporate Governance Welfarism*, 15 J. LEG. ANALYSIS 108, 122-23 (2023).

First, consider history. There have been several moments in our nation's past when the governmental political system seemed incapable of solving profound social problems, but where focused political energy finally generated change. The fragile first couple of decades of our republic were characterized by extreme political vituperation, with partisans holding radically different views concerning the appropriateness of social hierarchy, the proper role of the federal government, and the management of foreign relations.¹⁵⁸ These decades were followed, though, by a period of relative political calm, often referred to as the "era of good feelings,"¹⁵⁹ accompanied by expansive growth in population and national wealth.¹⁶⁰

But the nation then fell back into gridlock again over the issue of slavery. This involved a standoff between the growing abolitionist movement in the industrializing North and the supporters of slaveholding in the still predominantly agricultural South,¹⁶¹ a standoff aggravated by relentless westward expansion.¹⁶² Again, there was resolution, albeit one involving a terrible civil war, when anti-slavery forces grew strong enough to elect Abraham Lincoln.¹⁶³

¹⁵⁸ See GORDON S. WOOD, *EMPIRE OF LIBERTY: A HISTORY OF THE EARLY REPUBLIC, 1789–1815*, xv (2009).

¹⁵⁹ SEAN WILENTZ, *THE RISE OF AMERICAN DEMOCRACY: JEFFERSON TO LINCOLN* 182 (2005)

¹⁶⁰ See DANIEL WALKER HOWE, *WHAT HATH GOD WROUGHT: THE TRANSFORMATION OF AMERICA, 1815–1848*, at 92-93 (2007). During this period, the Federalists and their ideas of social hierarchy and relatively unconstrained federal governmental power died out, with many becoming Whigs. See RICHARD HOFSTADTER, *THE IDEA OF A PARTY SYSTEM 182-188* (1969); MICHAEL F. HOLT, *THE RISE AND FALL OF THE AMERICAN WHIG PARTY 2-3* (1999). Meanwhile, other former Federalists joined the growing "national" wing of the Democratic-Republicans, a group that, along with the Whigs, came to understand the necessity of Federal supremacy and internal improvements. See RONALD P. FORMISANO, *THE TRANSFORMATION OF POLITICAL CULTURE: MASSACHUSETTS PARTIES, 1790s–1840s*, at 168-70 (1983).

¹⁶¹ See DAVID M. POTTER, *THE IMPENDING CRISIS: AMERICA BEFORE THE CIVIL WAR, 1848–1861*, at 63-69 (1976); ERIC FONER, *THE FIERY TRIAL: ABRAHAM LINCOLN AND AMERICAN SLAVERY* 51-62 (2010); MANISHA SINHA, *THE SLAVE'S CAUSE: A HISTORY OF ABOLITION* 465-470; (2016); JAMES M. MCPHERSON, *BATTLE CRY OF FREEDOM: THE CIVIL WAR ERA* (1988) 40.

¹⁶² See JAMES M. MCPHERSON, *BATTLE CRY OF FREEDOM: THE CIVIL WAR ERA* 41(1988); POTTER, *supra* note 161 at 63-89; WILENTZ, *supra* note 159 at 635-36; SINHA, *supra* note 161 at 479-480.

¹⁶³ See FONER, *supra* note 161 at 132-144.

The late nineteenth century saw the rise of the trusts, with their outsized economic and political power,¹⁶⁴ and the Gilded Age's extreme concentration of personal wealth.¹⁶⁵ This was followed in the early twentieth century by the progressive era's achievements in combatting these trends.¹⁶⁶ Relative governmental timidity characterized the first four years of the Great Depression but as the economic crisis deepened, it gave way to the New Deal.¹⁶⁷ Similarly, the civil rights legislation of the 1960s broke nearly a century of inaction by Congress with regard to *de jure* racial segregation and black political disenfranchisement in the South.¹⁶⁸

Of course, the fact that our governmental system has, after periods of costly delay, risen to solve our gravest problems several times in the past is hardly an ideal story and not proof that it will solve them this time. Currently, many feel a sense of hopelessness about government's ability to respond constructively to critical social issues, such as climate change and wealth and income inequality.¹⁶⁹ Still, where there is substantial majority sentiment in favor of changing the situation, there are good reasons to think that government action will ultimately follow. And where sentiment this strong does not exist, there is little reason to think that the broadened corporate franchise will solve these problems, or, for that matter, even be adopted.

¹⁶⁴ See MATTHEW JOSEPHSON, *THE ROBBER BARONS: THE GREAT AMERICAN CAPITALISTS, 1861–1901*, at 380-81, 347-58 (1934); RICHARD WHITE, *THE REPUBLIC FOR WHICH IT STANDS: THE UNITED STATES DURING RECONSTRUCTION AND THE GILDED AGE, 1865–1896* (2017).

¹⁶⁵ See *Id.*; SVEN BECKERT, *THE MONIED METROPOLIS: NEW YORK CITY AND THE CONSOLIDATION OF THE AMERICAN BOURGEOISIE, 1850–1896*, at 19-20 (2001).

¹⁶⁶ See ROBERT WIEBE, *THE SEARCH FOR ORDER, 1877–1920*, at 185-195 (1967); MICHAEL MCGERR, *A FIERCE DISCONTENT: THE RISE AND FALL OF THE PROGRESSIVE MOVEMENT IN AMERICA, 1870–1920*, at 153-160 (2003)

¹⁶⁷ See Sidney M. Milkis, *Franklin D. Roosevelt and the Transcendence of Partisan Politics*, 100 *POL. SCI. Q.* 473, 484 (1985); DAVID M. KENNEDY, *FREEDOM FROM FEAR: THE AMERICAN PEOPLE IN DEPRESSION AND WAR, 1929–1945*, at 362 (1999).

¹⁶⁸ See HUGH DAVIS GRAHAM, *THE CIVIL RIGHTS ERA: ORIGINS AND DEVELOPMENT OF NATIONAL POLICY, 1960-1972*, at 152 (1990); RICHARD M. VALELLY, *THE TWO RECONSTRUCTIONS: THE STRUGGLE FOR BLACK ENFRANCHISEMENT* (2004); CHARLES WHALEN & BARBARA WHALEN, *THE LONGEST DEBATE: A LEGISLATIVE HISTORY OF THE 1964 CIVIL RIGHTS ACT* (1985).

¹⁶⁹ See, e.g., Megan Brennan, Gallup, *Federal Government Least Trusted to Act in Society's Interest* (2025), <https://news.gallup.com/poll/693446/federal-government-least-trusted-act-society-interest.aspx> (poll showing that less than one-third of U.S. adults trust the federal government to act in society's best interest).

Much of the sense of political polarization stems from growing ideological divergence in Congress. Comparing the last couple of decades to most of the twentieth century, each party's Congressional members are much more uniform ideologically,¹⁷⁰ and there is much less ideological overlap between the membership of one party and that of the other. The question, though, is how does this affect lawmaking? At the same time that the parties have become more ideologically coherent and divergent from one another, the margins in the number of their representatives and senators has narrowed considerably.¹⁷¹ As a result, since 1980, there have been multiple party turnovers in the control of each house of Congress and in the presidency, with a single party controlling all three only about a quarter of the time.¹⁷² Consequently, bipartisan support remains necessary to pass legislation.¹⁷³

More polarized parties, combined with legislative success continuing to require bipartisan support, could suggest a greater ability for a minority to frustrate the preferences of the majority of citizens. This situation could conceivably include frustration of preferences held by a majority voters that corporations should be regulated in some fashion that would advance one or more social objectives but lower share value. Indeed, whether or not that is the case with regard to regulating corporations, frustration by a minority appears to be the case with many issues today. Such frustration is far from an inevitable result over the longer run, however. There is a third factor at work that pushes in the opposite direction: Americans in general hold pragmatically mixed¹⁷⁴ or

¹⁷⁰ JAMES M. CURRY & FRANCES E. LEE, *THE LIMITS OF PARTY CONGRESS AND LAWMAKING IN A POLARIZED ERA 2* (2020).

¹⁷¹ *Id.* at 5-6; Pew Research Center, *Narrow Majorities in U.S. House Have Become More Common But Haven't Always Led to Gridlock* (2023), available at <https://www.pewresearch.org/short-reads/2023/05/05/narrow-majorities-in-u-s-house-have-become-more-common-but-havent-always-led-to-gridlock/?utm>

¹⁷² CURRY & LEE, *supra* note 170 at 12.

¹⁷³ *Id.* at 16.

¹⁷⁴ Pew Research Center, *Political Polarization in the American Public* 6 (2014); MORRIS P. FIORINA, *CULTURE WAR? THE MYTH OF A POLARIZED AMERICA* 18-30 (3rd ed. 2010)

moderate views.¹⁷⁵ The narrow margins between the parties thus provide especially strong incentives for a party to achieve legislative accomplishments that appeal to the median voter, who by definition is a person in the majority. The present balance may tend to favor the scenario in which the voices of a minority are dominant but, as in the past, there is a good chance that accumulated frustration or some shock to the system will move us back more toward the median voter scenario. In other words, as at other points in our nation's history, there are good reasons to think that the current moment of political dysfunction eventually will give way to a time when government can more effectively address the nation's environmental and social problems.

8. *Corporate manager problems with implementation.* Returning to our assessment of shareholder voting on specific business decisions, note that for a shareholder resolution to actually affect firm behavior, it must not only receive majority support but also be implemented by management. The resolution, though intended to bind management, would usually still need to be general enough that management has some discretion in its implementation. Few resolutions would be as specific as an instruction to DuPont management to incinerate, rather than dump, the toxic output of a given plant.¹⁷⁶ Management exists because, whatever shareholders wish the corporation to do, the ever-changing details of the world in which a firm operates requires discretion in how it is operated day to day. But once discretion exists, management's own interests and their incentive structure come into play.

The message of a successful shareholder resolution would be that a majority of shareholders want a deviation from share value maximization to advance some social end. Recall, though, that, everything else being equal, all shareholders prefer share value maximization. So,

¹⁷⁵ DONALD R. KINDER & NATHAN P. KALMOE, *NEITHER LIBERAL NOR CONSERVATIVE* 56, 64, 79 (2017).

¹⁷⁶ Indeed, if shareholders had the right to bind business decisions back at the time management was contemplating the DuPont dumping, not enough would have been known in advance by outsiders to permit a proposal with this level of specificity to come before its shareholders.

managers would be asked by their principals—the shareholders—to do two things: advance to some given extent the social aim that is the object of the resolution, and, subject to that constraint, maximize share value. Multi-task principal-agent arrangements are inherently complicated.¹⁷⁷

Consider first a manager who does not herself feel any particular concern for the social end advanced by the resolution. In that case, the manager’s self-regarding interest will be their primary motivator, and this interest, as we saw in Part I, is best served by operating the firm in a share value maximizing way. We discussed earlier why shareholders are typically far from sufficiently informed to know what firm behavior would best satisfy their incipient preferences. These same reasons suggest that shareholders will not be very well informed as to how well managers are doing in fulfilling these twin objectives.

At first glance, this problem may not seem that difficult to overcome. The resolution could include establishing a managerial compensation scheme tied in part to indices purporting to measure progress in advancing the resolution’s social end. Yet as previously discussed, when a change in corporate behavior would involve a decrease in share value, the share-price-based component of executive compensation currently overwhelmingly outweighs the effectiveness of any ESG index-based component.¹⁷⁸ The share-price-based component could of course be drastically cut back to give the chosen indices more heft in encouraging the resolution’s faithful implementation. However, doing so would come at a high price because it would decrease the effectiveness of the overall compensation package in motivating managers to enhance share value in ways unrelated to the resolution.¹⁷⁹

¹⁷⁷ See Bengt Holmstrom & Paul Milgrom, *Multitask Principal-Agent Analyses: Incentive Contracts, Asset Ownership, and Job Design*, 7 J. LAW. ECON. ORG. 24 (1991); Bartlett & Bubb, *supra* note 14, at 465-68.

¹⁷⁸ See I.D.2.e *supra*.

¹⁷⁹ Even where the indices do motivate managers, they cannot be more effective than their accuracy in tracking successful implementation. Equally important, the index or indices chosen will be the ones relating to progress along the dimensions that are most easily measurable and so they will likely distort firm behavior in those directions at the expense of the less measurable dimensions.

Two other elements of managers' incentive structure—the hostile takeover and the activist hedge fund campaign threats—give rise to similar problems.¹⁸⁰ These forces push against effective implementation of a share-value-diminishing resolution whether or not the managers themselves seek to further the social end involved. The very existence of the resolution suggests that shareholders' preferences have become manifest. As discussed earlier, when preferences are manifest, the ability of these two threats to incentivize share value maximization may be somewhat weakened,¹⁸¹ but that in no way renders them impotent at impeding effective implementation. These threats could also be lessened by legal changes that as a general matter make it more difficult for hostile tender offers or activist campaigns to succeed.¹⁸² Such changes, however, would lead to managers running companies in a more self-serving fashion at all times, meaning that the resulting welfare losses with regard to decisions not involving market imperfections could quite possibly overwhelm the welfare gains from more effective implementation of whatever number of market-imperfection-correcting resolutions are adopted over time.¹⁸³

9. *Process problems with voting on resolutions.* The process by which binding shareholder proposals would be voted upon would also create problems. A large dispersed-ownership corporation has hundreds of thousands of shareholders, or more, and engages in business activities with many different kinds of social impact. Absent limits, the firm might receive hundreds, maybe even thousands, of share-value-reducing proposals purportedly advancing various social causes. If

¹⁸⁰ Because of the business judgement rule, the need for managerial discretion makes very likely the failure of any derivative suit seeking to judicially enforce a socially oriented binding shareholder vote.

¹⁸¹ See I.C.a.ii and I.C.b.ii *supra*.

¹⁸² The tender offer threat could be reduced by modifying state corporate law to make various tender offer defenses more readily available. Also, Exchange Act §13(d) requires anyone who acquires at least 5% of an issuer's shares to disclose her holdings and her reasons for acquiring them. When the disclosure occurs, share price usually spikes. The disclosure requirement, though, provides a grace period after the threshold is reached. Shortening this grace period would lessen both threats because, with less time to buy shares at the pre-spike price, the overall effort would be more expensive.

¹⁸³ See, e.g., Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001).

all of these were put before the shareholders for a vote, the process would obviously be overwhelmed and few, if any, would receive serious attention.¹⁸⁴ Hart & Zingales suggest that the SEC could stem any tide of proposals by increasing the dollar amount of the issuer's shares required to be held by the proponent or extending the required holding period.¹⁸⁵ Such filters, however, are unlikely to discriminate very well in terms of advancing proposals that appear to genuinely advance some worthwhile aim and have a minimally plausible chance of adoption, while blocking those that do not meet these criteria. There is also the risk that the reformed franchise could be used by a subset of shareholders who claim some social concern but actually seek to redirect corporate behavior toward their own self-regarding interests. The SEC's proxy rules provide a history of how difficult it is to filter out such efforts.¹⁸⁶

10. Inaccurate identification of market imperfections. When voting on a proposed change in firm behavior, shareholders may be unable to accurately assess whether the claimed market failure really exists, and, if it does, whether the change will correct it. When that is the case, there is no reason to believe that a change prompted by such a vote will advance social welfare. This is a significant problem because, as suggested, the proposal may have been introduced by someone pursuing private gain or someone blinded by ideological fervor.

¹⁸⁴ See Sean J. Griffith, *Opt-In Stewardship: Toward an Optimal Delegation of Mutual Fund Voting Authority* 98 TEX. L. REV. 983, 1006 (2022) ("When there are a great many shareholders, many of them are likely to be uninformed about corporate matters, and their general preferences are likely to diverge, making it impossible for them to cohere around a stable course of action."). Hart and Zingales point out that the current flow of precatory resolutions making it onto the corporate proxy statements of S&P 500 corporations results in each on average including about one proposal every three years, a perfectly manageable rate. See Hart & Zingales, *Corporate Governance*, *supra* note 7, at 214-15. Citing this figure as evidence that their proposal would not open the floodgates, though, ignores that currently, under Exchange Act Rule 14(a)-8(i)(7), the SEC permits managers to exclude resolutions relating to ordinary business operations from proxy statements. See *supra* note 132 and associated text. As they recognize, their proposal requires this provision's elimination, but with it would go the dam keeping back the flood.

¹⁸⁵ *Id.* at 215-16.

¹⁸⁶ See John Pound, *Proxy Voting and the SEC: Investor Protection Versus Market Efficiency*, 29J. FIN. ECON. 241 (1991). Any rule designed to weed out such proposals would invite litigation against proposals that are in fact being offered by other-regarding proponents but are contrary to someone's interests.

Of course, something very similar can happen in the public sphere. A person with similarly selfish motivations can push for governmental action purporting to correct a market imperfection that either does not exist or is not corrected by the action. Still, relative to having a debate on these questions firm by firm, there are large economies of scale associated with having the debate in the public sphere instead. This can lead to more accurate decision-making: competing considerations can be weighed more fully, and false claims more reliably debunked.¹⁸⁷

II. Use of the shareholder franchise to facilitate redistribution. While our focus is on correcting market imperfections, some equity investors, as noted above, will likely be willing to forego share value in exchange for corporations undertaking behavior that somehow reduces income or wealth inequality. Thus, if shareholders could vote on specific business decisions, the end sought by some of the successful proposals might be income or wealth redistribution rather than market imperfection correction. One can view this use of the corporate franchise too as making up for some kind of governmental failure and as moving the world in a positive direction. Again, as with correcting a market imperfection, only a small portion of the cost of corporate behavior that achieves the redistribution will be borne by each shareholder, but all can empathetically enjoy the full benefits that disadvantaged people gain from the equality-promoting corporate behavior.

That said, relative to using binding shareholder votes to correct for market imperfections, using them to advance distributive concerns has additional downsides. For starters, each shareholder would bear considerably more of the cost of benefiting those receiving the distributive

¹⁸⁷ A public debate about whether the change advances social welfare can be advantageous even when the proponent's motives are purer. Consider a life-saving patented drug that is priced well above marginal cost. From a static efficiency point of view, such pricing is a market imperfection, and many socially conscious investors might press for a lower price. The reason for patent protection, though, is one of dynamic efficiency: to create incentives for innovation. Whether that protection results in too high a price or not involves the complicated task of figuring out the right balance between these two considerations.

gain than they would as a taxpayer if the redistribution were done by the government, where the cost would be spread across the whole tax base instead of just the firm's shareholders.¹⁸⁸ Additionally, spreading the cost of the redistribution across the nation's entire tax base would transfer wealth from rich to poor more systematically: although shareholders on average are wealthier than the median citizen, a substantial portion of all stock is held directly or indirectly by people of modest means.¹⁸⁹

Using a subject-broadened franchise to advance distributional concerns also raises a tricky "public-private divide" issue. Should the holders of a majority of a corporation's shares be able to force the minority to give up wealth to improve the wealth position of some third parties? Every individual is entitled to her own view of what a just distribution of wealth and income looks like. Still, most people probably think that a conscious decision to take wealth involuntarily from one person and give it to another, as an end in itself, should be made within the constitutionally structured public sphere.¹⁹⁰ In contrast, when it comes to a legal reform governing the private sector that would increase Kaldor-Hicks efficiency, there is much more tolerance of the fact that the reform will lead private persons to act in ways that will result in losers as well as winners. The

¹⁸⁸ The government can redistribute directly through cash transfers, or compensate the corporation for the cost a redistributive behavior such as selling a life-saving product to poor people at less than marginal cost.

¹⁸⁹ See BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, *Changes in U.S. Family Finances from 2019 to 2022*, 19 (2023), <https://www.federalreserve.gov/publications/files/scf23.pdf>.

¹⁹⁰ For the simplest version of this kind of thinking, consider person A, who is receiving a large inheritance from a distant childless uncle, person B, who cares deeply about wealth inequality, and person C, who is poor. Most people who think wealth is currently distributed to unequally would nevertheless find it inappropriate for the law to permit B to forcibly remove significant property from A and give it to C so that wealth is distributed more evenly. Most would also, think, however, that it is within the appropriate range of governmental powers to tax A's inheritance and provide benefits to a person like C. Philosophical explorations of this line of thinking are very complex and vary in their justifications and tolerance of exceptions. John Rawls describes how a just society needs a collection of institutions that includes the property and contract rights necessary for a well-functioning market, but it also needs government institutions responsible for redistribution to meet claims of need. JOHN RAWLS, *A THEORY OF JUSTICE* 242-251 (rev ed. 1999). For examples of legal philosophers who conclude more specifically that all redistribution should occur through widely accepted public procedures and not through modifications to private law, see Arthur Ripstein, *Private Order and Public Justice*, 92 *VIRGINIA L. REV.* 1391, 1395, 1431-32 (2006); ERNEST J. WEINRIB, *THE IDEA OF PRIVATE LAW* 80 (1995). For a more skeptical approach, see, e.g., Alex Raskolnikov, *Distributional Arguments, in Reverse*, 105 *MINN. L. REV.* 3303 (2021).

difference, as previously noted, is that if the overall legal regime endeavors to promote efficiency, then everyone will likely be better off than if it does not, even though any individual efficiency enhancing measure would generate losers alongside the winners.¹⁹¹

Distribution-oriented deviations from share value maximization initiated by shareholder majorities face one more telling criticism. In many situations, shareholders with redistributive concerns have an alternative way to transfer wealth in the direction they want without causing the efficiency losses associated with deviating from share value maximization. The distribution-oriented shareholders, through some charitable institution, can send the would-be beneficiaries of the redistributive deviation an amount equal to these shareholders' pro-rata shares of what they would have given up had the corporation undertaken the deviation. Moreover, without being worse off than if the corporation deviated, the shareholders can add to this amount their pro-rata portion of the extra wealth created by the corporation because it did not deviate.¹⁹² This alternative might or might not transfer as much wealth to the beneficiaries as if the corporation had engaged in the deviation. Even if it does not, however, it has the virtue that the majority does not force the minority to contribute to a cause the minority does not find worthwhile.

In sum, redistributing wealth and income and correcting market imperfections are both compelling causes. However, the case for undertaking redistribution through deviations from share

¹⁹¹ See Section II.A.3, *supra*.

¹⁹² Using Hart and Zingales' terminology, this is an example of Friedman's separation theorem, where the social objective (here, income redistribution) is fully separable from the firm's business activities, such that the social objective is more efficiently achieved through the shareholders themselves make cash transfers to those they wish to benefit, rather than benefiting them through changes in firm behavior. See Hart & Zingales, *Corporate Governance*, *supra* note 7, at 201 (citing Milton Friedman, *A Friedman Doctrine: The Social Responsibility of Business is to Increase its Profits*, N.Y. TIMES (Sept. 13, 1970)). In most other instances, including those involving market imperfections, the social objective will not necessarily be separable from the firm's business activities, in which case it may be more efficient to facilitate that objective through changes in firm behavior than shareholder giving. See *id.* at 202. As an example of an inseparability, consider a firm that generates a negative externality in the form of water pollution. In this case, it would be more efficient to address the externality through changes in the firm's behavior than through shareholders directing their residuals to efforts to clean up the pollution the firm generated. See also Hart & Zingales, *Shareholder Welfare*, *supra* note 7, at 249 (providing other examples).

value maximization is much weaker than the case for correcting market imperfections because of the additional downsides just discussed. These two possible uses of binding shareholder votes probably cannot be practically separated with one allowed and the other prohibited. So, in our view, the availability of the binding vote for redistribution counts against the overall desirability of the proposed reform.

C. Facilitating Identity Investing

We considered in Part II whether identity investing, through its impact on share prices, can affect corporate behavior in ways that reflect the social concerns of the economy's willing-to-sacrifice equity investors. Theory suggests it has some impact, but empirical studies are equivocal as to whether, at current levels, identity investing's impact is more than *de minimis*. If there were significantly more identity investing than today, however, it clearly would have a meaningful impact. This raises three questions. Would changing corporate behavior through identity investing be more desirable than through the franchise? How might the law be reformed to promote more identity investing? Would the changes in corporate behavior resulting from these reforms be worth the reforms' costs?

1. Comparing facilitation of identity investing versus the franchise as ways of changing corporate behavior. Identity investing has several advantages over the franchise in terms of how it changes corporate behavior.

a. Information processing costs. Each approach to modifying corporate behavior—facilitating identity investing and facilitating the effectiveness of the franchise—is associated with substantial information costs. As discussed below, one way identity investing might be facilitated is to expand mandatory disclosure under the securities laws to include information concerning aspects of an issuer's negative social impacts and, perhaps, the costs of

mitigating them. Such disclosure could help facilitate use of the franchise to advance social ends. However, there is a significant difference between the two approaches in equity investors' costs of processing this information. With identity investing, only investors with at least incipient willing-to-sacrifice preferences need to process the information to decide what to do,¹⁹³ whereas with the franchise, all investors must process it.¹⁹⁴

b. Concentrating the losses on the equity investors willing to sacrifice. If a majority of shareholders vote for a proposal that sacrifices share value in furtherance of a social end, the minority who did not wish to sacrifice are forced to come along for the ride. Identity investing, in contrast, predominantly concentrates all the losses on those that practice it. To start, the process by which identity investors exclude disapproved issuers from their portfolios cannot disadvantage non-identity investors. In voluntary transactions, non-identity investors obtain the rights to future cash flows for which the identity investors no longer have any demand, i.e., the disapproved firms' shares. To the extent that firms owned by non-identity investors end up subsequently switching their use of existing productive capacity to an approved activity, this also will not hurt the non-identity investors. Managers will only make the switch if the approved activity's lower discount

¹⁹³ First consider a passive investor whose preferences do not incline her to identity investing with regard to social concerns. She simply wishes to maintain a fully diversified portfolio. She has no need to read and process the social impact disclosures. An active investor with similar views would benefit by shifting her portfolio to take advantage of the fact that the identity investors no longer wish to hold shares of disapproved firms. To do this, however, she also does need not to read and process these disclosures. Price signals in the market will prompt her to make the shift. To the extent that the identity investing is actually expected to change the behavior of firms and thus to affect their expected cashflows, this active investor would benefit from learning of the change and trading accordingly, but only if she can do so in advance of the expected change's effect on prices. This is no different than any other piece of news, however, and, in an efficient market, the window is so narrow that trying to trade on the news is not worthwhile absent special capabilities.

¹⁹⁴ Consider a shareholder proposal for a corporation to change behavior to further some social end. When an investor whose preferences incline in favor of sacrificing in furtherance of this end casts her ballot for that proposal, she needs to know if the social gain is sufficient to justify the sacrifice. For an investor whose preferences do not incline in this direction, she also needs to know the information to assess whether the behavior called for in fact deviates from share value maximization, and, if so, by enough to make the effort to vote or even to mobilize others against the proposal.

rate adds more to share price than the diminution of expected future cash flows depresses the price.¹⁹⁵

There are multiple advantages to concentrating investor losses on the equity investors who are actually willing to sacrifice to support the social end involved. To start, suppose the social end is greater wealth equality. If the method of achieving the change in corporate behavior concentrates investor losses on those willing to sacrifice, we avoid the problem, discussed above, of wealth being taken from one person and given to another for purely redistributive purposes outside of the constitutionally constructed public process.¹⁹⁶ Second, even when a share-value-decreasing change in corporate behavior is claimed to be Kaldor-Hicks efficiency improving, it is often not obvious whether the claim is true. Concentrating investor losses on those favoring the behavior change creates an incentive for those investors to make an accurate assessment.

c. Lower agency costs of management. We noted earlier that if a willing-to-sacrifice shareholder proposal is adopted, implementation by managers will be more successful if the share-price-based portion of their compensation is reduced and if legal reforms were to lessen the threat of hostile tender offers and activist hedge fund campaigns.¹⁹⁷ These changes would come at a significant cost because they would result in managers running all companies at all times in a more self-serving fashion, including, with regard to all the decisions not involving any market imperfections where share value maximization maximizes social welfare. In contrast, when identity investing is the mechanism used to change corporate behavior, the forces that push managers to maximize share value can be left undiminished.

¹⁹⁵ See II.D.3.a *supra*. The non-identity investors could be hurt in one regard, relating to the shares they already owned in the disapproved firms at the time that identity investing develops. The managements of these firms are presumably specialized in finding positive NPV projects in their own industries and their ability to do so is reflected in their share prices. These abilities are worth less when the cost of capital for disapproved activities increases because they will yield fewer positive NPV projects, something that will be reflected in the prices of these firms. See II.D.3.b *supra*.

¹⁹⁶ See III.B.3.b.vii *supra*.

¹⁹⁷ See III.B.3.b.iv *supra*.

2. *Should identity investing be facilitated by legal reforms?* Even if changing corporate behavior to further social ends through identity investing is preferred to doing so through the corporate franchise, that still leaves open whether it would be socially desirable to adopt any legal reforms to facilitate identity investing.

The first step in answering this question is straightforward. When investor losses from such a change are concentrated on those willing to sacrifice, as is the case with identity investing, and the investors are acting on good information, the change in corporate behavior is desirable. This is certainly true for any such change that is Kaldor-Hicks efficiency improving, and it is likely true where the aim is purely redistributive as well. The second step, though, is to consider whether the reform that facilitates the change has costs that exceed the benefits from the changed behavior. We undertake this second step with regard to the multiple kinds of reforms designed to promote identity investing.

a. Investment fund disclosure. The least controversial reform relates to mandating disclosure by investment funds that purport to support particular social ends.¹⁹⁸ If investors cannot rely on the claims of those fund's sponsors, less identity investing will occur and investors who do continue to invest may end up paying management fees for something they are not getting. The cost of this type of disclosure would be confined just to these funds (presumably later passed on to only their investors). The fund disclosure rule would simply require the subject funds to truthfully disclose, in a manner that retail investors can understand, their equity positions (perhaps with a delay or some kind of averaging to protect their strategies) and how these positions relate

¹⁹⁸ See, e.g., Adriana Z. Robertson & Sarath Sanga, *Aggregating Values: Mutual Funds and the Problem of ESG*, University of Chicago Law Review Online, <https://lawreview.uchicago.edu/online-archive/aggregating-values-mutual-funds-and-problem-esg-0> (discussing and proposing modifications to the SEC's 2022 ESG Fund Disclosure Rule).

to the social goals they say their funds seek to advance. The monetary sacrifice involved in indirectly owning these positions would be revealed by their risk-adjusted returns over time.

b. Issuer disclosure. Potential identity investors with willing-to-sacrifice preferences need information to determine which firms they should exclude from their portfolios. Firms already disclose their industry classifications and that is all the information that some identity investors need. Firms in the same industry can produce different types and levels of negative externalities, however. As a result, more nuanced identity investors would want this additional information. Highly-nuanced identity investors would want even more information. When comparing two firms whose operations include legal activities equally damaging to society, but where one firm would incur a low cost of eliminating the damage and the other a very high cost, these investors would want to exclude the low cost firm but not the high cost one. So, these highly-nuanced identity investors would want information about the costs of correction, not just the extent of the damage. Mandating that issuers provide the information that the more nuanced identity investors want would obviously increase the level and precision of identity investing in the economy, and providing what the highly-nuanced investors would want, do so even more.¹⁹⁹ These higher levels of required disclosure would be expensive both for issuers to provide and for regulators to monitor compliance.

Some commentators argue that mandating social impact disclosure is only appropriate if the disclosure relates to purely financial matters, i.e., helps investors assess an issuer's expected future cashflow.²⁰⁰ This position is too narrow. If identity investing were already significantly changing corporate behavior through its price effects, the case for mandatory disclosure related

¹⁹⁹ For an early and well-known argument in favor of some level of mandatory social disclosure, see Cynthia A. Williams, *The Securities Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197 (1999).

²⁰⁰ See, e.g., Financial Economists Roundtable, *SEC Should Mandate ESG Disclosures Limited to Matters that Directly Affect the Firm's Cash Flows* (2021), <https://www.financialeconomistsroundtable.com/s/2021.pdf>

to identity investors' social concerns would be as strong as it is for information useful in predicting a firm's future cashflows. Identity investing, though, does not seem all that widespread, and there is no empirical consensus as to whether its price effect is large enough so far to meaningfully affect corporate behavior.²⁰¹ Thus, if these are the only factors to consider, the case for imposing costly new disclosure regulations is not well supported.

The interesting question, though, is whether more disclosure would lead to a level of identity investing sufficiently greater that it would produce a clearly visible effect on firm behavior. We think the potential benefits from greater disclosure are significant enough to make experimentation worthwhile. This is particularly so because, as we noted earlier, an increase in identity investing will likely have a dynamic, self-reinforcing aspect that will lead to a yet higher level of such investing.²⁰²

A possible starting point for this experimentation is the SEC's abandoned-for-now climate disclosure rules, including their contentious requirement that issuers disclose their Scope 1 and Scope 2 greenhouse gas emissions.²⁰³ The rules' proponents argue that the SEC's objective in enacting the rules was to satisfy investor demand for the information.²⁰⁴ Opponents are skeptical

²⁰¹ See Part II.D.2, *supra*.

²⁰² See Part II.D.4. There are countervailing considerations. As discussed, identity investing generates a price effect by reducing the effective diversification for the unconstrained investors. See *supra* Part II.D.1. If, as Berk and Binsbergen's results suggest, there is a very high correlation between the bundled returns of the clean firms and the bundled returns of the dirty firms, *see* note 90 and associated text, sorting might not result in much price effect even if identity investing is widely engaged in. Investors who, simply based on their association with a firm through share ownership, gain satisfaction from holding shares in clean firms and dissatisfaction from holding them in dirty firms, will not need to sacrifice much in returns to gain what they are looking for. In that event, identity investing may become widely engaged in but have little effect on corporate behavior.

²⁰³ See SEC, *SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures for Investors* (2024), <https://www.sec.gov/newsroom/press-releases/2024-31>. These rules were challenged in court and the SEC. The new Trump administration recently decided to end its defense of the rules in these proceedings. See SEC, *SEC Votes to End Defense of Climate Disclosure Rules* (2025), <https://www.sec.gov/newsroom/press-releases/2025-58>. Climate change continues, however, and the issue of climate disclosures will not go away.

²⁰⁴ See, e.g., SEC, *SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures for Investors* (2024), <https://www.sec.gov/newsroom/press-releases/2024-31> ("The [climate disclosure rules] reflect the Commission's efforts to respond to investors' demand for more consistent, comparable, and reliable information about the financial effects of climate-related risks on a registrant's operations").

that investors are interested in disclosure that goes beyond the standard, financially-related matters that help predict an issuer's future cash flows.²⁰⁵ They argue that the true objective of the SEC's proposed rules was to limit firms' greenhouse gas emissions by damaging high-emitting firms' reputations with their customers, employees, and voters in government elections.²⁰⁶

Our analysis suggests that the two positions are more aligned than they might initially appear. The critics are correct that the disclosures will broadly affect firm images, but traditionally mandated financial disclosure also has effects beyond the securities markets.²⁰⁷ The purpose of experimentation is to see whether there are incipient identity investors whose preferences would become manifest with the disclosures, in which case the information is, by definition, important for their securities choices.²⁰⁸

c. ERISA. In addition to reforms to securities law, reforms to pension law can also facilitate identity investing. One such reform relates to the ongoing debate as to whether ERISA permits sponsors of private retirement plans to rely on ESG considerations when making investment determinations on behalf of plan participants.²⁰⁹ As implied by our discussion of identity investing, there is no justification for limiting ERISA fiduciaries' ability to include ESG-

²⁰⁵ See, e.g., Lawrence Cunningham, et al., *The SEC's Misguided Climate Disclosure Proposal* 4-5 (2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4256724.

²⁰⁶ See, e.g., Richard C. Breeden, et al., *The Enhancement and Standardization of Climate-Related Disclosures for Investors* (2022), <https://www.sec.gov/comments/s7-10-22/s71022-20132519-303005.pdf>, at 4 (“[The SEC’s proposed climate disclosure rules] represent[] a roundabout way of regulating greenhouse gas emissions themselves”).

²⁰⁷ In the larger debate concerning whether financial disclosure needs to be mandated, these broader effects of disclosure, including on competitors, suppliers, and customers, is offered as reason why the mandates are beneficial. See Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice is Not Investor Empowerment*, 85 VA. L. REV. 1335 (1999).

²⁰⁸ Increasing issuer disclosure would also mitigate the incomplete information problems discussed above in connection with the shareholder franchise, see Part I.C.3.a, *supra*, but that would not address the various other factors that prevent shareholder voting from being an effective vehicle for translating the preferences of willing-to-sacrifice shareholders into corporate behavior.

²⁰⁹ The Department of Labor recently abandoned the defense against a legal challenge of a rule allowing consideration of ESG matters. See 29 CFR § 2550.404a-1(b)(4), allowing ERISA fiduciaries to include ESG considerations in their investment determinations so long as those considerations are relevant to a risk-return analysis. See Elizabeth Goldberg & Rachel Mann, *US Administration Announces Intent to Replace Biden Era ESG Rule* (June 24, 2025), <https://www.morganlewis.com/blogs/mlbenebits/2025/06/us-administration-announces-intent-to-replace-biden-era-esg-rule>.

based investment alternatives in the mix of investments from which plan participants can choose. This should be allowed as long as the options are fairly presented and the funds are managed by competent, responsible persons charging reasonable fees. Any limitation would pose an unnecessary impediment to identity investing, with its capacity to provide ESG-minded investors with satisfaction and to advance their preferred social ends without imposing a sacrifice of returns on other investors.

IV. Conclusion

Not all equity investors simply want the highest possible risk-adjusted returns. Some would be willing, to one extent or another, to sacrifice their returns to advance a social end. This important difference among investors is largely overlooked in academic literature and motivates this Article's two primary questions: (1) to what extent is firm behavior currently affected by the existence of these willing-to-sacrifice equity investors; and (2) should existing law be changed to enable corporate behavior to be better aligned with the desires of these investors.

In this conclusion, we first discuss how our findings contribute to the existing corporate governance literature, both regarding the still limited literature focused specifically on harnessing the willingness of some equity investors to sacrifice returns in furtherance of worthwhile social ends, and regarding the much more abundant literature on corporations pursuing social ends more generally. We then discuss how the Article's analysis can be extended to analyze circumstances where shareholder preference heterogeneity arises for some reason other than shareholders' differing preferences about whether firms should advance social ends at the expense of share value.

A. The Willing-to-Sacrifice Literature

Most scholarship concerning willing-to-sacrifice equity investors changing corporate behavior concludes that identity investing is not having any meaningful effect, and that the focus

therefore must be on changing corporate behavior through the shareholder franchise.²¹⁰ In contrast, we show that under current law, using the franchise will not work. Further, reforms designed to make the franchise more effective would likely have only limited success, and to the extent they do succeed, the reforms are likely not worth their costs. We also suggest that whether or not identity investing at its current level meaningfully alters corporate behavior, at sufficiently higher levels, it would do so. A higher level of identity investing could be facilitated by reforms to securities and pension law. We concluded that experimentation is worthwhile to see whether such reforms prove to be worthwhile in terms of the social gains achieved versus the reforms' costs.

Although our conclusions contrast with that of most of the willing-to-sacrifice literature, it in fact parallels what a large literature has already found for investors whose aim is simply share value maximization: managerial incentives, not the franchise, is what will prompt managers to steer firms toward whatever end investors seek and share prices are key to the how these incentives work.²¹¹

B. The Larger Literature on Corporations Furthering Social Ends

The Article's analysis also illuminates important, open issues in corporate law scholarship relating to the longstanding debate about the proper purpose of the corporation. At least since the 1970s, the leading vision of corporate purpose among commentators in the United States has been shareholder primacy, which posits that the normatively preferred objective of a corporation is to maximize share value.²¹² In recent years, however, some prominent scholars have articulated

²¹⁰ Berk & Binsbergen, *supra* note 77, at 2; Brest, Gilson & Wolfson, *supra* note 84, at 209-213; Broccardo, Hart & Zingales, *supra* note 15, at 3137; Quinn Curtis & Gabriel Rauterberg, *The Social Portfolio* (working paper, 2025).

²¹¹ For a classic exposition of this conclusion with respect to share value maximizing investors, see KRAAKMAN ET AL., *supra* note 22, at 49.

²¹² See, e.g., Dorothy Lund & Elizabeth Pollman, *Corporate Purpose*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE __ (Jeffrey N. Gordon & Wolf-Georg Ringe eds. 2025) (documenting the history of the

competing visions of corporate purpose—for instance ESG and CSR, each of which we refer to as an “alternative ends” approach to corporate purpose—that would have corporations focus corporate activity on serving one or more ends beyond share value maximization.²¹³

This Article’s analysis advances the corporate purpose debate by showing that, despite whatever gains to efficiency or wealth distribution might arise from a move to an alternative ends approach, the move cannot be expected to arise organically. Even if that approach were at least incipiently preferred by the direct or indirect holders of a substantial portion of the economy’s equity, that would not be enough to change corporate behavior significantly.²¹⁴

This observation flows directly from the analysis in Parts I and II. Suppose, as most commentators advocating an alternative ends approach would likely acknowledge, many equity

corporate purpose debate). At its general level, shareholder primacy posits that corporate activity should be singularly directed at advancing the interests of the corporation’s shareholders. When paired with the usual assumption that a corporation’s shareholders all want the firm to maximize share value, shareholder primacy reduces to the proposition that corporations should endeavor to maximize share value as a normative matter. Shareholder primacy is sometimes referred to as shareholder wealth maximization perhaps for this reason. *See, e.g.,* Lynn M. LoPucki, *The End of Shareholder Wealth Maximization*, 56 U.C. DAVIS L. REV. 2017 (2023).

²¹³ For a small sample of this vast literature, see COLIN MAYER, PROSPERITY: BETTER BUSINESS MAKES THE BETTER GOOD (2018); LYNN STOUT, THE SHAREHOLDER VALUE MYTH (2012); Elhauge, note 23 *supra*; Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999); Martin Lipton, *Stakeholder Governance and the Eclipse of Shareholder Primacy*, *Harvard Law School Forum on Corporate Governance* (2022), <https://corpgov.law.harvard.edu/2024/05/07/stakeholder-governance-and-the-eclipse-of-shareholder-primacy/>; Leo E. Strine, Jr., *Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy: A Reply to Professor Rock*, 76 BUS. LAWYER 397 (2021). Some scholarship evaluates the notion of “enlightened shareholder value” or “ESV,” which concerns the circumstance where agency costs cause firm managers to fail to undertake conduct that would benefit both stakeholders and shareholders. *See* Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 12 BUS. ETHICS QUARTERLY 235, 245-46 (2002) Another strand of the literature takes direct aim at the assumptions and implications of shareholder primacy, rather than advocating for stakeholderism per se. *See, e.g.,* Frank Partnoy, *Shareholder Primacy is Illogical*, in RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD 186 (E. Pollman & Robert B. Thompson, eds. 2021). For additional critiques of shareholder primacy, see Lynn A Stout, *Bad and Not-so-Bad Arguments for Shareholder Primacy*, 75 CORNELL L. REV. 1189 (2002).

²¹⁴ Bebchuk and Tallarita evaluate whether the prevailing corporate governance structure incentivizes managers to adopt a stakeholder approach to corporate purpose and conclude that it does not, *see* Lucian A. Bebchuk and Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 94 (2020), and find that it does not. *Id.* at 139. *See also* Dorothy S. Lund, *Corporate Finance for Social Good*, 121 COLUM. L. REV. 1617, 1620-21 (2021) (reaching a similar conclusion); Edward B. Rock, *For Whom is the Corporation Managed in 2020?*, *The Debate Over Corporate Purpose*, 76 BUS. LAW. 363, 394 (2021) (same); Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2578-2609 (2021) (same). This article builds on these findings by embedding the managerial incentives analysis in an environment where some investors, if fully informed, prefer that shareholder primacy be replaced with the corporation pursuing some alternative social ends.

investors still want firms to focus solely on share value maximization, which means those investors favor shareholder primacy, even if others are willing to sacrifice returns in furtherance of some social end. This is the same world as we described in Parts I and II. Applying our analysis yields the conclusion that, given the current structures shaping corporate decision-making, the existence of equity investors wishing corporations to advance interests beyond share value maximization will not result in a transition from shareholder primacy to an alternate ends approach. This is an important conclusion because the alternative ends literature is largely silent concerning what mechanism might move corporations from their current positions to the alternative ends approach that proponents advocate.²¹⁵ In other words, our analysis shows that a transition to an alternate ends approach will not occur organically, and would require legal reforms significantly altering to the current structure of our corporate governance arrangements.

C. Extending the Analysis

The Article's analysis also illuminates the significance for corporate behavior of differences among investors relating to matters other than the social impact of firm behavior and, in so doing, suggests possible directions for future research.

²¹⁵ The few mechanisms that have been suggested in the literature are insufficient to displace shareholder primacy. For instance, some proponents of the alternative ends approach implicitly or explicitly contemplate a change in the fiduciary duties of directors and officers to embrace this wider version of corporate purpose. See, e.g., Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C. L. REV. 1189 (1991). Our analysis, however, suggests that this change will have little or no effect on corporate behavior, whether all shareholders prefer share value maximization or the holders of a substantial portion are willing to sacrifice to further some social end.

Of course, expanding the franchise so that other stakeholders have a role in choosing management could more effectively implement an alternative ends approach to corporate governance. See, e.g., Brett M. McDonnell, *From Duty and Disclosure to Power and Participation in Social Enterprise*, 70 ALA. L. REV. 77 (2018); Dan Galaia & Zvi Wiener, *Stakeholders and the Composition of the Voting Rights of the Board of Directors*, 14 J. CORP. FIN. 107 (2008). These proposals involve an entirely different project about which this Article has little to say other than to note that in any arrangement where investors remain as at least one class of residual claimants, they need control rights in order to protect against being taken advantage of. Oliver Hart & John Moore, *Property Rights and the Nature of the Firm*, 98 J. POL. ECON. 1119 (1990). Enterprises with multiple classes of control rights-possessing residual claimants have been viewed by some eminent scholars as tending to have high governance costs. HANSMANN, *supra* note 5, at 44; Easterbrook & Fischel, *supra* note 24; Eugene Fama, *Contract Costs and Financing Decisions*, 63 J. BUS. 571 (1990).

1. *Selfish return sacrificers.* The Article’s analysis can be extended to address a wider range of differences in investor preferences. In addition to socially minded return sacrificers, the economy also contains “selfish return sacrificers.” These are a firm’s shareholders who are willing to sacrifice returns in terms of dividends and capital gains so as to alter firm behavior in ways that advance their own self-interests in other regards.

In prior work, we evaluated one type of selfish return sacrificer: the so-called common owners, which are investors who maintain meaningful share positions in rival firms.²¹⁶ The influence of common owners on firm behavior has taken on prominence due to the large stakes that the index funds managed by each of the major fund managers hold in competing firms across many of the economy’s oligopolistic industries. This ownership of equity stakes in rival firms means that a fund is better-off if each firm in which it is invested chooses an output level lower than its share-value-maximizing level. This is because each firm’s output curtailment benefits the common owner by increasing the profits of the other industry firms in which the common owner is invested. If this were to happen, the shareholders of each firm who did not own shares in the other firms would be worse off, because they would prefer the output level that maximizes that firm’s share value. We used an analytical structure similar to that in Part II to evaluate whether managers of a firm with such common owners would choose a lower level of output, relative to a circumstance in which there were no such common owners. We concluded that they would not, at least at current common ownership levels.²¹⁷ The policy implication of this finding is that

²¹⁶ See Merritt B. Fox & Menesh S. Patel, *Common Ownership, Do Managers Really Compete Less*, 39 YALE J. REG. 136 (2022). The leading example of common owners are the three big asset managers—Vanguard, BlackRock, and State Street. In any given industry, each of these asset managers has approximately a 4-9% equity interest in every one of the industry’s constituent publicly traded firms. See Matthew Backus, Christopher Conlon & Michael Sinkinson, *Common Ownership in America: 1980-2017*, 13 AM. ECON. J.: MICROECONOMICS 273, 285 fig.5 (2021).

²¹⁷ See Fox & Patel, *supra* note 216.

common ownership is not currently causing firms to compete less, as some have argued.²¹⁸ Thus, common ownership does not call for a policy response that might undermine the large index fund's very inexpensive way for retail investors to maximize risk reduction through diversification.

Future work could use the Article's analytical structure to similarly analyze other situations involving shareholder bodies with both selfish return sacrificers and return maximizers. These selfish return sacrificers also include, for instance, equity holders who transact with the corporation as an input supplier (for example, as an employee), equity holders who are direct or indirect downstream customers of the firm, and equity holders who want the firm to deviate from share value maximization because that financially benefits the investor for some tax-related reason.

The work in this Article permits at least three initial observations concerning selfish-return-sacrificers generally. First, the preferences of such shareholders are generally much more likely to be manifest than those of social-end-oriented sacrificers. Second, allowing binding shareholder resolutions concerning specific business decisions would make corporations more sensitive to all types of willing-to-sacrifice shareholders, social-end-oriented ones and selfish ones alike, something that takes on particular importance given the first observation. To the extent that these resolutions are used by selfish return sacrificers, they raise all of the troubling issues as related party transactions more generally. Moreover, bypassing the board of directors bypasses the decision-makers who have fiduciary duties and specified procedures for dealing with interested party transactions. Finally, for at least some kinds of selfish-return-sacrificers, such as

²¹⁸ See, e.g., Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267 (2016); Eric A. Posner, Fiona M. Scott Morton & E. Glen Weyl, A Proposal to Limit the Anticompetitive Power of Institutional Investors, 81 ANTITRUST L.J. 669, 686 (2017).

common owners, any reform that as a general matter made firm behavior more sensitive to their preferences would serve to undermine efficiency with no clear offsetting distributional gain.

2. *Divergent Investor Predictions.* Even if all investors desire share value maximization, they might still differ among themselves as to what they predict will be the consequences of some corporate act on the firm's cash flow and therefore its share value.²¹⁹ These differences can arise because different equity investors possess different information sets or because of differences in the models with which they generate predictions from any given information set. We are not aware of any scholarship that evaluates the implications of this source of investor heterogeneity on corporate behavior. Future work can rectify this gap in the literature by conducting an analysis along the same lines as in Parts I and II above but directed at the circumstance in which investors agree on the preferred corporate end but have different predictions on the effects of a given corporate action on the firm's cash flow.

While sharp conclusions await that future work, two preliminary observations are possible at this stage. First, the extent to which an investor's personal beliefs concerning how to maximize a firm's cash flow motivates her to act to change firm behavior will depend on investor type. Passive investors—persons who purchase shares just to be part of a diversified stock portfolio with no views as to whether the shares are under- or over-priced—are not guided by any kind of future cash flow analysis. It is therefore extremely unlikely that such investors will have strong enough views about what behavior management should pursue to initiate action to seek to change that behavior to maximize share value. That contrasts with speculative investors, who are very likely to have views on the consequences of management's current policies, as well as, possibly, of various alternative policies.

²¹⁹ More generally, whatever might be investors preferred corporate objective, they still might disagree on how to best achieve that objective.

Second, financial economic models demonstrate that differences in beliefs among speculative investors concerning firms' expected returns are incorporated in share prices.²²⁰ The implication is that the effect on corporate behavior of such investor differences will be largely intermediated through the process by which each corporation's shares are priced, and not, in the first instance, through the operation of the shareholder franchise.

²²⁰ See, e.g., John Lintner, *The Aggregation of Investor's Diverse Judgments and Preferences in Purely Competitive Security Markets*, 4 J. FIN. & QUANT. ANALYSIS 347 (1969).

Appendix

Consider a corporation that generates a negative externality. The corporation can eliminate the externality, but only at the expense of share value. The question addressed is whether a corporation's shareholder, if fully informed, would favor the corporation deviating from share value maximization to eliminate the negative externality.

Model²²¹

The corporation has N shareholders. Shareholders differ in the extent of their equity interest in the corporation and the weight they place on the wealth status of others. Specifically, for any given shareholder i :

s_i = the fraction of the total value of the corporation's equity possessed by shareholder i , where $0 < s_i < 1$, such that shareholders' fractional interests sum to 1.

λ_i = shareholder i 's "empathy factor," which is the weight that the shareholder places on changes in the aggregate wealth of others relative to her own wealth, where $0 \leq \lambda_i < 1$.

So, shareholders are socially-minded, in the sense that they place some weight on the wellbeing of others, as reflected by a strictly positive empathy factor. Other shareholders are not socially-minded in this sense and so have a zero empathy factor. No shareholders are fully empathetic, in the sense that they equally value changes in the aggregate wealth of others and changes in their own wealth.

Additional Definitions:

δ = the cost to the corporation, and hence ultimately to its shareholders, of deviating from share value maximization and eliminating the externality, where $\delta > 0$

C_i = the cost to shareholder i in the reduced value of her shares if the corporation eliminates the externality, i.e., $C_i = s_i * \delta$

C_{-i} = the aggregate cost to the rest of the corporation's shareholders in terms of the reduced value of their shares if the corporation eliminates the externality

G = the aggregate gains of everyone whose position is improved by elimination of the externality (for example, the improvement in the lives of people who were suffering from smoke being emitted by a factory run by the corporation, where the externality elimination involves shutting the factory down)

L = the aggregate losses, other than to the corporation itself, resulting from the corporation's elimination of the externality (in the same example, persons who lost their jobs from the factory's closure)

²²¹ This model is based on the one in Hart & Zingales, *Corporate Governance*, *supra* note 7.

$h = G - L$, i.e., the net of the gains and losses by persons affected by corporation's decision to eliminate the externality, excluding the cost to the corporation itself

W_i = shareholder i 's willingness to support the corporation's deviation of share value maximization to eliminate the externality, which is defined as the net benefit to the shareholder from the externality elimination

$E = h/\delta$ (the "externality improvement ratio"). Note that if $E > 1$, then the deviation is welfare improving, while the cases $E = 1$ and $E < 1$ represent the circumstance in which the deviation maintains or decreases social welfare, respectively.

Proposition 1: A necessary condition for a socially-minded shareholder to support the deviation is that the deviation is social welfare improving, i.e., $E > 1$.

Proof

The benefit to shareholder i if the corporation eliminates the externality is $\lambda_i G$. The cost to shareholder i is $C_i + \lambda_i C_{-i} + \lambda_i L$. Therefore,

$$(1) W_i = \lambda_i(G - L - C_{-i}) - C_i$$

Shareholder i favors the corporation eliminating the externality if and only if $W_i \geq 0$.²²² In other words, the necessary and sufficient condition for shareholder i to support the deviation is:

$$(2) \lambda_i(G - L - C_{-i}) - C_i \geq 0$$

Suppose shareholder i is socially minded, so that $\lambda_i > 0$, and supports the deviation. This means that (2) is met, which means, after multiplying by $1/\lambda_i$ and rearranging, that:

$$(3) (1/\lambda_i)C_i + C_{-i} < G - L$$

Because $\lambda_i \leq 1$, $1/\lambda_i \geq 1$. And thus:

$$(4) C_i + C_{-i} \leq (1/\lambda_i)C_i + C_{-i}$$

Combining (3) and (4) implies:

$$(5) C_i + C_{-i} < G - L$$

which means that $\delta < h$, or $E > 1$.

A shareholder that is not socially minded does not support the deviation in any circumstance.

²²² We assume for convenience that the shareholder supports the deviation if she is indifferent.

Proposition 2: A socially minded shareholder supports the deviation if and only if E is greater than or equal to some cutoff E^* , where the cutoff E^* is a function of s_i and λ_i .

Proof

Suppose that shareholder i is socially minded and let $E^* = s_i/\lambda_i + (1-s_i)$.

Suppose $E \geq E^*$. Then this means $E \geq s_i/\lambda_i + (1-s_i)$, which, after manipulation, means that $-s_i + \lambda_i[E - (1-s_i)] \geq 0$. Multiplying by δ yields:

$$(6) -s_i\delta + \lambda_i[h - (1-s_i)\delta] \geq 0.$$

This is equivalent to $C_i < \lambda_i(G - L - C_{-i})$, or $\lambda_i(G - L - C_{-i}) - C_i \geq 0$, which is equation (2) – the necessary and sufficient condition for shareholder i to vote in favor of the deviation.

Next, suppose that shareholder i supports the deviation. This means that $\lambda_i(G - L - C_{-i}) - C_i \geq 0$, or, after manipulation, that $E \geq E^*$.

Proposition 3: A socially minded shareholder's willingness to support a social welfare improving deviation increases as the shareholder's fractional equity interest decreases, all else equal.

Proof

Suppose that shareholder i is socially minded and that the deviation is welfare improving. Recall that $W_i = \lambda_i(G - L - C_{-i}) - C_i$, which can be rewritten as:

$$(7) W_i = \lambda_i[h - (1-s_i)\delta] - s_i\delta.$$

$$\text{So, } \partial W_i / \partial s_i = \lambda_i\delta - \delta = -\delta(1 - \lambda_i) < 0.$$

Proposition 4: A socially minded shareholder's willingness to support a social welfare improving deviation increases as their empathy factor increases, all else equal.

Proof

Suppose the shareholder is socially minded and that the deviation is welfare improving. From (1), $\partial W_i / \partial \lambda_i = G - L - C_{-i}$. Because $E > 1$, $G - L > C_i + C_{-i}$, which means that $G - L - C_{-i} > C_i$, and so, because $C_i > 0$, $G - L - C_{-i} > 0$. Thus, $\partial W_i / \partial \lambda_i > 0$.

Proposition 5: A socially-minded shareholder's willingness to support a social welfare improving deviation increases with the deviation's externality improvement ratio, all else equal

Proof

Suppose that shareholder i is socially-minded and that the deviation is welfare improving Recall from (7) that $W_i = \lambda_i[h - (1-s_i)\delta] - s_i\delta$. This means that that $W_i = \delta*\lambda_i[E - (1-s_i)] - s_i\delta$. So $\partial W_i/\partial E = \delta*\lambda_i > 0$.

Example 1

Suppose that $s_i = 1/10,000,000$, i.e., i owns $1/100,000$ of 1% of a publicly traded company, and that $E = 1.2$, i.e., the net social benefit from the impact of the corporation's externality eliminating behavior change is 1.2 times the cost to the corporation and thus to its shareholders.

Recall from (6), that for i to favor the deviation, it must be that $\lambda_i > s_i\delta/[h - (1 - s_i)\delta]$, which means that:

$$(14) \lambda_i > s_i/(E - 1 + s_i)$$

So, using the provided values, this means that $\lambda_i > 0.0000001/(1.2 - 1 + 0.0000001) \approx 0.0000005$.

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