Introduction

There are a lot of books on the market praising stakeholder capitalism. They proclaim a new age in which big corporations should embrace – and, in fact, are embracing – environmental, social, and governance (ESG) goals. Whether putatively objective academic tomes filled with statistics or mass market books filled with bullet points, the bottom line is the same; namely, that stakeholder capitalism is the right thing to do both morally and financially.

This is not one of those books.

I.1 DOES THE WORLD NEED ANOTHER BOOK ON STAKEHOLDER CAPITALISM?

We are concerned with the foundational question of corporate governance: What is the purpose of a corporation? Is it, as Nobel Economics laureate Milton Friedman famously claimed, "to increase its profits"?[1] Or is it, as the Business Roundtable recently claimed, "generating good jobs, a strong and sustainable economy, innovation, a healthy environment and economic opportunity for all."[2]

Although I try to be fair to competing perspectives, my goal is to put forward an unabashed defense of the proposition that the purpose of the corporation is to sustainably maximize shareholder value over the long term. The book defends that proposition as both descriptively accurate and normatively appealing, arguing that shareholder value maximization is both what the law requires and what the law ought to require. Admittedly, as we go along, we will need to introduce some nuances here and there but that basic claim makes an excellent starting point.

At the outset, it is appropriate to acknowledge that that claim has a long and controverted past. There is a very considerable body of scholarship on the corporate purpose and a corporation's social responsibility.[3] Academics in multiple disciplines beyond just law and business, not to mention corporate leaders, prominent lawyers, and politicians, spent much of the twentieth century arguing about the respective merits of profit maximization and social responsibility. In places, we thus will be traveling down a well-trodden path. So why go down that path yet again? Because things have changed or, at least, conventional wisdom so claims.

In the 1980s, it seemed like the debate had finally been settled in favor of what is variously known as shareholder value maximization or shareholder wealth maximization:

> [Economists] William Meckling and Michael Jensen … argued that shareholder value maximization should be the primary metric for assessing the performance of a business. In 1990, Jensen co-authored another influential article in Harvard Business Review alongside Kevin Murphy which suggested CEOs were being paid like bureaucrats and therefore acting like bureaucrats rather than value-maximizing entrepreneurs. They recommended providing stronger incentives for CEOs to maximize the value of their companies, such as having CEOs become substantial owners of company stock and providing big financial rewards for superior performance. The following decades generated greater acceptance of these theories, and they had a profound impact on how businesses ran and operated, particularly in the United States.[4]

These and other similar developments led prominent corporate law professors Reinier Kraakman and Henry Hansmann to claim that we had reached, as the title of their 2001 article put it, *The End of History for Corporate Law*.[5] Their article's title was a play on the title of Francis Fukuyama's 1992 book, *The End of History and the Last Man*, which claimed that liberal democracy and democratic capitalism had triumphed over socialism and other competing ideologies.[6] Just as Fukuyama thought political science had reached the final phase of ideological evolution, Kraakman and Hansmann thought corporate governance had reached a final consensus. In their view, there was "no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."[7]

Just as 9/11, the steady rise of state capitalist systems such as China, and many other factors called Fukuyama's thesis into question, so have similar developments called Hansmann and Kraakman's thesis into question. Indeed, it considerably understates the case to say shareholder value maximization is being called into question. Today, shareholder value maximization is under attack on multiple fronts.[*]

In the academic sphere, although stakeholder capitalism has long had substantial academic support, the weight of scholarly opinion has tilted even more greatly towards stakeholder capitalism in recent years.[8] My former colleague, the late law professor Lynn Stout, dismissed shareholder value maximization as a mere myth, albeit a powerful one she claimed "causes companies to indulge in reckless,

[*] Although we are focused herein on U.S. law and business, it is worth noting that Hansmann and Kraakman – like Fukuyama – claimed to have identified global convergence on their identified end of history. Indeed, at the turn of the millennium there was an emerging consensus that "the stakeholder ideal" was in retreat even in countries like Germany and Japan where it had traditionally prevailed. John Micklethwait & Adrian Wooldridge, The Company: A Short History of a Revolutionary Idea 187 (2003). As with Fukuyama's thesis about political systems converging, however, claims that capitalism had settled on the shareholder rather than stakeholder version foundered on the success and spread of China's system of state capitalism. Tim Wu, *The Goals of the Corporation and the Limits of the Law*, The CLS Blue Sky Blog (Sept. 3, 2019), https://clsbluesky.law.columbia.edu/2019/09/03/the-goals-of-the-corporation-and-the-limits-of-the-law/.

sociopathic, and socially irresponsible behaviors."[9] Canadian law professor Joel Bakan went even further by condemning the business corporation itself as a "pathological institution" whose relentless pursuit of profit has psychopathic attributes.[10] In making such arguments, they reflected a widely shared narrative that "corporations are powerful, evil, malevolent, bad-actors intent on profit-making at the expense of the health, safety, and well-being of individuals."[11]

In the investing world, there long have been so-called socially responsible investors, who structured their portfolios using various social justice filters that excluded companies believed to have negative social and environmental impacts. Although it was claimed that socially responsible investing was a profitable strategy, it was primarily justified by moral and ethical arguments. Today, however, as investor interest in ESG metrics has grown, there has been a distinct shift in recent years from moral and ethical justifications to financial justifications. Although many ESG investors likely are still motivated by traditional socially responsible investor concerns, ESG investing is explicitly premised on the belief that ESG oriented portfolios provide superior risk-adjusted returns to traditional portfolios lacking ESG or social responsibility filters. Hence, for example, the three largest institutional investors – asset managers BlackRock, State Street, and Vanguard – all claim to have embraced ESG because they believe that ESG factors are positively correlated with firm performance. They offer investment funds that supposedly invest exclusively in firms that score highly in ESG measures and that exercise their voting rights as shareholders to support ESG policies. ESG-focused investors thus are supposedly pushing both asset managers and portfolio companies to be more ESG friendly.[12] Whether that's true is an issue to which we will return in Chapters 8 and 10.*

Finally, stakeholder capitalism and politics are increasingly intertwined. In the 2020 US Presidential campaign, perhaps influenced by the Occupy Wall Street movement of a few years earlier, numerous Democratic politicians carved out strong positions in favor of stakeholder capitalism. Senator Elizabeth Warren (D-MA), for example, contended that a root cause of many of America's economic problems was the emphasis by businesses on maximizing shareholder wealth. Her proposed Accountable Capitalism Act would have required boards of public corporations with over $1 billion in revenues to consider the interests of stakeholders when making corporate decisions. Eventual Democratic 2020 nominee and now President Joe Biden called for an "end to the era of shareholder capitalism." Strikingly, however, one also finds skepticism about shareholder wealth maximization on the right end of the political spectrum. Senator Marco Rubio (R-FL), for example, argues that shareholder wealth maximization "provides a framework to reduce or ignore the longer-term, economy-and-society wide negative externalities that result [from business activity], by placing them outside the realm of business decisions."[13]

* It is estimated that by 2018 ESG funds managed about $22 trillion, which represented a quarter of the total assets under management of the global asset management industry. Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 Vand. L. Rev. 1401, 1451–52 (2020).

These political developments at least in part reflect the grass roots resurgence of populism on both the left and right, which share a distrust of big business and the pursuit of corporate profit.[14] The rise of the latter potentially is a particularly important development. Although there are older antecedents, such as the Southern Agrarians of the 1930s, right of center populist critiques of shareholder capitalism are properly traced to Pat Buchanan's 1996 campaign for the Republican presidential nomination. Unlike traditional pro-business conservative campaigns, Buchanan's campaign was marked by hostility to globalization, in general, and transnational corporations, in particular. His campaign solidified a view among the emergent populist movement that large corporations and crony capitalism were diluting America's exceptional culture and identity through globalization and impoverishing working-class Americans while enriching financial and technology oligarchs.

The Tea Party and the 2016 Trump campaign were of even greater import. They espoused a strong aversion to Wall Street, especially in their opposition to post-2008 financial crisis government bailouts of financial firms. Both movements share many attributes with the other major twenty-first century American populist movement – Occupy Wall Street – including an antagonism towards corporate power.[15]

The potential impact of these resurgent populist movements was noted by The Economist's Schumpeter column in the wake of Donald Trump's 2016 election:

> As they slid down the streets of Davos this week, many executives will have felt a question gnawing in their guts. Who matters most: shareholders or the people? Around the world a revolt seems under way. A growing cohort – perhaps a majority – of citizens want corporations to be cuddlier, invest more at home, pay higher taxes and wages and employ more people, and are voting for politicians who say they will make all that happen ….
>
> Should [corporate managers] fire staff, trim costs and expand abroad – and face the wrath of Donald Trump's Twitter feed, the disgust of their children and the risk that they'll be the first against the wall when the revolution comes? Or do they bend to popular opinion and allow profits to fall … ?[16]

Taken together, these developments inevitably impacted corporate C-suites. Leaders of the business community traditionally were somewhat ambivalent about shareholder value maximization. Today, some have actually switched sides and joined the stakeholder capitalism movement or, at least, claim to have done so. Consider, to cite but a few examples, recent high-profile disputes over public restrooms, travel and immigration, high capacity rifle magazines, and voting by mail. What these seemingly very disparate debates have in common was the active role played in each by US corporations aggressively supporting the progressive position.

In 2016, North Carolina adopted House Bill 2, which among other things required transgendered persons to use public restrooms assigned to their biological sex. In the uproar that followed, many corporations publicly opposed the new law. Over 200 major corporations signed an open letter calling for the law's repeal, arguing that it did not reflect their values. Some prominent firms put their money where their mouth was, by cancelling major investments in North Carolina.[17]

When former President Donald Trump took office in 2017 some observers expected – even hoped – that his would be a populist administration siding with workers rather than big business.[18] Although those expectations did not come to pass, neither did initial overtures between the Trump administration and business leaders. Trump's travel bans suspending the refugee program and barring entry by nationals of a number of predominately Muslim countries triggered a backlash from many major corporations, especially in the tech sector.[19] The subsequent suspension of the DACA program, which protected undocumented persons brought into the US as children from deportation, triggered a similar backlash.

The following year the 2018 mass shooting in Parkland, Florida, again brought a sweeping reaction from corporate America. Citigroup and Bank of America restricted loans to the gun industry. BlackRock rolled out new index funds excluding gun manufacturers and retailers. Numerous airlines and car rental companies cancelled discount programs offered to NRA members.[20]

Taken together, these developments gave an old legal term new life as a hot management buzzword: corporate purpose.[21] The surging interest in this issue is reflected in the substantial increase in the number of news articles dealing with it. In 2011, the Factiva data base listed 18,558 news articles containing the phrase "corporate social responsibility." By 2020 that number had risen to 24,253. In 2011, just 64 news articles contained the phrase "stakeholder theory." By 2020 that number had risen to 157.

The resurgent debate over corporate purpose hit a high point in August 2019, when the Business Roundtable rejected the view that the profit motive ought to drive decisions by corporate officers and directors. Instead, the Business Roundtable argued, corporate decision makers also should take into account the interests of various other constituencies, such as workers, customers, communities, and so on. The Business Roundtable matters because it is probably the most prominent and influential association of large corporation CEOs. Since its formation in 1972, the Roundtable has periodically issued policy statements on a wide range of economic, political, and social issues. Because the Roundtable's membership consists of approximately 200 CEOs whose companies collectively employ 20 million people, generate annual revenues of $9 trillion, and have a stock market capitalization of approximately $18 trillion, those policy statements have frequently proven quite influential.

Corporate purpose and governance long has been a core area of policy interest for the Business Roundtable. Since 1978, Business Roundtable has periodically issued statements on Principles of Corporate Governance, which purport to summarize law and best practice in this area. Since 1997, all versions of those statements embraced the view that corporations exist primarily to serve their shareholders. The original 1997 version, for example, stated:

> In The Business Roundtable's view, the paramount duty of management and of boards of directors is to the corporation's stockholders; the interests of other stakeholders are relevant as a derivative of the duty to stockholders. The notion that the board must somehow balance the interests of stockholders against the interests of other stakeholders fundamentally misconstrues the role of directors. It is, moreover, an unworkable notion because it would leave the board with no criterion for resolving conflicts between interests of stockholders and of other stakeholders or among different groups of stakeholders.[22]

The Statement recognized that directors in appropriate cases could consider the effects of their decision on constituencies such as employees, but only when consistent with their duty to manage the corporation in the long-term interests of the shareholders.

In recent years, however, the rhetoric coming from America's C-suites increasingly took into account social "pressure for companies to articulate and justify their broader purpose, in terms of how they address society's unmet needs in an era of great social change, activism, and political uncertainty."[23] In response to that pressure, the Business Roundtable's 2019 statement adopted a much broader conception of corporate purpose, which posited that corporations should commit to a series of bullet points elevating shareholder theory over shareholder value maximization. According to the Business Roundtable's new conception, a corporation's purpose includes:

- *Delivering value to our customers* ….
- Investing in our employees. This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect.
- Dealing fairly and ethically with our suppliers ….
- Supporting the communities in which we work. We respect the people in our communities and protect the environment by embracing sustainable practices across our businesses.
- Generating long-term value for shareholders, who provide the capital that allows companies to invest, grow and innovate. We are committed to transparency and effective engagement with shareholders.[24]

That statement – and the renewed debate it triggered – provided the primary motivation for this book. Accordingly, the Business Roundtable's statement is one of my principal foils throughout.

I.1.1 *What the Moment Requires*

In light of the developments we just traced, what the present moment requires is a defense of shareholder value maximization that takes those developments into account. Or, to paraphrase William F. Buckley, what the moment needs is for someone to stand athwart the tracks of corporate governance and yell "stop" as the stakeholder capitalism train pulls out of the station.

Accordingly, three major themes animate the project. First, any conception of corporate purpose that embraces goals other than creating value for shareholders is inconsistent with the mainstream of US corporate law. Second, directors do – and should – have wide and substantially unfettered discretion as to how they go about generating shareholder value. Although many commentators claim that those statements are inconsistent, in fact they both reflect fundamental normative principles deeply embedded in US corporate law. Third, a shareholder-centric conception of corporate purpose is preferable to stakeholder capitalism.

I.2 THE INTENDED AUDIENCE

I am an academic. The publisher is an academic press. But you do not need to be an academic to read this book. My goal in writing it is to be as clear as possible and even to entertain or amuse when appropriate. Toward those ends, I went so far as to make frequent of the first person singular, which is a mortal sin in purely academic prose.

Granted, the book is interdisciplinary in nature, drawing on law, history, and economics. It will be of interest to lawyers and legal academics, as it explains how current law evolved. Because the work will be written in a way that is accessible to the educated general reader, however, it should also appeal to businesspersons, management school academics, and other audiences interested in corporate governance. Accordingly, the book is intended to reach a large and varied audience; including anyone who is interested – for whatever reason – in how corporations work and how corporate governance can be improved.

I.3 WHY SHOULD WE CARE ABOUT CORPORATE PURPOSE?

Put simply, corporate purpose matters because corporations matter. Corporations are “far wealthier and far more able to negatively affect our individual lives than virtually any local government or even most Federal agencies.”[25] Worse yet, like elephants crashing through a forest, corporations can trample individuals and communities underfoot without even meaning to do so. As such the corporation is “the perfect externalizing machine.”[26] By incorporating a business, it becomes possible for the owners of the business – whether intentionally or not – to externalize substantial costs and risks onto corporate constituencies such as employees or creditors and society at large.

Limited liability is the attribute that makes this possible.[27] Put simply, limited liability means that shareholders of a corporation are not personally liable for debts incurred or torts committed by the firm. If the firm fails, a shareholder’s losses thus are limited to the amount the shareholder has invested in the firm – that is, the amount the shareholder initially paid to purchase his or her stock. Creditors of the corporation may not seek compensation for unpaid debts or other obligations from the shareholders’ personal assets.

Limited liability has been something of a mixed blessing. On the one hand, it is reasonable to say that the limited liability of corporations made our modern economy possible. Limited liability made it possible for entrepreneurs to raise the enormous amounts of investment capital necessary for large industrial corporations to arise and flourish by allowing many investors to invest small amounts of money in a business enterprise without risking their entire fortune. "One of the great advantages of the large corporate system is that it allows individuals to use small fractions of their savings for various purposes, without risking a disastrous loss if any corporation in which they have invested becomes insolvent."[28] As such, it is "an essential aspect of a large corporate system with widespread public participation."[29] President Nicholas Murray of Columbia University thus exaggerated only slightly when, in 1911, he opined that:

> I weigh my words when I say that in my judgment the limited liability corporation is the greatest single discovery of modern times …. Even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative impotence without it.[30]

On the other hand, limited liability has a dark side. Specifically, as already noted, it allows shareholders to externalize part of the costs of their investment onto other corporate constituencies to society in general. A very simple example will suffice to illustrate the point.[31] Suppose a corporation borrowed $2,000 from a bank to invest. There are two available investments: A and B, each of which has three possible payoffs: best case, worst case, and break even.

Investment A

	Probability	Nominal Value	Expected Value
Best-case	10%	$3,000	$300
Break-even	80%	$2,000	$1,600
Worst-case	10%	$1,000	$100
Expected Value			$2000

Investment B

	Probability	Nominal Value	Expected Value
Best-case	20%	$5,000	$1,000
Break-even	60%	$2,000	$1,200
Worst Case	20%	$0	$0
Expected Value			$2,200

Investment B is the more risky of the two options. Both default risk (the risk that the company won't be able to pay back its debt) and volatility risk (the likelihood of an outcome other than the break-even scenario) are much higher in Investment B.

In a world of zero transaction costs and unlimited liability – that is, one in which shareholders are personally liable for corporate debts – the bank would be indifferent as to which investment the company made. If the company fails, the bank can simply collect from the shareholder. Conversely, because the bank can collect any unpaid debt from the shareholder, the shareholder will fully internalize the risks associated with the choices.

In a world of limited liability – that is, one in which the shareholders have no liability for the corporation's contract debts – the bank will prefer Investment A. Even in the worst case scenario, the bank will get half its money back, plus there's a 90 percent probability the bank will be repaid in full. The bank will not be impressed that Investment B offers a higher expected return, because the bank has no claims on the residual. Anything over $2,000 goes to the shareholders, not the bank (ignoring interest). Conversely, shareholders will strongly prefer Investment B. Because creditors (like the bank) have a prior claim on the firm's assets and earnings, they get paid first; shareholders get the residual – whatever is left over. Shareholders thus prefer projects offering potentially high rate of returns, so there will be something left over after the creditors get paid.

The problem, of course, is that high return projects usually involve high levels of risk. The greater the risk, the more likely it becomes that the project will be unsuccessful. In that event, it becomes more likely that the firm's income will not suffice to pay the creditors, let alone leave anything over for the shareholders. Shareholders will not care about Investment B's greater risk, however, because the doctrine of limited liability means their personal assets are not at risk. Limited liability thus generates negative externalities by creating incentives for shareholders to cause the company to invest in higher risk projects than would the firm's creditors. Because shareholders do not put their personal assets at jeopardy, they effectively externalize some portion of the risk associated with such investments to creditors.

The externalities problem has been around since corporations were first vested with limited liability. As corporations grew ever larger in the wake of the industrial revolution, however, the scope of the problem likewise grew. In an industrial economy, limited liability is of particular concern because it may encourage overinvestment in hazardous activities. Because the shareholder can externalize some part of the risks associated with such activities, those activities could have a positive value for the investor even though they have negative net social costs.

Sometimes these externalities are the result of decisions by corporate management to transfer some of the costs of running their business onto the corporation's various constituencies or society at large. When I was young my family lived for a time at Fort Devens, Massachusetts, which is on the Nashua River. At that time, many textile and paper mills operated along the Nashua. Both industries generated enormous amounts of waste water and the mills simply dumped their effluent into the river. The river was incredibly noxious, with a reek that could be smelled at a considerable distance. As far back as 1877, a Massachusetts State Board of Health report opined that the river was "so polluted throughout its whole length that it would be unwise to use any part of it for a domestic water supply."[32] Instead of incurring costs to clean up their waste, the corporations whose plants abutted the river opted to externalize those costs onto those who lived downriver.

Other externalities, however, are the unintended consequence of what famed economist Joseph Schumpeter called "creative destruction." At the heart of the capitalist system is an engine of constant and dynamic change. New services and products arise, replacing old services and products and often displacing those who produced the older ones. Likewise, new ways of producing established goods are developed, potentially displacing those who were trained in the old ways.

At one level, the debate over corporate purpose thus is really a debate about how to deal with these corporate externalities. If we tell directors and officers to maximize corporate profits, will we simply encourage them to externalize even more costs? Conversely, is asking them to behave responsibly likely to induce them to internalize those costs?

Having said that, however, the corporate purpose debate goes beyond simply the negative externalities inevitably resulting from corporate activities. It also asks whether corporations should be managed so as to generate positive externalities. Should managers conduct the corporation's business so as to generate benefits to stakeholders and society in general? Advocates of stakeholder capitalism commonly contend that the profit motive discourages corporate directors and managers to ignore not just the social costs of corporate activities but also the potential for corporate activities to generate social benefits.

In many cases, however, corporate actions that benefit stakeholders – such as employees – help the firm become more profitable and thus redound to the benefit of shareholders. When the corporation faces a true zero-sum decision, however, one must make a choice between the competing interests of stakeholders and shareholders. In such cases, the law requires directors to prefer shareholder interests. This text will defend that claim as both a descriptive and normative matter.

I.4 DEFINING OUR TERMS

I.4.1 *The Corporation*

To say either that a corporation acted responsibly or irresponsibly is error. By making either statement, the speaker engages in reification; that is, treats an abstraction as a physical entity. While reification provides a necessary semantic shorthand, it creates a sort of false consciousness when taken to extremes.[33] The corporation is not a thing. The corporation is a legal fiction representing the unique vehicle by which large groups of individuals, each offering a different factor of production, order their relationships so as to collectively produce marketable goods or services. Accordingly, we must always keep in mind that when we talk about the corporation