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Professor Bebchuk's Errant Attack on Stakeholder Governance

In an article posted yesterday on the Harvard Law School Forum on Corporate Governance blog, Professor Lucian Bebchuk rejects stakeholder governance and, in so doing, attacks the committed positions of influential institutions as varied as the Business Roundtable, the World Economic Forum, BlackRock, State Street, Vanguard, the UK Financial Reporting Council, and the European Union High-Level Expert Group on Sustainable Finance.

Professor Bebchuk summarizes his article as follows:

> "Following the publication of the [Business Roundtable] statement, in December 2019 the World Economic Forum took the unusual step of publishing a manifesto that urged companies to move from the traditional model of "shareholder capitalism" to the model of "stakeholder capitalism." Shortly thereafter, Larry Fink, head of BlackRock, the world's largest asset manager, issued a letter to all CEOs exhorting them to be "committed to embracing purpose and serving all stakeholders." And a memorandum by Wachtell, Lipton declared 2019 to be a "watershed year" in corporate governance due to "the advent of stakeholder governance." These and other recent developments reflect growing support for an approach to which we refer as "stakeholderism"—the view that corporate leaders should give weight to the well-being of stakeholders (not just of shareholders) when making business decisions.
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> In our new study we wish to warn against the rise and growing acceptance of stakeholderism. To this end, we conduct an economic, empirical, and conceptual analysis of stakeholderism and the claims made by its supporters. Stakeholderism, we conclude, should not be expected to benefit stakeholders. To the contrary, it would impose substantial costs on stakeholders and society, as well as on shareholders."

In a series of papers issued before and after the publication of the Business Roundtable statement in 2019, we explained the pressing need to abandon shareholder primacy and adopt stakeholder governance: The New

Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth; Corporate Governance; Corporate Governance: Stakeholders; BlackRock Supports Stakeholder Governance; The Purpose of the Corporation; Corporate Governance—The New Paradigm—A Better Way Than Federalization; Capitalism at an Inflection Point; Corporate Purpose—Stakeholders and Long-Term Growth; Business Roundtable Embraces Stakeholder Corporate Governance; Stakeholder Governance and the Fiduciary Duties of Directors; Directors' Duties in an Evolving Risk and Governance Landscape; Stakeholder Governance—Issues and Answers; Stakeholder Corporate Governance; Purpose, Stakeholders, ESG and Sustainable Long-Term Investment; and Embracing The New Paradigm. As we set out in those memoranda, the law fully authorizes stakeholder governance as anticipated by The New Paradigm—and practical business, political and social imperatives require it.

Relying on cherry-picked data and recycled arguments, Professor Bebchuk supports the position taken by activist hedge funds, like Paul Singer's Elliott Management, which has stated that:

> "A . . . potentially even more impactful force is "stakeholder supremacy." This idea has exploded on the scene in a period of months as a major force in corporate governance theory and, one would expect, a harbinger of future regulatory and legal changes. This theory holds that instead of managements working for the owners of companies, public and private, managements should equally serve workers, customers, the community, the environment, social justice and suppliers."

But this critique from the activist community comes as little surprise. Stakeholder governance is a grave threat to the activist hedge fund business model—precisely because it ensures that corporations will operate for long-term sustainable growth in value and the social good. While the combination of Professor Bebchuk's article and the self-serving position of activist hedge funds will undoubtedly create confusion, it can do nothing to impede the growing momentum among mainstream investors toward stakeholder governance.

We reject Professor Bebchuk's economic, empirical and conceptual arguments. They are ill-conceived and ignore the real-world challenges companies and directors face today. Martin Wolf framed those challenges well in a December 3, 2019, *Financial Times* article:

> "[W]e need a dynamic capitalist economy that gives everybody a justified belief that they can share in the benefits. What we increasingly seem to have instead is an unstable rentier capitalism, weakened competition, feeble productivity growth, high inequality and, not coincidentally, an increasingly degraded democracy." So what is to be done? . . . . The limited liability join stock corporation was a great invention, but it is also a highly privileged entity. The narrow focus on maximizing shareholder value has exacerbated the bad side-effects. As the British Academy's "Principles for Purposeful Business" report argues, "the purpose of business is to solve the problems of people and planet profitably, and not profit from causing problems." That is self-evident. It is also hopeless to rely on regulation alone to save us from the consequences of myopic business behavior, particularly when business uses its vast resources to lobby on the other side. The US Business Roundtable has recognized this. We need new laws, to effect required changes."

As we have discussed, new laws—such as federal legislation of the type proposed by Elizabeth Warren—are likely to sweep far too broadly and risk substantial destruction of corporate value. They are also unnecessary if companies and investors embrace stakeholder capitalism as contemplated by The New Paradigm and as adumbrated by the actions Professor Bebchuk condemns.

We recommend that companies and boards monitor and review their stakeholder and ESG profiles as a matter of increasing priority, and engage regularly with their major investors on these issues.

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