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Stakeholder Governance and the Eclipse of Shareholder Primacy

For decades, advocates of "shareholder primacy" as the North Star of corporate governance have steered our leading corporations and our Nation's economic engine perilously off-course. Since the 1970s, when the work of Milton Friedman, Michael Jensen, and Frank Easterbrook took hold in business schools, activists and raiders in high-profile proxy fights and hostile takeovers on Wall Street have wrapped their arms around the shareholder-primacy narrative to advance their own short-termist objectives. Far from shared scholarly interest, their objective was plain: To justify cutting off directors' reasoned judgment, in favor of maximizing short-term shareholder value, notwithstanding the attendant harm to the health of our corporate and economic landscape and even our national security. To be sure, some in academia and in the corporate world fought back, in favor of responsible corporate stewardship in pursuit of long-term sustainable value, by advocating consideration of other stakeholders who make essential contributions to the creation of sustainable value. And the 2008 financial crisis alerted others to the dangers of the shareholder-primacy paradigm. But until recently, shareholder primacy remained stubbornly ascendant, largely crowding out other voices. Even the Business Roundtable, which officially adopted shareholder primacy in 1997, did not recognize its existential threat to society and abandon it for stakeholder corporate governance until 2019.

Over this period, the long shadow cast by the theory of shareholder primacy has wreaked havoc on American public companies, providing ostensible cover for activists and raiders who divert the attention and undermine the commitment of CEOs and boards from investing in the sustainable long-term value of their companies. The mantra to maximize value for shareholders has evolved into myopic demands for short-termist corporate policies and practices, including enormous pressure on companies to increase profits on a quarter-to-quarter basis, to engage in large share buybacks, and to sacrifice the interests of employees and other stakeholders. Shareholder primacy thereby engineered a short-sighted reluctance to make expenditures in pioneering R&D and investments critical to the manufacturing capacity that many great companies once had to build heavy equipment like battleships and aircraft carriers or cutting-edge devices like the advanced semiconductor chips fueling today's AI and tomorrow's quantum computing.

From innovations in chips to the capacity to construct ships, our technological and manufacturing leadership risks being eclipsed, with ramifications for our economic strength and our national security in the increasingly volatile landscape being shaped by China, Russia, North Korea, Iran, and others. Encapsulating short-termism's albatross on both our national security and our economy, Niall Ferguson offers a sobering portrait of an emerging "Cold War II" and points to Treasury Secretary Janet Yellen's complaint that China's "excess capacity . . . in 'new' industries like solar, EVs, and lithium-ion batteries" is "hurting American firms and workers." The short-termism that activists have imposed on American corporations in the name of shareholder primacy has also complicated and confused broader societal and political issues, from climate change to diversity and equality. In these ways and more, short-termism has hobbled would-be corporate innovators and impeded long-term economic prosperity.

Today, there is a growing recognition of the harm that shareholder primacy has wrought. In a widely heralded edition of his annual letter to shareholders, Jamie Dimon, CEO of JPMorgan Chase, recently decried the "treadmill to ruin" for companies that succumb to the undue pressure of quarterly earnings by resorting to shortcuts, calling instead for building shareholder value over the long run by considering all of the company's stakeholders, from customers to employees to communities. Echoing that concern, The *Financial Times*' Rana Foroohar regularly implores policymakers and business leaders to beware "the perils of short-term financial market pressures" confronting the United States, warning in particular about a looming transport-and-logistics "crisis moment" due to the dramatic contraction in the American shipbuilding industry over the past several decades. And in the academic world, a variety of scholars have been rethinking prevailing theories of corporate governance — from Harvard Business School's Joseph Bower and Lynn Paine, in *The Error at the Heart of Corporate Leadership*; to Oxford University's Colin Mayer, who decisively states in his book *Capitalism and Crises* that the purpose of the corporation is "to produce profitable solutions for the problems of people and planet, not profiting from producing problems for either." Indeed, recent debates about the corporation's fundamental purpose have borne fruit in powerful statements of the urgency of stakeholder governance for our Nation's economy, and for society more broadly.

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This recent wave of revelation about the need for a stakeholder model of governance to eclipse the shareholder-primacy paradigm sounds a warmly welcome note — but hardly a new one. For our part, we have supported stakeholder governance for more than 50 years — first to empower boards of directors to reject opportunistic takeover bids by corporate raiders, especially those using junk-bond financing, and later to combat short-termism and preserve directors' reasoned decision-making for the long-term.

In 1979, in *Takeover Bids in the Target's Boardroom*, we emphatically rejected an exclusive focus by directors on short-term share price in assessing a takeover bid, calling instead for attention to long-term value by considering the interests of all stakeholders, including the corporation's "employees, customers, suppliers, and the community." The stakes, we wrote, were clear: "Whether the long-term interests of the nation's corporate system and economy should be jeopardized in order to benefit speculators interested not in the vitality and continued existence of the business enterprise in which they have bought shares, but only in a quick profit on the sale of those shares?" That question would reverberate, without sufficient public resonance, for years to come.

A decade later, the ascendant "shareholders-only view" continued to "ignore[] the reality that other constituencies both share the risk and are vital to the success of corporate activity." In 1991, we observed: "The health and stability of these economies depends on the ability of corporations to maintain healthy and stable business operations over the long term." Before the 2008 financial crisis, we reaffirmed the board's obligation to manage the affairs of the corporation to ensure its sustainable long-term growth. And more recently, at the request of the International Business Council of the World Economic Forum, we distilled these imperatives into a single framework, *The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth*. The New Paradigm seeks to recalibrate the relationship between corporations and investors, to help corporations resist short-termism and facilitate long-term, sustainable value creation. We have since updated this framework in response to a number of developments, in an effort to offer a practical and comprehensive roadmap that could be adopted by all proponents of governance and stewardship guidelines. An interesting approach to achieve this has been articulated by the UK Investor Forum.

Even as we note the rising tide of attention to stakeholder governance and its virtues, it is worth remembering that the intellectual roots of this paradigm, far from nascent, run deep. In fact, it was Adam Smith, the 18th-century father of capitalism, who warned against a focus on maximizing shareholder profits in the short-term, to the exclusion of broader stakeholder considerations. Nearly two decades before extolling capitalism's benefits in *The Wealth of Nations*, Smith recognized in *The Theory of Moral Sentiments* that the viability of capitalism depends upon fundamental commitments to the well-being of communities and to a long-term view of private and public investment that support growth and prosperity for all. This oft-ignored part of Smith's legacy is finally bolstering the foundation of today's corporate governance terrain.

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With this history in mind, we continue to believe that *It's Time to Adopt The New Paradigm* — CEOs and boards of corporations should forge partnerships with shareholders and other stakeholders in order to resist short-termism and embrace stakeholder governance in pursuit of sustainable, long-term value creation. And, it bears cautioning, corporations must not be diverted from this commitment by the growing politicization and polarization around specific environmental, social, and governance issues.

The panoply of complex stakeholder issues that companies face today remain integral to corporate sustainability, responsible risk management, and value creation. But the agendas of activists targeting stakeholder issues — in some cases, opposing consideration of such issues altogether, and in other cases, seeking to mandate the board's prioritization of a specific stakeholder issue — threaten to distort stakeholder governance and undermine our progress away from the era of shareholder primacy. As we recently reiterated, "There should be no doubt that the law in Delaware and every other U.S. jurisdiction empowers well-advised boards . . . to vindicate long-term value as the true purpose of the corporation." It remains incumbent upon and entirely within the purview of boards of directors to exercise their reasoned business judgment in carefully balancing the interests of *all* stakeholders in order to create long-term, sustainable value.

The emerging consensus about the essential role of stakeholder governance in America's long-term corporate, economic, national security, and societal prosperity, heralds a development long overdue: the eclipse of shareholder primacy.

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