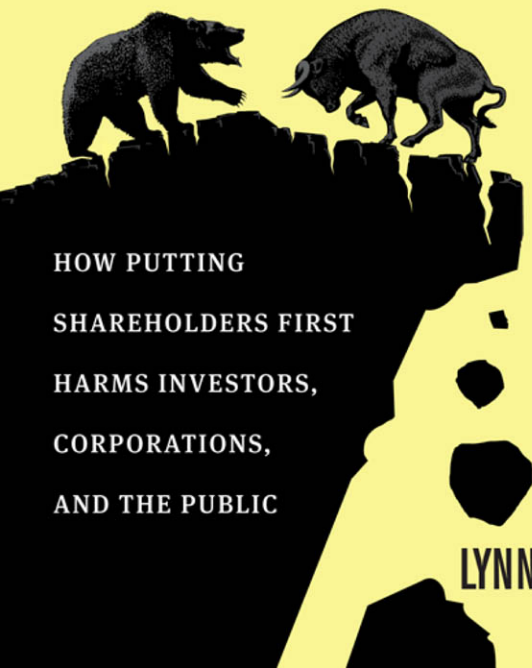


THE
SHAREHOLDER
VALUE **MYTH**



HOW PUTTING
SHAREHOLDERS FIRST
HARMS INVESTORS,
CORPORATIONS,
AND THE PUBLIC

LYNN STOUT

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Contents

<i>Preface</i>	v
INTRODUCTION: “THE DUMBEST IDEA IN THE WORLD”	1
PART I: DEBUNKING THE SHAREHOLDER VALUE MYTH	13
Chapter One The Rise of Shareholder Value Thinking	15
Chapter Two How Shareholder Primacy Gets Corporate Law Wrong	24
Chapter Three How Shareholder Primacy Gets Corporate Economics Wrong	33
Chapter Four How Shareholder Primacy Gets the Empirical Evidence Wrong	47
PART II: WHAT DO SHAREHOLDERS REALLY VALUE?	61
Chapter Five Short-Term Speculators versus Long-Term Investors	63
Chapter Six Keeping Promises to Build Successful Companies	74
Chapter Seven Hedge Funds versus Universal Investors	86
Chapter Eight Making Room for Shareholder Conscience	95
CONCLUSION: “SLAVES OF SOME DEFUNCT ECONOMIST”	103
<i>Notes</i>	117
<i>Index</i>	129
<i>About the Author</i>	133



INTRODUCTION

“The Dumbest Idea in the World”

The *Deepwater Horizon* was an oil drilling rig, a massive floating structure that cost more than a third of a billion dollars to build and measured the length of a football field from bottom to top. On the night of April 20, 2010, the *Deepwater Horizon* was working in the Gulf of Mexico, finishing an exploratory well named Macondo for the corporation BP. Suddenly the rig was rocked by a loud explosion. Within minutes the *Deepwater Horizon* was transformed into a column of fire that burned for nearly two days before collapsing into the depths of the Gulf of Mexico. Meanwhile, the Macondo well began vomiting tens of thousands of barrels of oil daily from beneath the sea floor into the Gulf waters. By the time the well was capped in September 2010, the Macondo well blowout was estimated to have caused the largest offshore oil spill in history.¹

The *Deepwater Horizon* disaster was tragedy on an epic scale, not only for the rig and the eleven people who died on it, but also for the corporation BP. By June of 2010, BP had suspended paying its regular dividends, and BP common stock (trading around \$60 before the spill) had plunged to less than \$30 per share. The result was a decline in BP's total stock market value amounting to nearly \$100 billion. BP's shareholders were not the only ones to suffer. The value of BP bonds tanked as BP's credit rating was cut from a prestigious AA to the near-junk status BBB. Other oil companies working in the Gulf were idled, along with BP, due to a government-

imposed moratorium on further deepwater drilling in the Gulf. Business owners and workers in the Gulf fishing and tourism industries struggled to make a living. Finally, the Gulf ecosystem itself suffered enormous damage, the full extent of which remains unknown today.

After months of investigation, the National Commission on the BP *Deepwater Horizon* Oil Spill and Offshore Drilling concluded the Macondo blowout could be traced to multiple decisions by BP employees and contractors to ignore standard safety procedures in the attempt to cut costs. (At the time of the blowout, the Macondo project was more than a month behind schedule and almost \$60 million over budget, with each day of delay costing an estimated \$1 million.)² Nor was this the first time BP had sacrificed safety to save time and money. The Commission concluded, “BP’s safety lapses have been chronic.”³

The Ideology of Shareholder Value

Why would a sophisticated international corporation make such an enormous and costly mistake? In trying to save \$1 million a day by skimping on safety procedures at the Macondo well, BP cost its shareholders alone a hundred thousand times more, nearly \$100 *billion*. Even if following proper safety procedures had delayed the development of the Macondo well for a full year, BP would have done much better. The gamble was foolish, even from BP’s perspective.

This book argues that the *Deepwater Horizon* disaster is only one example of a larger problem that afflicts many public corporations today. That problem might be called shareholder value thinking. According to the doctrine of shareholder value, public corporations “belong” to their shareholders, and they exist for one purpose only, to maximize shareholders’ wealth. Shareholder wealth, in turn, is

typically measured by share price—meaning share price today, not share price next year or next decade.

Shareholder value thinking is endemic in the business world today. Fifty years ago, if you had asked the directors or CEO of a large public company what the company's purpose was, you might have been told the corporation had many purposes: to provide equity investors with solid returns, but also to build great products, to provide decent livelihoods for employees, and to contribute to the community and the nation. Today, you are likely to be told the company has but one purpose, to maximize its shareholders' wealth. This sort of thinking drives directors and executives to run public firms like BP with a relentless focus on raising stock price. In the quest to "unlock shareholder value" they sell key assets, fire loyal employees, and ruthlessly squeeze the workforce that remains; cut back on product support, customer assistance, and research and development; delay replacing outworn, outmoded, and unsafe equipment; shower CEOs with stock options and expensive pay packages to "incentivize" them; drain cash reserves to pay large dividends and repurchase company shares, leveraging firms until they teeter on the brink of insolvency; and lobby regulators and Congress to change the law so they can chase short-term profits speculating in credit default swaps and other high-risk financial derivatives. They do these things even though many individual directors and executives feel uneasy about such strategies, intuiting that a single-minded focus on share price may not serve the interests of society, the company, or shareholders themselves.

This book examines and challenges the doctrine of shareholder value. It argues that shareholder value ideology is just that—an ideology, not a legal requirement or a practical necessity of modern business life. United States corporate law does not, and never has, required directors of public corporations to maximize either share price or shareholder wealth. To the contrary, as long as boards do not use their

power to enrich themselves, the law gives them a wide range of discretion to run public corporations with other goals in mind, including growing the firm, creating quality products, protecting employees, and serving the public interest. Chasing shareholder value is a managerial choice, not a legal requirement.

Nevertheless, by the 1990s, the idea that corporations should serve only shareholder wealth as reflected in stock price came to dominate other theories of corporate purpose. Executives, journalists, and business school professors alike embraced the need to maximize shareholder value with near-religious fervor. Legal scholars argued that corporate managers ought to focus only on maximizing the shareholders' interest in the firm, an approach they somewhat misleadingly called "shareholder primacy." ("Shareholder absolutism" or "shareholder dictatorship" would be more accurate.)

It should be noted that a handful of scholars and activists continued to argue for "stakeholder" visions of corporate purpose that gave corporate managers breathing room to consider the interests of employees, creditors, and customers. A small number of others advocated for "corporate social responsibility" to ensure that public companies indeed served the public interest writ large. But by the turn of the millennium, such alternative views of good corporate governance had been reduced to the status of easily ignored minority reports. Business and policy elites in the United States and much of the rest of the world as well accepted as a truth that should not be questioned that corporations exist to maximize shareholder value.⁴

Time for Some Questions

Today, questions seem called for. It should be apparent to anyone who reads the newspapers that Corporate America's mass

embrace of shareholder value thinking has not translated into better corporate or economic performance. The past dozen years have seen a daisy chain of costly corporate disasters, from massive frauds at Enron, HealthSouth, and Worldcom in the early 2000s, to the near-failure and subsequent costly taxpayer bailout of many of our largest financial institutions in 2008, to the BP oil spill in 2010. Stock market returns have been miserable, raising the question of how aging baby boomers who trusted in stocks for their retirement will be able to support themselves in their golden years. The population of publicly held U.S. companies is shrinking rapidly as formerly public companies like Dunkin' Donuts and Toys"R"Us "go private" to escape the pressures of shareholder-primacy thinking, and new enterprises decide not to sell shares to outside investors at all. (Between 1997 and 2008, the number of companies listed on U.S. exchanges declined from 8,823 to only 5,401.)⁵ Some experts worry America's public corporations are losing their innovative edge.⁶ The National Commission found that an underlying cause of the *Deepwater Horizon* disaster was the fact that the oil and gas industry has cut back significantly on research in recent decades, with the result that "knowledge and experience within the industry may be decreasing."⁷

Even former champions of shareholder primacy are beginning to rethink the wisdom of chasing shareholder value. Iconic CEO Jack Welch, who ran GE with an iron fist from 1981 until his retirement in 2001, was one of the earliest, most vocal, and most influential adopters of the shareholder value mantra. During his first five years at GE's helm, "Neutron Jack" cut the number of GE employees by more than a third. He also eliminated most of GE's basic research programs. But several years after retiring from GE with more than \$700 million in estimated personal wealth, Welch observed in a *Financial Times* interview about the 2008 financial crisis

that “strictly speaking, shareholder value is the dumbest idea in the world.”⁸

It’s time to reexamine the wisdom of shareholder value thinking. In particular, it’s time to consider how the endless quest to raise share price hurts not only non-shareholder stakeholders and society but also—and especially—*shareholders themselves*.

Revisiting the Idea of “Shareholder Value”

Although shareholder-primacy ideology still dominates business and academic circles today, for as long as there have been public corporations there have been those who argue they should serve the public interest, not shareholders’ alone. I am highly sympathetic to this view. I also believe, however, that one does not need to embrace either a stakeholder-oriented model of the firm, or a form of corporate social responsibility theory, to conclude that shareholder value thinking is destructive. The gap between shareholder-primacy ideology as it is practiced today, and stakeholders’ and the public interest, is not only vast but much wider than it either must or should be. If we stop to examine the reality of who “the shareholder” really is—not an abstract creature obsessed with the single goal of raising the share price of a single firm today, but real human beings with the capacity to think for the future and to make binding commitments, with a wide range of investments and interests beyond the shares they happen to hold in any single firm, and with consciences that make most of them concerned, at least a bit, about the fates of others, future generations, and the planet—it soon becomes apparent that conventional shareholder primacy harms not only stakeholders and the public, but most shareholders as well. If we really want corporations to serve the interests of the diverse human beings who ultimately own their shares either directly or through institutions like pension and mutual funds, we need

to seriously reexamine our ideas about who shareholders are and what they truly value.

This book shows how the project of reexamining shareholder value thinking is already underway. While the notion that managers should seek to maximize share price remains conventional wisdom in many business circles and in the press, corporate theorists increasingly challenge conventional wisdom. New scholarly articles questioning the effects of shareholder-primacy thinking and the wisdom of chasing shareholder value seem to appear daily. Even more important, influential economic and legal experts are proposing alternative theories of the legal structure and economic purpose of public corporations that show how a relentless focus on raising the share price of individual firms may be not only misguided, but harmful to investors.

These new theories promise to advance our understanding of corporate purpose far beyond the old, stale “shareholders-versus-stakeholders” and “shareholders-versus-society” debates. By revealing how a singled-minded focus on share price endangers many shareholders themselves, they also demonstrate how the perceived gap between the interests of shareholders as a class and those of stakeholders and the broader society in fact may be far narrower than commonly understood. In the process, they also offer better, more sophisticated, and more useful understandings of the role of public corporations and of good corporate governance that can help business leaders, lawmakers, and investors alike ensure that public corporations reach their full economic potential.

The Structure of This Book

This book offers a guide to the new thinking on shareholder value and corporate purpose. Part I, *Debunking the Shareholder Value Myth*, discusses the intellectual origins of conventional shareholder-primacy thinking. It shows how the ideology of

shareholder value maximization lacks solid grounding in corporate law, corporate economics, or the empirical evidence. Contrary to what many believe, U.S. corporate law does not impose any enforceable legal duty on corporate directors or executives to maximize profits or share price. The philosophical case for shareholder value maximization similarly rests on incorrect factual claims about the economic structure of corporations, including the mistaken claims that shareholders “own” corporations, that they have the only residual claim on the firm’s profits, and that they are “principals” who hire and control directors to act as their “agents.” Finally, although researchers have searched diligently, there is a remarkable lack of persuasive empirical evidence to demonstrate that either corporations, or economies, that are run according to the principles of shareholder value perform better over time than those that are not. Put simply, shareholder value ideology is based on wishful thinking, not reality. As a theory of corporate purpose, it is poised for intellectual collapse.

Part II, *What Do Shareholders Really Value?*, surveys several promising new alternative theories of the public corporation being offered by today’s experts in law, business, and economics. These new theories have two interesting and important elements in common.

First, as noted earlier, most historical challenges to shareholder primacy have focused on the fear that what is good for shareholders might be bad for other corporate stakeholders (customers, employees, creditors) or for the larger society. The new theories, however, focus on the possibility that *shareholder value thinking can harm many shareholders themselves*. Indeed, if we think of shareholders as an interest group that persists over time, shareholder value thinking maybe contrary to shareholders’ own collective interests.

Second, the new theories raise this counterintuitive possibility by showing how “the shareholder” is an artificial and highly misleading construct. Most economic interests in

stocks are ultimately held by human beings, either directly or indirectly through pension funds and mutual funds. Where “shareholders” are homogeneous, people are diverse. Some plan to own their stock for short periods, and care only about today’s stock price. Others expect to hold their shares for decades, and worry about the company’s long-term future. Investors buying shares in new ventures want their companies to be able to make commitments that attract the loyalty of customers and employees. Investors who buy shares later may want the company to try to profit from reneging on those commitments. Some investors are highly diversified and worry how the company’s actions will affect the value of their other investments and interests. Others are undiversified and unconcerned. Finally, many people are “prosocial,” meaning they are willing to sacrifice at least some profits to allow the company to act in an ethical and socially responsible fashion. Others care only about their own material returns.

Once we recognize the reality that different shareholders have different values and interests, it becomes apparent that one of the most important functions that boards of public companies of necessity must perform is to balance between and mediate among different shareholders’ competing and conflicting demands. Conventional shareholder value thinking wishfully assumes away this difficult task by assuming away any differences among the various human beings who own a company’s stock. In other words, in directing managers to focus only on share price, shareholder value thinking *ignores the reality that different shareholders have different values*. It blithely assumes that the question of corporate purpose must be viewed solely from the perspective of a hypothetical entity that cares only about the stock price of a single company, today. As UCLA law professor Iman Anabtawi has noted, this approach allows shareholder-primacy theorists to characterize shareholders “as having interests that are fundamentally in harmony with one another.”⁹ But it also reduces investors to their lowest pos-

sible common human (or perhaps subhuman) denominator: impatient, opportunistic, self-destructive, and psychopathically indifferent to others' welfare.

This book does not advance a theory of how, exactly, directors should mediate among different shareholders' demands. Nor does it directly address the question of whether some shareholders' interests (say, those of long-term or more-diversified investors) should be given greater weight in the balancing process than other shareholders' interests. These are, of course, critically important questions. But before we can even start to answer them, we must begin by recognizing that conventional shareholder-primacy ideology "solves" the problem of inter-shareholder conflict by simply assuming—without explanation or justification—that the only shareholder whose interests count is the shareholder who is short-sighted, opportunistic, undiversified, and without a conscience. This approach keeps public corporations from doing their best for either their investors or society as a whole.

Why It Matters

It's time to rethink the wisdom of shareholder value. The stakes are high: for most of the twentieth century, public companies drove the U.S. economy, producing innovative products for consumers, attractive employment opportunities for workers, tax revenues for governments, and impressive investment returns for shareholders and other investors. Corporations were the beating heart of a thriving economic system that served both shareholders and America.

But in recent years the corporate sector has stumbled badly. Americans are beginning to lose faith in business. One recent poll found that where in 2002, 80 percent of Americans strongly supported capitalism and the free-enterprise system, by 2010 that number had fallen to only 59 percent.¹⁰ Perhaps understandably, in the wake of each new scandal or disaster,

public anger and media attention tend to focus on the sins of individuals: greedy CEOs, inattentive board members, immoral executives. This book argues, however, that many and perhaps most of our corporate problems can be traced not to flawed individuals but to a flawed *idea*—the idea that corporations are managed well when they are managed to maximize share price.

To help corporations do their best for investors and the rest of us as well, we need to abandon the simplistic mantra of “maximize shareholder value,” and adopt new and better understandings of the legal structure and economic functions of public companies. It’s time to free ourselves from the myth of shareholder value.

PART I

Debunking the Shareholder Value Myth





CHAPTER 1

The Rise of Shareholder Value Thinking

The public corporation as we know it today was born in the late 1800s and did not reach its full maturity until the early twentieth century. Before then, most business corporations were “private” or “closely held” companies whose stock was held by a single shareholder or small group of shareholders. These controlling shareholders kept a tight rein on their private companies and were intimately involved in their business affairs.

By the early 1900s, however, a new type of business entity had begun to cast a growing shadow over the economic landscape. The new, “public” corporation issued stock to thousands or even tens of thousands of investors, each of whom owned only a very small fraction of the company’s shares. These many small individual investors, in turn, expected to benefit from the corporation’s profit-making potential, but had little interest in becoming engaged in its activities, and even less ability to effectively do so. By the 1920s, American Telephone and Telegraph (AT&T), General Electric (GE), and the Radio Company of America (RCA) were household names. But their shareholders were uninvolved in and largely ignorant of their daily operations. Real control and authority over public companies was now

vested in boards of directors, who in turn hired executives to run firms on a day-to-day basis. The publicly held corporation had arrived.¹¹

The Great Debate over Corporate Purpose: The Early Years

Of all the controversies surrounding this new economic creature, the most fundamental and enduring has proven the debate over its proper purpose.¹² Should the publicly held corporation serve only the interests of its atomized and ignorant shareholders, and should directors and executives focus only on maximizing those shareholders' wealth through dividends and higher share prices? This perspective, which today is called "shareholder primacy" or the "shareholder-oriented model," may have made sense in the early 1900s to those who viewed public corporations as fundamentally similar to the private companies from which they had evolved. After all, in private companies, the controlling shareholder or shareholder group enjoyed near-absolute power to determine the firm's future. The question of corporate purpose was easy to answer: the firm's purpose was whatever the shareholders wanted it to be, and when in doubt, it was assumed the shareholders wanted as much money as possible.

But other observers in the first half of the twentieth century thought differently about the public corporation. To them, these new economic entities seemed strikingly dissimilar, in both structure and function, from the privately held firms that preceded them. The "separation of ownership from control" that allowed the creation of enormous enterprises like AT&T and GE worked a change that was qualitative, not just quantitative. Public corporations seemed to have a broader social purpose that went beyond making money for their shareholders. Properly managed, they also served the interests of stakeholders like customers and employees, and even the society as a whole.

Thus began the Great Debate over the purpose of the public corporation (as it has been dubbed by three influential judges specializing in corporate law).¹³ The Great Debate was joined in full as early as 1932, when the *Harvard Law Review* published a high-profile dispute between two leading experts in corporate law, Adolph Berle of Columbia and Harvard law professor Merrick Dodd. Berle was the coauthor of a famous study of public corporations entitled *The Modern Corporation and Private Property*.¹⁴ He took the side of shareholder primacy, arguing that “all powers granted to a corporation or to the management of the corporation . . . [are] at all times exercisable only for the ratable benefit of the shareholders.”¹⁵ Professor Dodd disagreed. He thought that the proper purpose of a public company went beyond making money for shareholders and included providing secure jobs for employees, quality products for consumers, and contributions to the broader society. “The business corporation,” Dodd argued, is “an economic institution which has a social service as well as a profit-making function.”¹⁶

To many people today, Dodd’s “managerialist” view of the public corporation as a legal entity created by the state for public benefit and run by professional managers seeking to serve not only shareholders but also “stakeholders” and the public interest, may seem at best quaintly naïve, and at worst a blatant invitation for directors and executives to use corporations to line their own pockets. Yet in the first half of twentieth century, it was the managerialist side of the Great Debate that gained the upper hand. By 1954, Berle himself had abandoned the notion that public corporations should be run according to the principles of shareholder value. “Twenty years ago,” Berle wrote, “the writer had a controversy with the late Professor Merrick E. Dodd, of Harvard Law School, the writer holding that corporate powers were powers held in trust for shareholders, while Professor Dodd argued that these powers were held in trust for the entire community.

The argument has been settled (at least for the time being) squarely in favor of Professor Dodd's contention."¹⁷

The Rise of Shareholder Primacy

But only a few decades after Berle's surrender to managerialism, shareholder-primacy thinking began to resurface in the halls of academia. The process began in the 1970s with the rise of the so-called Chicago School of free-market economists. Prominent members of the School began to argue that economic analysis could reveal the proper goal of corporate governance quite clearly, and that goal was to make shareholders as wealthy as possible. One of the earliest and most influential examples of this type of argument was an essay Nobel-prize winning economist Milton Friedman published in 1970 in the *New York Times* Sunday magazine, in which Friedman argued that because shareholders "own" the corporation, the only "social responsibility of business is to increase its profits."¹⁸

Six years later, economist Michael Jensen and business school dean William Meckling published an even more influential paper in which they described the shareholders in corporations as "principals" who hire corporate directors and executives to act as the shareholders' "agents."¹⁹ This description—which the next two chapters will show completely mischaracterizes the actual legal and economic relationships among shareholders, directors, and executives in public companies—implied that managers should seek to serve only shareholders' interests, not those of customers, employees, or the community. Moreover, true to the economists' creed, Jensen and Meckling assumed that shareholders' interests were purely financial. This meant that corporate managers' only legitimate job was to maximize the wealth of the shareholders (supposedly the firm's only "residual claimants") by every means possible short of violating the law. According to

Jensen and Meckling, corporate managers who pursued any other goal were wayward agents who reduced social wealth by imposing “agency costs.”

Why Shareholder Value Ideology Appeals

The Chicago School’s approach to understanding corporations proved irresistibly attractive to a number of groups for a number of reasons. To tenure-seeking law professors, the Chicago School’s application of economic theory to corporate law lent an attractive patina of scientific rigor to the shareholder side of the longstanding “shareholders versus society” and “shareholders versus stakeholders” disputes. Thus shareholder value thinking quickly became central to the so-called Law and Economics School of legal jurisprudence, which has been described as “the most successful intellectual movement in the law in the last thirty years.”²⁰ Meanwhile, the idea that corporate performance could be simply and easily measured through the single metric of share price invited a generation of economists and business school professors to produce countless statistical studies of the relationship between stock price and variables like board size, capital structure, merger activity, state of incorporation, and so forth, in a grail-like quest to discover the secret of “optimal corporate governance.”

Shareholder-primacy rhetoric also appealed to the popular press and the business media. First, it gave their readers a simple, easy-to-understand, sound-bite description of what corporations are and what they are supposed to do. Second and perhaps more important, it offered up an obvious suspect for every headline-grabbing corporate failure and scandal: misbehaving corporate “agents.” If a firm ran into trouble, it was because directors and executives were selfishly indulging themselves at the expense of the firm’s shareholders. Managers’ claims that they were acting to preserve the firm’s long-term future, to protect stakeholders like employees and

customers, or to run the firm in a socially or environmentally responsible fashion, could be waved away as nothing more than self-serving excuses for self-serving behavior.

Lawmakers, consultants, and would-be reformers also were attracted to the gospel of shareholder value, because it allowed them to suggest obvious solutions to just about every business problem imaginable. The prescription for good corporate governance had three simple ingredients: (1) give boards of directors less power, (2) give shareholders more power, and (3) “incentivize” executives and directors by tying their pay to share price. According to the doctrine of shareholder value, this medicine could be applied to any public corporation, and better performance was sure to follow. This reasoning influenced a number of important developments in corporate law and practice in the 1990s and early 2000s. For example, the Securities Exchange Commission (SEC) changed its shareholder proxy voting rules in 1992 to make it easier for shareholders to work together to challenge incumbent boards; Congress amended the tax code in 1993 to encourage public companies to tie executive pay to objective performance metrics; and, thanks to the protests of shareholder activists, many public corporations in the 1990s and early 2000s abandoned “staggered” board structures that made it difficult for shareholders to remove directors en masse.

Finally, shareholder value thinking came to appeal, through the direct route of self-interest, to the growing ranks of CEOs and other top executives who were being showered, in the name of the shareholders, with options, shares, and bonuses tied to stock performance. In 1984, equity-based compensation accounted for zero percent of the median executive’s compensation at S&P 500 firms; by 2001, this figure had risen to 66 percent.²¹ Whether or not linking “pay to performance” this way actually increased corporate performance, it unquestionably increased the thickness of executives’ wallets. In 1991, just before Congress amended the tax code to encourage stock performance-based pay, the average CEO of

a large public company received compensation approximately 140 times that of the average employee. By 2003, the ratio was approximately 500 times.²² The shareholder-primacy inspired shift to stock-based compensation ensured that, by the close of the twentieth century, managers in U.S. companies had stronger personal incentives to run public corporations according to the ideals of shareholder value thinking than at any prior time in American business history.

Shareholder Primacy Reaches Its Zenith

The end result was that, by the close of the millennium, the Chicago School had pretty much won the Great Debate over corporate purpose. Most scholars, regulators and business leaders accepted without question that shareholder wealth maximization was the only proper goal of corporate governance. Shareholder primacy had become dogma, a belief system that was rarely questioned, seldom explicitly justified, and had become so pervasive that many of its followers could not even recall where or how they had first learned of it. A small minority of dissenters concerned with the welfare of stakeholders like employees and customers, or about corporate social and environmental responsibility, continued to argue valiantly for broader visions of corporate purpose. But they were largely ignored and dismissed as sentimental, anti-capitalist leftists whose hearts outweighed their heads. In the words of Professor Jeffrey Gordon of Columbia Law School, “by the end of the 1990s, the triumph of the shareholder value criterion was nearly complete.”²³

The high-water mark for shareholder value thinking was set in 2001, when professors Reinier Kraakman and Henry Hansmann—leading corporate scholars from Harvard and Yale law schools, respectively—published an essay in *The Georgetown Law Journal* entitled “The End of History for Corporate Law.”²⁴ Echoing the title of Francis Fukayama’s

book about the overwhelming triumph of capitalist democracy over communism, Hansmann and Kraakman described how shareholder value thinking similarly had triumphed over other theories of corporate purpose. “[A]cademic, business, and governmental elites,” they wrote, shared a consensus “that ultimate control over the corporation should rest with the shareholder class; the managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders; other corporate constituencies, such as creditors, employees, suppliers, and customers, should have their interests protected by contractual and regulatory means rather than through participation in corporate governance; . . . and the market value of the publicly traded corporation’s shares is the principal measure of the shareholders’ interests.”²⁵ What’s more, Hansmann and Kraakman asserted, this “standard shareholder-oriented model” not only dominated U.S. discussions of corporate purpose, but conversations abroad as well. In their words, “the triumph of the shareholder-oriented model of the corporation is now assured,” not only in the United States, but in the rest of the civilized world.²⁶

There were at least two ironic aspects to the timing of this prediction. First, it was only a few months after Hansmann and Kraakman published their article that Enron—a poster child for maximizing shareholder value and for “good corporate governance” whose managers and employees were famous for their fixation on raising stock price—collapsed under the weight of bad business decisions and a massive accounting fraud.²⁷ Second and more subtly, Hansmann and Kraakman’s argument was primarily descriptive; they were painting a picture of what had become conventional wisdom about the purpose of the firm. Yet even as Hansmann and Kraakman published their essay, a number of leading scholars and researchers (including Hansmann and Kraakman themselves)

had begun to question the empirical and theoretical foundations of conventional wisdom.

At least among experts, shareholder value thinking had reached its zenith and was poised for decline. The first sign was a number of articles that began appearing in legal journals in the late 1990s and early 2000s. These articles, mostly written by lawyers, began pointing out a truth the Chicago School economists seemed to have missed: U.S. corporate law does not, and never has, required public corporations to “maximize shareholder value.”

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