The Limits of Corporate Governance

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INTRODUCTION

What is the purpose of the corporation? For decades, the answer was clear: to put shareholders' interests first.[1] In many cases, this theory of shareholder primacy also became synonymous with the imperative to maximize shareholder wealth.[2] In the world where shareholder primacy

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1. *See, e.g.*, Lisa M. Fairfax, *The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms*, 31 J. CORP. L. 675, 676 (2006) ("For the past few decades, corporate scholars have agreed almost universally that the shareholder primacy norm most accurately captures the corporation's personality and purpose."); Andrew Keay, *Shareholder Primacy in Corporate Law: Can it Survive? Should it Survive?*, 7 EUR. CO. & FIN. REV. 369, 370 (2010) ("The dominant theory in Anglo-American jurisdictions, as far as determining the objective of large public corporations, has been, certainly since the 1970s, the shareholder primacy theory, also known as 'shareholder value' or 'shareholder wealth maximization.'"); Robert J. Rhee, *A Legal Theory of Shareholder Primacy*, 102 MINN. L. REV. 1951, 1951 (2018) ("A foundational concept of corporate law and corporate governance is the principle of shareholder primacy.").

2. Cathy Hwang & Yaron Nili, *Shareholder-Driven Stakeholderism*, U. CHI. L. REV. ONLINE (2020), https://lawreviewblog.uchicago.edu/2020/04/15/shareholder-driven-stakeholderism-hwang-

was a north star, courts, scholars, and policymakers had relatively little to fight about: most debates were minor skirmishes about exactly *how* to maximize shareholder wealth.[3]

In recent years, however, corporations' larger role in society has become more salient. Corporate law impacts some of the most important social issues of our time, including reproductive rights,[4] gun control,[5] and gay marriage.[6] Many scholars have, as a result, argued that the corporation's larger societal role demands a rethinking of the core tenets of corporate governance: that corporations should, for instance, account for the needs and preferences of non-shareholders and stakeholders, too.[7] In 2019, the Business Roundtable, a group of nearly 200 CEOs of major American companies, also endorsed this view of "stakeholder theory," asserting in a statement that their companies were committed not only to shareholders but also to employees, customers, suppliers, and the broader community.[8]

Stakeholder theory is alluring in many ways. For example, it allows corporations to think beyond financial returns for shareholders. Corporations can thus consider broader and longer-term impacts, making decisions

nili/ [https://perma.cc/F9U2-KEXV]; Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 97 (2020).

3. Mark J. Roe, *Corporate Short-Termism—In the Boardroom and in the Courtroom*, 68 BUS. LAW. 977, 979 (2013).

4. Burwell v. Hobby Lobby Stores, Inc., 573 U.S. 682, 683 (2014) (holding that private for-profit corporations can be exempt from regulations that its owners are religiously opposed to).

5. Trinity Wall Street v. Wal-Mart Stores, Inc., 792 F.3d 323, 327 (3d Cir. 2015) (finding that the decision to sell firearms with high-capacity magazines is a merchandizing decision that should be left to management, rather than to shareholder proposals).

6. Brief for Corporate Law Professors as Amici Curiae Supporting Respondents at 3, Masterpiece Cakeshop, Ltd. v. Colo. C.R. Comm'n, 138 S. Ct. 1719 (2018) (No. 16-111) (arguing that because owners of firms are not the same as the firms themselves, the firm may have an obligation to bake a cake for a gay couple even if the owners have religious beliefs that are opposed to baking the cake).

7. *See* Andre O. Laplume, Karan Sonpar & Reginald A. Litz, *Stakeholder Theory: Reviewing a Theory that Moves Us*, 34 J. MGMT. 1152 (2008) (reviewing the literature on stakeholder theory as it developed); Lynn A. Stout, *Takeovers in the Ivory Tower: How Academics Are Learning Martin Lipton May Be Right*, 60 BUS. LAW. 1435, 1445 (2005) ("The principal-agent model has so dominated academic discussions of corporate law that, until quite recently, the idea that directors might show concern for stakeholders has been associated mostly with sandals-wearing activists who want to pressure corporations to redistribute wealth, promote racial and gender equality, or protect the environment."). LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 12 (2012); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 24 J. CORP. L. 751 (1999) (challenging the idea of shareholder primacy and posing stakeholder primacy as a way to avoid the principal-agent issues inherent in shareholder primacy); Martin Gelter, *The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance*, 50 HARV. INT'L. L.J. 129 (2009); Katharine V. Jackson, *Towards A Stakeholder-Shareholder Theory of Corporate Governance: A Comparative Analysis*, 7 HASTINGS BUS. L.J. 309 (2011).

8. *Our Commitment*, BUS. ROUNDTABLE, https://opportunity.businessroundtable.org/ourcommitment/ [https://perma.cc/JT8L-TGFU].

that might, for instance, be costly short-term but have the potential to provide longer-term returns. Proponents of stakeholder theory argue that the potential to do long-term good beyond shareholder returns is a good thing, especially in a world plagued by climate change, persistent racial injustice, income inequality, and other important social issues.[9] Stakeholder theory also allows a variety of groups to get involved in corporate decision-making, which is, of course, a benefit for those who might not own stock directly but who wish to get involved in influencing corporate decisions.[10]

While we agree with stakeholder theory proponents that it is important for corporations to do good, we argue that neither shareholder primacy nor stakeholder theory is the right way to maximize the net good that corporations do. Instead, we argue that direct regulation, rather than a change in governance focus, is the best way to incentivize corporations to do good—and that the need to create those incentives is more urgent now than ever.

At its core, this Essay makes an argument about institutional choice: we argue that legislators and regulators are better than corporations themselves at figuring out what is good for society, and at effectively improving corporations' social outcomes. By contrast, corporations are necessarily myopic. In the end, they are bound by the duty of loyalty to their shareholders to do what is at least beneficial for shareholders.[11] However, many Americans do not own any shares in corporations, and among those who do own shares, their voting power is determined by their wealth.[12] Thus, the shareholder electorate is not representative of society more broadly.

We recognize that arguments of institutional choice are also limited by practicalities, such as the realities of slow-moving legislatures, regulatory goals that change with political administrations, coordination problems between states and countries that are competing for corporations' business, and corporations' ability to engage in regulatory arbitrage. Our goal, in this short essay contributed to the Berle XIV Symposium, is not

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9. Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189 (2002); Virginia E. Harper Ho, *"Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 J. CORP. L. 59 (2010); Andrew R. Keay, Stakeholder Theory in Corporate Law: Has It Got What It Takes? (Jan. 4, 2010) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1531065 [https://perma.cc/7T67-S4BZ].

10. *See generally* Cathy Hwang, Jeremy McClane & Yaron Nili, *The Lost Promise of Private Ordering*, 108 CORNELL L. REV. (forthcoming 2023) (discussing the role of corporate debtors in shaping corporate governance).

11. Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 768 (2015).

12. Edward N. Wolff, *Household Wealth Trends in the United States, 1962 to 2019: Median Wealth Rebounds . . . But Not Enough* 65 tbl.17b (Nat'l Bureau of Econ. Rsch., Working Paper No. 28383, 2021) (showing that as of 2019, 49.6% of Americans owned stock, whether directly or indirectly).

meant to address all of these issues. Instead, we mean to start a conversation about whether the shareholderism and stakeholderism debate is really the best way for us, as scholars, to spend our time—or if it is time to move on to a broader discussion about the limits of corporate governance and how we might curb corporate misbehavior.

The remainder of this Essay proceeds as follows. Part I of this Essay discusses the shortcomings of shareholder primacy and stakeholder governance, arguing that neither of these modes of governance provides an adequate framework for incentivizing corporations to do good. Instead, as we argue in Part II, regulation is the best way to curb corporate misbehavior.

I. THE LIMITS OF SHAREHOLDERISM AND STAKEHOLDERISM

Proposals to re-orient corporate governance to better account for corporate social impacts may be roughly divided into two approaches. One argues that shareholders can be entrusted to use their powers to improve the social impacts of corporations.[13] Another argues that corporate managers can or should advance the interests of other stakeholder groups even without shareholder pressure.[14] This Part identifies the limitations of each of these approaches. Part II will propose that a more effective solution lies outside the realm of corporate governance.

A. The Limits of Relying on Shareholders

1. Shareholder Profits as a Means to Achieve Social Good

Debates over the proper orientation for corporate managers have existed since corporations grew large and management separated from control at the turn of the twentieth century.[15] However, by the middle of the century, a shareholder-first perspective began to dominate the debate.[16] Economist Milton Friedman famously wrote in 1970 that "there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits."[17] This perspective had a

13. *See generally* Fairfax, *supra* note 1 (advancing the notion that rhetoric adopted by the business community has value regardless of its behavior impact).

14. *See* Stout, *supra* note 9, at 1204.

15. Emily Winston, *Benefit Corporations and the Separation of Benefit and Control*, 39 CARDOZO L. REV. 1783, 1790–91 (2018).

16. WILLIAM MAGNUSON, FOR PROFIT: A HISTORY OF CORPORATIONS 7 (2022) ("Few economic theories have had such a remarkable effect on the world.").

17. Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 17.

commanding influence on policymaking in the decades that followed.[18] More recently, however, extensive scholarship and commentary has forcefully questioned shareholder primacy, pointing out various ways in which a myopic focus on shareholders has caused social and environmental harm.[19]

Shareholder primacy was not a theory explicitly designed to enrich a few at the expense of the rest. After all, Friedman did say the *social* responsibility of business was to increase profits.[20] One theoretical avenue by which shareholder primacy was expected to maximize the social good produced by corporations was the characterization of shareholders as residual claimants.[21] The concept of shareholders as residual claimants describes shareholders as the corporate stakeholders who get whatever is left over after all obligations to other stakeholders have been met.[22] From this perspective, if corporate payments to all other stakeholders are fixed, then maximizing the "residual" that goes to shareholders necessarily maximizes the total social output of the corporation.[23] That is, the slice of corporate profits being paid to other stakeholders is fixed, so the only way to increase the size of the pie is to increase the returns to shareholders.

However, in modern corporations, the proportion of corporate resources used to compensate stakeholders is not fixed. Rather it is the consequence of decisions made by corporate managers.[24] Once we acknowledge that corporate managers make tradeoffs among stakeholders when deciding how to allocate corporate profits, it becomes clear why a unilateral focus on shareholder returns would lead to worse outcomes for other stakeholders. Shareholder profits are a limited means to achieve social good because the choice to return more to shareholders is a choice not to distribute those returns to stakeholders.

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18. Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2575 (2021).

19. *See, e.g.*, ASPEN INST. BUS. & SOC'Y PROGRAM, OVERCOMING SHORT-TERMISM: A CALL FOR A MORE RESPONSIBLE APPROACH TO INVESTMENT AND BUSINESS MANAGEMENT (2009); DEAN KREHMEYER, MATT ORSAGH & KURT SCHACT, BREAKING THE SHORT-TERM CYCLE (2006); POLICY & IMPACT COMM. OF THE COMM. FOR ECON. DEV., RESTORING TRUST IN CORPORATE GOVERNANCE: THE SIX ESSENTIAL TASKS OF BOARDS OF DIRECTORS AND BUSINESS LEADERS 14–15 (2010); MATTEO TONELLO, CONF. BD., REVISITING STOCK MARKET SHORT-TERMISM (2006); Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. CORP. L. 265 (2012).

20. Friedman, *supra* note 17.

21. PAUL MILGROM & JOHN ROBERTS, ECONOMICS, ORGANIZATION AND MANAGEMENT 291 (1992).

22. *See generally id.* (describing the "residual claimants" theory).

23. *Id.*

24. Emily Winston, *Managerial Fixation and the Limitations of Shareholder Oversight*, 71 HASTINGS L.J. 699, 736 (2020) [hereinafter Winston, *Managerial Fixation*].

2. Shareholder Benevolence as a Means to Social Good

Recently, scholars have acknowledged that many shareholders in fact care about things other than maximizing their financial return.[25] Some, for example, have argued that Millennial shareholders care about social issues—and they can and should vote their shares in line with those values.[26] This has led several scholars to argue that these benevolent shareholder tendencies can be harnessed for the public good—for example, asset managers representing shareholders can act as regulators of corporate misbehavior when corporations themselves cannot or do not do so.[27] That is, perhaps a governance structure focused on shareholders is fine if those shareholders use their influence to advocate on behalf of other stakeholder groups.

For example, Broccardo, Hart and Zingales argue that socially-minded investors can best further their altruistic goals by maintaining their investment in socially irresponsible companies and utilizing their shareholder rights to advocate for change.[28] David Webber argues that union pension funds can and do lead campaigns for meaningful social change at businesses.[29] And, indeed, since shareholder primacy has come to dominate corporate governance policymaking, shareholders have successfully launched a number of successful campaigns to improve the social and environmental impact of publicly traded corporations. Such successes include the shareholder campaign to eliminate discriminatory hiring practices at Cracker Barrel,[30] shareholder proposals to stop the sale of semi-automatic weapons at Wal-Mart,[31] and the recent success of a hedge fund in placing climate-conscious directors on the board at ExxonMobil.[32]

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25. LYNN A. STOUT, CULTIVATING CONSCIENCE: HOW GOOD LAWS MAKE GOOD PEOPLE (2011); *See also* Michal Barzuza, Quinn Curtis & David H. Webber, The Millennial Corporation: Strong Stakeholders, Weak Managers (Sept. 10, 2021) (unpublished manuscript), https://papers.ssn.com/sol3/papers.cfm?abstract_id=3918443 [https://perma.cc/4DVX-ZR2U] [hereinafter Barzuza, Curtis & Webber, The Millennial Corporation]); David H. Webber, Michal Barzuza & Quinn Curtis, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243 (2020).

26. Barzuza, Curtis & Webber, The Millennial Corporation, *supra* note 25, at 19–20.

27. *See generally* Dorothy Lund, *Asset Managers as Regulators*, 171 U. PA. L. REV. 77 (2022) (arguing that powerful asset managers can step into the role of regulators when regulators fail to act).

28. Eleonora Broccardo, Oliver Hart & Luigi Zingales, *Exit vs. Voice* (Nat'l Bureau of Econ. Rsch, Working Paper No. 27710, 2020).

29. *See generally* DAVID WEBBER, THE RISE OF THE WORKING CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON (2018) (describing in part how workers can use their pensions to leverage their power); *See also* Barzuza, Curtis & Webber, The Millennial Corporation, *supra* note 25, at 41.

30. *See* Joseph A. Roy, *Non-Traditional Activism: Using Shareholder Proposals to Urge LGBT Non-Discrimination Protection*, 74 BROOK. L. REV. 1513, 1523–25 (2009).

31. Trinity Wall Street v. Wal-Mart Stores, Inc., 792 F.3d 323 (3d Cir. 2015).

32. The Daily, *The Sunday Read: 'The Little Hedge Fund Taking Down Big Oil'*, N.Y. TIMES (July 25, 2021), https://www.nytimes.com/2021/07/25/podcasts/the-daily/the-sunday-read-the-little-hedge-fund-taking-down-big-oil.html.

While these are laudable successes, there are limitations to how much social progress can be made via this type of activism. The activities and choices of large businesses can impact virtually any social cause. Businesses have impacts not only on climate change, hiring discrimination and weapon sales, they also affect access to credit, nutrition, healthcare availability, and any number of other crucial social issues. Shareholder campaigns to improve these impacts are extremely costly and must be waged one corporation at a time. The New York City Employees' Retirement System's (NYCERS) success at Cracker Barrel is worth celebrating, as is their ongoing use of their shareholder power to fight for equality in hiring.[33] However, these are years-long battles involving multiple appearances in court.[34] The result is a non-binding advisory vote of shareholders requesting the change. And, even when this advisory vote is enough to convince management to change its policies, it only changes the policy at one corporation.[35] A law prohibiting hiring discrimination on the basis of sexual orientation would have a much broader social impact than NYCERS' very costly campaign at Cracker Barrel.

Likewise, while Engine No.1's successful proxy contest at ExxonMobil made a big media splash, it was an extremely costly method of trying to pressure the leadership of this fossil fuel giant to pay more attention to the company's climate impacts.[36] It remains to be seen if this very costly campaign resulted in any notable improvement in ExxonMobil's climate impact. Regulation requiring that ExxonMobil and all other fossil fuel companies reduce their climate impacts would likely have had a much more sweeping impact on climate change.

Moreover, these highly motivated, well-funded shareholders can only succeed in their socially-minded shareholder campaigns when they have the legal tools necessary to use their shareholder rights for good. Many interests are not well-funded, which means that the route of

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33. NYCERS v. Apache Corp*: Remember Cracker Barrel?*, HARV. L. SCH. F. ON CORP. GOV. (Apr. 20, 2008), https://corpgov.law.harvard.edu/2008/04/20/nycers-v-apache-corp-remember-cracker-barrel/ [https://perma.cc/AY2W-VLWX].

34. *See* Matthew J. Petrozziello, *Beyond Cracker Barrel: Shareholder Proposals as a Means of Effectuating CSR Policies*, 13 RUTGERS BUS. L. REV. 22, 36 (2016); H. Rodgin Cohen & Glen T. Schleyer, *Shareholder vs. Director Control Over Social Policy Matters: Conflicting Trends in Corporate Governance*, 26 NOTRE DAME J.L. ETHICS & PUB. POL'Y 81, 120 (2012).

35. *See* L. Doron & N. Malenko, *Nonbinding Voting for Shareholder Proposals*, 66 J. FIN. 1579–614 (2011). "[T]he company's board can make its own determination as to whether adoption of all or any part of a shareholder proposal is in the company's best interest, even if the proposal received substantial majority support from shareholders." *Id.* at 1579.

36. Matt Phillips, *Exxon's Board Defeat Signals the Rise of Social-Good Activists*, N.Y. TIMES (June 9, 2021), https://www.nytimes.com/2021/06/09/business/exxon-mobil-engine-no1-activist.html (describing activist investor Engine No. 1's successful takeover of three board seats of ExxonMobil, and noting that Engine No. 1 took over the board seats in part because it felt that ExxonMobil's management was not making changes fast enough in the face of environmental concerns).

shareholder-driven activism is simply closed to those groups unless they find a benefactor. Moreover, while decades of focus on shareholder primacy in corporate governance have caused regulators to change and enact rules that would make it easier for shareholders to convey their preferences to corporate managers,[37] these tools can be and are used by all sorts of investors. Both socially-conscious investors and those with a narrow focus on shareholder returns can use proxy access, for example, to advance their aims.[38] Thus, the net effect of this type of activism probably does not favor non-shareholder stakeholder outcomes.

One additional area worth addressing is the recent interest in "meme stocks," in which large groups of retail investors on platforms like Reddit organize to move stock prices.[39] Meme stock investors have affected the stock prices of companies like GameStop, Bed Bath & Beyond, AMC Entertainment, and others.[40] The changes caused by meme stocks have caused some observers to believe that there are ways to engage a new generation of retail investors who might care about social issues.[41]

This avenue to shareholder-driven social benefits also has limitations. One limitation is a numerical one. The meme-stock trend has created the impression that the pendulum is swinging away from the dominance of institutional investors and that we are seeing a resurgence of retail investors.[42] This may well be the case, though data on the growth of retail investors in the last several years remains to be calculated.[43] However, even if retail investing is growing in popularity, it is hard to imagine that any such growth would be adequate to counterbalance the enormous

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37. Winston, *Managerial Fixation*, *supra* note 24, at 719–21.

38. Indeed, anyone can use these tools to motivate corporations to do anything. For example, a few years ago, a pair of law professors bought shares of Tejon Ranch, a public real estate company that they believed was underperforming. Their activism with Tejon Ranch was the basis of an amusing article in The Atlantic. *See* Frank Partnoy & Steven Davidoff Solomon, *Frank and Steven's Excellent Corporate-Raiding Adventure*, ATLANTIC (May 2017), https://www.theatlantic.com/magazine/archive/2017/05/frank-and-stevens-excellent-corporate-raiding-adventure/521436/.

39. *See* Sergio Alberto Gramitto Ricci & Christina M. Sautter, *Harnessing the Collective Power of Retail Investors*, *in* RESEARCH AGENDA FOR CORPORATE LAW (Christopher M. Bruner & Marc Moore, eds.) (forthcoming) (manuscript at 12), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4147388 [https://perma.cc/H7LL-PJTX].

40. *See* Jill E. Fisch, *GameStop and the Re-emergence of the Retail Investor*, 102 B.U. L. REV. 1799, 1809 (2022).

41. *See generally* James Fallows Tierney, *Investment Games*, 72 DUKE L. J. 353 (2022) (discussing in part how gamification of investing has impacted investment behavior); Kyle Langvardt & James Fallows Tierney, *On "Confetti Regulation": The Wrong Way to Regulate Gamified Investing*, 131 YALE L.J.F. 717 (2022) (discussing in part how retail investors are assessing data on to more effectively appeal to their interests).

42. *See* Sergio Alberto Gramitto Ricci & Christina M. Sautter, *Corporate Governance Gaming: The Collective Power of Retail Investors*, 22 NEV. L.J. 51, 73–75 (2021).

43. *See* Fisch, *supra* note 40, at 1840–41.

influence of large institutions,[44] especially given the United States' heavy reliance on stock markets for retirement savings.[45] People may be more inclined than in the past to purchase shares directly, but it is unlikely that this retail investing will substantially displace the trillions of dollars currently invested in mutual funds.[46]

It is true that retail investors were able to successfully exert their collective will at companies like GameStop, AMC, and Bed Bath & Beyond.[47] However, that required a substantial number of retail investors to all focus their efforts on a handful of companies all at one time. When so many retail investors are as motivated as they were to impact the stock price of those businesses, they have proven they can have real impacts.[48] However, that level of focus will not be possible across the market. Moreover, it remains to be seen whether those examples of shareholder activism were consequence of the unique circumstances of the COVID-19 pandemic—a time when people were much more focused on social media and virtual activism than they tend to be under normal circumstances.

Meme-stock investing also appears limited in the extent to which it can affect real social progress. The shareholder activism at GameStop, AMC, and Bed, Bath, & Beyond was focused on propping up floundering, outdated businesses. Despite its meme-stock popularity, Bed, Bath & Beyond recently closed all its stores nationwide.[49] This is not necessarily the

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44. *See, e.g.*, Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1 (2020) (examining the climate-related activism of institutional investors); Edward B. Rock, *Institutional Investors in Corporate Governance*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 363 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018); Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89 (2017) (identifying governance problems arising from the rise of institutional investors.); MATTEO TONELLO & STEPHAN RAHIM RABIMOV, CONF. BD., THE 2010 INSTITUTIONAL INVESTMENT REPORT: TRENDS IN ASSET ALLOCATION AND PORTFOLIO COMPOSITION 22 tbl.10 (2010).

45. *See* Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 960 (2013).

46. *See* INV. CO. INST., 2015 INVESTMENT COMPANY FACT BOOK: A REVIEW OF TRENDS AND ACTIVITIES IN THE U.S. INVESTMENT COMPANY INDUSTRY (2015). "2014 Facts at a Glance" is located on the unnumbered page after the cover, showing that as of 2014, U.S. mutual funds managed $17.9 trillion of assets. *Id.*

47. *See* Sue S. Guan, *Meme Investors and Retail Risk*, 63 B.C. L. REV. 2051, 2061 (2022). "The GameStop trading frenzy in January 2021 marked a reemergence of the retail investor in the securities markets. An unprecedented number of . . . accounts [] began trading so-called 'meme stocks'—companies that included GameStop, AMC Entertainment Holdings, Inc. ('AMC'), and Express." Fisch, *supra* note 40, at 1802.

48. *See* Ryan Clements, *Misaligned Incentives in Markets: Envisioning Finance That Benefits All of Society*, 19 DEPAUL BUS. & COMM. L.J. 1, 32–33 (2020). "[R]etail stock traders in a matter of days . . . bid up the prices of several stocks like the video game retailer *GameStop* (GME) to over 500 percent of their value." *Id.* at 32.

49. Alexander Gladstone, *Bed Bath & Beyond Shareholders to Recover Nothing Under Proposed Reorganization Plan*, WALL ST. J. (July 21, 2023), https://www.wsj.com/articles/bed-bath-beyond-shareholders-to-recover-nothing-under-proposed-reorganization-plan-6ae1130f.

type of public-minded goal we usually associate with socially-conscious investors. And, while it is conceivable that retail investors could begin to use this wave of retail energy to promote social causes,[50] their choice of causes will still not represent the populace as a whole. Owning stock requires having saved wealth that you are willing to invest in a risky asset. Most American households do not participate in the stock markets.[51] As a result, the will of energized investors does not represent the will of the populace.

Finally, retail investing comes with greater risks than investing in broadly diversified mutual funds.[52] When investors turn away from diversified funds in favor of retail investing, they are putting their savings at greater risk, risks that they may or may not fully understand.[53] Thus any social benefit from the retail investor movement must be weighed against the potential social cost of unexpectedly lost savings.

A final means by which socially minded shareholders could theoretically promote stakeholder welfare is by investing in socially conscious funds.[54] This route avoids many of the problems of both shareholder activism and retail investing. It does not require the extraordinary cost of shareholder activism. And it does not entail the investment risk of retail investing—socially conscious investment funds can be diversified just like traditional mutual funds.

The theoretical way in which socially responsible funds could improve corporate social outcomes is by raising the cost of capital for socially irresponsible companies. If investors want to invest in socially responsible companies, there are diversified investment funds that allow them to do so, and the socially responsible investors are sufficiently numerous, then more investor capital will be available for socially responsible companies. This should, theoretically, lower the cost of capital for socially responsible companies and raise the cost of capital for less responsible ones. This could then incentivize all companies to be more socially responsible.

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50. *See* Ricci & Sautter, *supra* note 42, at 7.

51. Emily Winston, *Unequal Investment: A Regulatory Case Study*, 107 CORNELL L. REV. 781, 844 (2022).

52. *See generally* BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET: THE TIME-TESTED STRATEGY FOR SUCCESSFUL INVESTING (2020).

53. *See* Tierney, *supra* note 41, at 356; Langvardt & Tierney, *supra* note 41, at 718.

54. *See* Hao Liang & Luc Renneboog, Corporate Social Responsibility and Sustainable Finance: A Review of the Literature (Eur. Corp. Gov. Inst., Finance Working Paper No. 701/2020, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3698631 [https://perma.cc/K3KF-DQCW]; Soohun Kim & Aaron Yoon, *Analyzing Active Fund Managers' Commitment to ESG: Evidence from the United Nations Principles for Responsible Investment*, 69 MGMT. SCI. 741 (2023); Aneesh Raghunadan & Shivaram Rajgopal, *Do ESG Funds Make Stakeholder-Friendly Investments?*, 27 REV. ACCT. STUDS. 822 (2022).

However, the challenge with forming these types of funds is defining the criteria for inclusion in a socially responsible investment fund. The social priorities of investors are diverse, limiting the effect on the cost of capital. For example, some investors may be interested in investing only in companies in the food industry that produce or use organic products—out of a concern about the effects of pesticides on the environment. Conversely, other investors may think that organic farming is harmfully water intensive and therefore believe that a socially responsible food company should only engage in traditional farming. If an equal number of investors share each of these views, the net effect on the cost of capital will be zero.

Beyond the diversity of opinions about socially responsible business behavior, investors may be unable to identify which funds really align with their conception of social responsibility. This is the motivation behind recent proposed rulemaking by the SEC for disclosure by "ESG" investment funds (funds that purport to employ investment strategies focused on environmental, social, and governance principles).[55] Disclosure could certainly solve some of the problems that investors face in identifying socially responsible funds. However, one of the benefits, for investors, of investing in diversified funds is the ability to outsource investment research. Thus, it remains to be seen how closely investors would scrutinize ESG fund disclosure.

B. The Limits of Refocusing on Stakeholders

In light of shareholder primacy's limits, many scholars and lawyers—and corporations themselves[56]—have argued for stakeholderism as an alternative. That is, perhaps we should turn away from our focus on shareholders and instead encourage corporate leaders to consciously account for corporate outcomes for all stakeholders. While stakeholder governance has presented a tempting alternative to shareholder primacy, it, too, has its problems.

One immediate issue is practical: Decades of shareholder primacy has led us to an era in which shareholders are quite powerful. It is this power that has allowed certain shareholders to wage the high-profile, socially minded campaigns described above, as well as many purely profit-driven shareholder campaigns.[57] But the source of this power is unique to

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55. Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices, Securities Act Release No. 11,068, Exchange Act Release No. 94,985, Investment Company Act Release No. 34,594, 87 Fed. Reg. 36,654 (Sec. & Exch. Comm'n, proposed June 17, 2022) (to be codified at 17 C.F.R. pts. 200, 230, 239, 249, 274, 279).

56. *Our Commitment*, *supra* note 8.

57. *See, e.g.*, JEFF GRAMM, DEAR CHAIRMAN: BOARDROOM BATTLES AND THE RISE OF SHAREHOLDER ACTIVISM (2016).

shareholders, who have the ability to vote out and replace directors at their target corporations.[58] No other stakeholder group possesses this power. Thus, a corporate manager who cares about their job security will rationally be hesitant to make decisions that redistribute returns from shareholders to other stakeholder groups. Operationally, asking managers to prioritize stakeholder interests also presents challenges. In some cases, it may be easy to see how managers can and should prioritize certain groups of stakeholders over other stakeholders, or over shareholders. For example, consider the managers of pharmaceutical companies like Moderna and Pfizer in 2020. They may choose to pour funding into researching and developing vaccines and treatments for COVID-19 because stakeholder needs—that is, the needs of the general public for vaccines—seems so great compared to the need to produce their regular line-up of drugs.

But outside of pharmaceutical companies operating in once-in-a-generation pandemics, it is harder for managers to identify the stakeholder group they should prioritize at any particular moment. For example, consider a manufacturer of Greek yogurt. The production of Greek yogurt has significant environmental impacts[59]—so should managers spend money researching how to reduce those impacts? Or, if there are limited financial resources, should manufacturers prioritize spending the money on higher worker wages and better benefits? Or should managers focus on more humane sourcing of raw materials, given the issues associated with the dairy industry? Or should they spend money on advertising the benefits of eating yogurt, which might yield returns for shareholders while also advancing the laudable goal of promoting healthy eating?

These questions also presume that managers act in good faith. In the age-old debate between shareholders and managers, some scholars have suggested that stakeholder theory's biggest problem is that it tips the scales in favor of managers.[60] The argument is that shareholder primacy is not ideal, but provides clear guardrails to management misbehavior.[61] Absent those clear guardrails, managers are left with wide discretion: they can claim to be looking out for a variety of stakeholder interests, while actually looking out for their own interests. In other words, shareholder primacy is

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58. DEL. CODE ANN. tit. 8, § 212 (1953).

59. Claire Maldarelli, *Greek Yogurt Creates a Ton of Wheyst—But Wheyt! There May Be a Whey Forward for All That Whey*, POPULAR SCI. (Dec. 21, 2017), https://www.popsci.com/greek-yogurt-whey-waste/ [https://perma.cc/GS6F-ZQ2H].

60. Hwang & Nili, *supra* note 2; Bebchuk & Tallarita, *supra* note 2, at 156.

61. *See generally* STEPHEN M. BAINBRIDGE, THE PROFIT MOTIVE: DEFENDING SHAREHOLDER VALUE MAXIMIZATION (2023).

a way to close the gap between principals and agents—but stakeholder theory allows manager-agents to run amok.[62]

One solution to this problem of managerial discipline is to empower stakeholders with their own governance rights so they need not rely on the benevolence of managers. Grant Hayden and Matthew Bodie have proposed one such idea: a system of "codetermination" modeled on the German system that empowers labor by granting workers seats on the board.[63] They note that empirical research on codetermination has shown a "positive effect on profitability and capital market valuation" for stakeholders.[64] But, while board representation might work well for one group of stakeholders—workers—how do other groups of stakeholders get involved? Board seats are not limitless, and it may be hard to find enough board seats to accommodate all groups. Other issues also arise—for instance, do the groups that get board seats change as companies grow and change?[65]

II. REGULATION AS A PATH FORWARD[66]

In Part I, we highlighted some of the major challenges facing shareholder theory and stakeholder theory. While we applaud efforts to expand corporate governance beyond shareholder wealth maximization, we worry that using corporate governance to motivate good corporate behavior is not the best tool. Our idea is, at its core, an argument about institutional competence. We argue that direct regulation is a more efficient and more effective tool, and urge lawmakers, voters, and academics to take seriously the urgent role of regulation in improving the social impacts of businesses in the United States.

In this Part, we discuss what role we think corporate governance should play in discussions of corporate social impacts. We then offer two reasons that regulation may work better than shareholder- or stakeholder-

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62. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 38 (1991).

63. Grant M. Hayden & Matthew T. Bodie, *Codetermination in Theory and Practice*, 73 FLA. L. REV. 321 (2021); GRANT M. HAYDEN & MATTHEW T. BODIE, RECONSTRUCTING THE CORPORATION: FROM SHAREHOLDER PRIMACY TO SHARED GOVERNANCE 173 (2021).

64. HAYDEN & BODIE, RECONSTRUCTING THE CORPORATION, *supra* note 63, at 179.

65. The problem of changing corporate purpose or focus, and how to deal with it, is a problem we see in other areas of corporate law. In the law of asset sales, however, there is the evergreen question of how to differentiate between regular run-of-the-mill asset sales, which do not require shareholder votes, and sales of all or substantially all of the assets, which do require shareholder votes. In the well-known case *Gimbel v. Signal Cos.*, for example, shareholders argued that the sale of Signal Companies' historically most important—although not most financially important—asset should require a shareholder vote. Management disagreed. Gimbel v. Signal Cos., 316 A.2d. 599 (Del. Ch. 1974).

66. *See* Matteo Gatti & Chrystin Ondersma, *Stakeholder Syndrome: Does Stakeholderism Derail Effective Protections for Weaker Constituencies?*, 100 N.C. L. REV. 167 (2021) (arguing that direct regulation will be more effective than governance reform in protecting workers).

driven corporate governance efforts in advancing social goals. The first is that corporations are different from one another, and necessarily have different social impacts from one another. Regulation, promulgated by regulators with subject-matter expertise, are better equipped than shareholders or stakeholders to push corporations toward prosocial changes that are tailored to maximize positive impact and minimize loss. Second, we argue that the goals of society, on the one hand, and shareholders and stakeholders, on the other hand, are often either substantively mismatched, or mismatched because they occur on different time horizons. The former is more worrying, as differing incentives might reasonably lead shareholders and stakeholders to push for corporations to make changes that are less prosocial and more for shareholders' and stakeholders' benefit.

We discuss each of these two rationales below in more detail. However, we emphasize that the ideas in this article are preliminary in nature. Rather than offer a comprehensive defense of regulation over governance, we offer these thoughts as a way to spark further discussion and conversation.

A. The Appeal and Usefulness of Corporate Governance

To begin, we do not mean to suggest that corporate governance is irrelevant to discussions of corporate social impacts. Corporations—or more precisely, the many humans they employ—make decisions every day that have real social consequences. They decide who to hire, fire, and how much to pay their workers. They make decisions to source inputs from suppliers that may or may not be socially and environmentally responsible. They make decisions about how to portray people in advertising, what services to provide to their customers, what new products to develop, and an innumerable number of other choices that impact human beings and the environment we live in. The way that corporations make these decisions is via their system of corporate governance.

The laws of corporate governance—enshrined in statute and the corporation's foundational documents—tell us what decisions executives can make, which decisions must be approved by the board of directors, and the limited instances in which shareholders are involved in corporate decisionmaking. So, when a corporation makes a decision that is socially harmful, understanding how that decision was made requires understanding the corporate governance structure. But that doesn't mean that changing the corporate governance structure is the path to more socially beneficial decisionmaking. For all the reasons outlined in Part I above, we cannot rely on reforms to corporate governance to improve corporate social impacts.

Corporate governance decides who gets to be involved in making decisions, but myriad pressures and considerations inform how corporate actors make those decisions. One constraint that corporate decisionmakers have no choice in considering is the complex network of laws and regulations that apply to any modern business. Corporations in the United States must comply with local, state, and federal laws that restrict corporate decisionmaking in numerous socially relevant ways such as employee rights,[67] environmental protection,[68] and consumer protection.[69] Utilizing this existing institutional regulatory structure is the most promising path to improve corporate social impacts for the reasons described in the remainder of this Part.

B. Diverse Corporate Impacts

One important advantage of using the United States' well-developed regulatory structure to improve corporate social impacts is the extraordinary diversity of corporate activity and thereby social impacts that require consideration. Within any one corporation, the constellation of corporate social impacts will be enormous. As has been described herein, corporate decisions impact employees, customers, the environment, suppliers, and communities. Corporate decisionmakers must weigh all these considerations, which can cause complicated conflicts. A decision to pay entry-level workers more can have a positive impact on recruitment, morale, and retention, which could make the corporation more valuable. But the money used to increase pay for employees can't be used for other purposes such as dividends for shareholders (who have a say in selecting corporate leadership), investment in new technology, or a transition to carbon neutral practices.

Regulation can place a constraint on this decision by, for example, setting (or increasing) a minimum wage for employees. This doesn't eliminate all flexibility afforded the corporate decisionmaker—they are still free to pay their workers above the minimum. But it does set a floor on this one social impact that applies to all corporations operating in the

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67. *See Summary of the Major Laws of the Department of Labor*, U.S. DEP'T OF LAB., https://www.dol.gov/general/aboutdol/majorlaws [https://perma.cc/CZU7-Y9MJ] (for a summary of federal level employment laws that apply to businesses, not including state or laws that businesses must follow as well).

68. *See Regulatory Information by Business Sector*, U.S. ENV'T PROT. AGENCY, https://www.epa.gov/regulatory-information-sector [https://perma.cc/V8NY-5Z8T] (for a summary of federal level environmental regulations that apply to businesses in distinct sectors).

69. *See* COMPTROLLER OF THE CURRENCY ADM'R OF NAT'L BANKS, OTHER CONSUMER PROTECTION LAWS AND REGULATIONS: COMPTROLLER'S HANDBOOK (2009) (for a summary of federal consumer protection laws that apply to banks); *Legal Library: Statutes*, FED. TRADE COMM'N, https://www.ftc.gov/legal-library/browse/statutes [https://perma.cc/UU4Q-ZTU2] (for a list of consumer protection statutes that apply to businesses more broadly).

United States or in the smaller local jurisdiction where the law was passed. We hope such a law would be made with a specific study of the social impact of wages on workers across the economy. It would thus have a much broader and clearer social impact than a corporation-by-corporation approach by which we hope the governance system of each individual corporation will be used to improve outcomes for employees.

In addition to the diversity of social impacts within any given corporation, there is also enormous diversity of social impacts across corporations. Both Pfizer and Rocket Mortgage create very important social impacts for their consumers, but protecting consumers from pharmaceutical harm and predatory lending are very different matters. The activities of both Starfish Tuna and ExxonMobil have important environmental impacts, but protecting oceans from over-fishing and protecting the atmosphere from carbon emissions are very different matters. While corporate governance is one uniform tool that many hope will reign in all these social and environmental harms, regulation can be very tailored to the specific social impacts of particular businesses and is often informed by a depth of expertise in those specific social impacts.

C. Stakeholder Interests Are Not Societal Interests

Even if we were to imagine that enough specialized expertise existed among those with decisionmaking power within a corporation to make informed decisions on all social impacts, the interests of those decisionmakers would rarely align with the interests of society at large. Corporate law, as currently written, grants three groups explicit rights to participate in corporate decisionmaking: directors, officers, and shareholders.[70] Members of these groups may well care about things other than their individual financial return. However, it is inevitable that almost all members of these groups will care at least somewhat about their own best interests, and it is probably safe to assume that most of them care a great deal about their own best interests.

Corporate directors and officers are legally bound to protect the best interest of the corporation.[71] Directors who do not do so will likely encounter trouble getting elected as directors. Corporate executives who do not strive to make the corporation more valuable will similarly find themselves difficult to employ. Frequently-used incentive compensation structures aim to align executives' financial interests with those of the

70. DEL. CODE ANN. tit. 8, § 211–233 (1953) (delineating the rights of shareholders); § 141–146 (delineating the rights and responsibilities of directors and officers).

71. *Id.* § 141–146 (delineating the rights and responsibilities of directors and officers).

corporation.[72] And, shareholders purchase shares as an *investment*, with an expectation of return on that investment. They purchase shares because they think the return will be better than if they deposited their money in a bank account or invested it elsewhere.

Although corporate decisionmakers may have some altruistic tendencies, these tendencies are tempered, or even overwhelmed by their self-interest. Even when furthering social good and financial success align, they may not do so on the same timeline. As the vast literature on "short-termism" in corporations has explored, corporate decisionmakers often cannot wait for the financial benefit of socially-conscious decisions to develop.[73] Investment in research and development of climate-friendly manufacturing practices may pay off in the long run, but corporate managers report results quarterly, and many shareholders may plan to sell before the investment pays off. This short-termism is yet another force that diminishes the power of socially conscious corporate decisionmakers.

Finally, many social issues present collective action problems which the government is best positioned to resolve. A shareholder may believe that all employees should have paid family leave. However, any one shareholder attempting to convince a company to offer paid family leave to its employees is unlikely to succeed. Even if the shareholder was willing to expend extraordinary resources to wage a successful campaign, they could only do so one corporation at a time. As such, the social return on investment is extremely limited. All of these forces will deter shareholders, or other corporate players, from using their governance role to press for social change. Government action can solve this collective action problem by mandating family leave across corporations.

CONCLUSION

In recent years, corporations' role in society has become very salient. At the same time, scholars and practitioners alike have debated whether

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72. *See* Wendy Netter Epstein, *Revisiting Incentive-Based Contracts*, 17 YALE J. HEALTH POL'Y L. & ETHICS 1, 10 (2017) ("To align incentives, shareholders may tie a CEO's bonus to stock price or profitability or give the CEO equity in the company."); Barbara Novick, *'The Goldilocks Dilemma': A Response to Lucian Bebchuk and Scott Hirst*, 120 COLUM. L. REV. 80, 88 (2020) (The "goal of any executive compensation program should be to incentivize senior executives to enhance their respective company's performance relative to prior years and its competitors for the benefit of all shareholders.").

73. *See, e.g.*, Joseph Manning, *Myopic Madness: Breaking the Stranglehold of Shareholder Short-Termism to Address Climate Change and Build A Sustainable Economy*, 10 ARIZ. J. ENV'T L. & POL'Y 425 (2020); Steven A. Rosenblum, *Hedge Fund Activism, Short-Termism, and A New Paradigm of Corporate Governance*, 126 YALE L.J.F. 538 (2017); Emeka Duruigbo, *Tackling Shareholder Short-Termism and Managerial Myopia*, 100 KY. L.J. 531 (2012); David Millon, *Shareholder Social Responsibility*, 36 SEATTLE U. L. REV. 911 (2013); Mark J. Roe, *Corporate Short-Termism: In the Boardroom and in the Courtroom*, 68 BUS. LAW. 977 (2012).

shareholder theory or stakeholder theory is the path forward. In this short contribution to the 2023 Berle Symposium, we argue that both theories have their own challenges and that regulation is the best way to align corporate incentives with societal needs.