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Reconsidering Stockholder Primacy in an Era of Corporate Purpose

Posted by David J. Berger, Wilson Sonsini Goodrich & Rosati, on Monday, March 4, 2019

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There is now a growing consensus that corporations must focus on corporate purposes beyond stockholder value. As Blackrock's Larry Fink recognized in his 2018 letter to CEOs (and largely reiterated in his 2019 letter), "society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers and the communities in which they operate. Without a sense of purpose, no company, either public or private, can achieve its full potential."[1] Similar views have been expressed by, among others, State Street, Vanguard and other institutional owners.[2]

Yet the continuing dominance of stockholder primacy ideology constrains the debate on corporate purpose by limiting the participants to stockholders, corporate leaders, corporate lawyers and scholars. Left out of this debate are the many who are significantly impacted by corporate behavior, including the communities where corporations are based, employees who rely on the corporation for the bulk of their income and wealth, consumers who use the corporation's products, and broader governmental interests who expect the corporation to follow the rules of law established by society and which lack the resources to continually monitor the corporation to ensure that the established rules are being followed. In short, the constituents identified by Larry Fink and others as being at the core of the corporate purpose debate are the same groups excluded from participating in the debate over corporate purpose.

In my forthcoming article titled Reconsidering Stockholder Primacy in an Age of Corporate Purpose I raise the issue of whether the ideology of stockholder primacy needs to be reexamined as part of the broader debate over corporate purpose. Alternatively stated, as the definition of "corporate purpose" expands to include constituencies beyond stockholders, is it time to consider expanding the definition of who owns the corporation to include corporate stakeholders central to

[1] Copies of the 2018 and 2019 letters may be found on Blackrock's web site. *See* https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter (2018 letter); https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter (2019 letter).

[2] The 2019 letter from State Street CEO Cyrus Taraporevala can be found on its web site. *See* https://www.ssga.com/investment-topics/environmental-social-governance/2019/01/2019%20Proxy%20Letter-Aligning%20Corporate%20Culture%20with%20Long-Term%20Strategy.pdf (State Street letter); *see also* Vanguard's 2018 Investment Stewardship Annual Report, available at https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2018_investment_stewardship_annual_report.pdf.

the evolving understanding of corporate purpose so that these other stakeholders can also participate in the on-going dialogue of corporate purpose?

Many of the leading technology companies over the last decade have struggled with this issue, as they have seen the public markets become more focused on short-term stockholder returns. These companies have responded in a number of ways, including by trying to avoid the public markets or by adopting alternative capital structures such as dual-class stock. In this way several of these companies were able to focus on some of the other corporate stakeholders—such as employees, communities and broader questions of society—that traditional single-class companies cannot consider in today's markets, where missing quarterly expectations can lead to stockholder activism, disruption of long-term plans and limiting necessary research costs to boost short-term stock price.

While these solutions have not worked perfectly—companies still need access to public markets, concentrating decision-making authority in a few individuals can create its own problems and some activists make valuable contributions to corporate strategy—having our public markets dominated by a handful of institutional investors and activists can be antithetical to a healthy debate over corporate purpose. As recognized in a recently released report from the British Academy, "the '*best owner*' is not necessarily the creator of the greatest shareholder value but the most enlightened and visionary deliverer of corporate purpose."[3] Ultimately, the concept of corporate ownership must correspond to corporate purpose, and as our definition of corporate purpose expands so must our definition of corporation ownership.

My article addresses two issues. First, it briefly identifies some problems caused when all corporate issues are viewed through the lens of stockholder value. Viewing corporate issues through stockholder value ignores the reality that only about half this country owns any stock. Further, even this ownership rate gets misunderstood, both because it does not differentiate between the amounts of stock held and because most people do not own stocks directly.

Again, while recent estimates show that only about half of all households own stocks, more than eighty percent of the value of the stock market is held by the wealthiest ten percent of our country; further, within that top ten percent, the percentage of stock wealth held by the top one percent is about equal to the percentage held by the remaining nine percent; and the percentage held by the entire top one percent is twice as large as that held by the entire bottom ninety percent.[4] In addition, almost all of the stock owned by investors other than the top 10% is invested in various ETFs and mutual funds, leading to a situation where a handful of institutional investors have significant control over most public companies (and this control is predicted to increase in coming years).[5]

All of this means that limiting the debate over corporate purpose to only those owning stocks (or executives in these companies) will limits the debate about corporate purpose to the wealthy who own stocks, a handful of large institutional investors and the practitioners and academics who

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[3] The British Academy, Reforming Business for the 21st Century: A Framework for the Future of the Corporation 20 (2018), https://www.thebritishacademy.ac.uk/sites/default/files/Reforming-Business-for-21st-Century-British-Academy.pdf.

[4] *See* Jared Bernstein, *Yes, Stocks Are Up. But 80% of the Value is Held by the Richest 10 Percent*, Wash. Post (Mar. 2, 2017), https://www.washingtonpost.com/posteverything/wp/2017/03/02/perspective-on-the-stock-market-rally-80-of-stock-value-held-by-top-10/.

[5] *See, e.g.*, John C. Coates IV, *"The Future of Corporate Governance Part I: The Problem of 12,"* (Sept. 20, 2018), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247337.

follow the issues. Excluded from the debate are the groups who are supposed to benefit from this broader discussion of corporate purpose, including employees, communities, consumers and others affected by corporate behavior.

The second purpose is to review some alternative structures that are currently under discussion and could significantly change the present focus on stockholder value. While there is a bit of a "chicken and egg" issue to be resolved—*to wit*, do you need a broader rejection of the ideology before you can adopt some of the changes, or will adoption of some changes to the system lead to a reconsideration of the dominant ideology—we have arrived at a point where, after more than forty years where stockholder primacy served as the dominant ideology and largely foreclosed any discussion of a broader corporate purpose, structural governance changes are now being considered to allow for a broader discussion of corporate purpose. One effect of this discussion is to raise the issue of whether stockholders should be allowed to exclusively claim the title of "owners" of the corporation. Necessarily related to this question is whether directors should be chosen exclusively by stockholders, or whether other stakeholders should have some role in the director-selection process.

Perhaps most significantly, these proposed changes are not just engaging the ideology of stockholder primacy on the basis of the "short-term/long-term" debate. Rather, the push now is on the core ideological issue, and seeks to develop structural solutions so that the board of directors represents the various stakeholders who are central to the corporation's purpose.

The complete article, to be published in the Spring edition of the *Business Lawyer*, is available here.