The case against the stakeholder capitalism model

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Question time at the McDonald’s AGM:
Don Thompson vs. the 9-year-old girl

It would be nice if you stopped trying to trick kids into wanting to eat your food all the time.

We don’t sell junk food.
Question time at the General Electric AGM:  
Jack Welch vs. the Nun

**In PCB Fight,  
It's the Nun  
Vs. the C.E.O.**

At the General Electric shareholders' meeting last month, there were several items of business likely to irritate even the most mild-mannered C.E.O.

First, there was a proposal to limit G.E.'s spending on political contributions, which the resolution's sponsor labeled "nothing more than a thinly disguised bribe."

Then there was a proposal to cap the chief executive officer's salary, linking it to the pay of the lowest janitor in the company. And finally there was Sister Patricia Daly.

Sister Pat stood up to advocate a shareholder resolution on G.E.'s pollution of the Hudson River. She called on the company to publicize the danger of eating fish from the river and to stop fostering misleading studies. And she compared the company's claim that PCB's are harmless with claims made by the tobacco industry executives about the harmlessness of smoking.

That is when John F. Welch Jr., G.E.'s chairman and chief executive, blew up.

"That's an outrageous comparison," he shouted at the nun. "You owe it to God to be on the side of truth."

As Sister Pat, a Dominican nun from Newton, Mass., recalled afterward, "He totally lost it."
Stakeholder capitalism:
“Breach of trust in hostile takeovers”
Andrei Shleifer and Larry Summers, 1988

• “... shareholder gains are redistributions from stakeholders ...
Stakeholder capitalism:
France’s 2011 dividend law

- Companies with more than 500 employees may not increase their dividends over the average of the prior two years . . .

- . . . unless they negotiate a bonus payment with their labor unions.

- Typical settlement: bonus pool = 1/3 of dividend pool
The basic problems with stakeholder capitalism

- The appropriate set of stakeholders is not clear.
- No guidance on how to balance or trade off the interests of these groups.
- Impossible to hold managers accountable for poor performance.
“The Social Responsibility of Business Is to Increase its Profits”
Milton Friedman, 1970

• “. . . to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom.”
Business is not a shadow government

• Should companies worry about the environment?
• Product safety?
• Workers’ wages?

• These are regulated by government, and should be addressed through that channel.
“Endogenous technical change”
Paul Romer, 1990

• “Technological change – improvement in the instructions for mixing together raw materials – lies at the heart of economic growth. . . .

• “Technological change arises in large part because of intentional actions taken by people who respond to economic incentives.”
Implications of Romer’s model

• Accumulation of human capital drives economic growth

• Corporate profits represent a return on households’ investments in human capital...

• ... and are distributed back to these households
“A theory of debt based on the inalienability of human capital”
Oliver Hart and John Moore, 1994

• “Consider an entrepreneur who has access to a profitable investment project, but does not have the funds to finance it.

• “... he can always threaten to repudiate the [debt] contract by withdrawing his human capital. We show that the threat of repudiation means that some profitable projects will not be financed.”
German co-determination

*Source:* Petry (2009)
German co-determination

• Labor directors are completely marginalized on the supervisory board. Little evidence that they play any role in governance.

• When firms become subject to codetermination, investment policy becomes much less risky.
Union pension funds as shareholders: How do they vote?
2003-06 data

Panel B: AFL-CIO Election Ballot Items and Voting Statistics

<table>
<thead>
<tr>
<th>Item</th>
<th>Number of Votes</th>
<th>% Support</th>
</tr>
</thead>
<tbody>
<tr>
<td>Director Nominees</td>
<td>10,407</td>
<td>65%</td>
</tr>
<tr>
<td>Stock Option Proposals</td>
<td>1,062</td>
<td>16%</td>
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<tr>
<td>Auditor Approvals</td>
<td>1,332</td>
<td>38%</td>
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</table>

Panel C: Institutional Investor Director Voting Statistics

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<tr>
<th>Fund</th>
<th>Number of Votes</th>
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</thead>
<tbody>
<tr>
<td>Fidelity Spartan Total Market Index Fund</td>
<td>7,501</td>
<td>98%</td>
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<tr>
<td>Vanguard Institutional Total Stock Market Index Fund</td>
<td>7,949</td>
<td>89%</td>
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<tr>
<td>TIAA-CREF Institutional Equity Index Fund</td>
<td>7,805</td>
<td>93%</td>
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<tr>
<td>United Brotherhood of Carpenters and Joiners of America Pension Funds</td>
<td>4,515</td>
<td>55%</td>
</tr>
</tbody>
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Source: Agrawal (2011)
Union pension funds pursue narrow objectives, unrelated to shareholder returns

Source: Agrawal (2011)