The London Business School Centre for Corporate Governance

Conference Opening

Shareholder Primacy

Shareholder Decision Rights

Employee Rights

Keynote and Q&A: The Case Against the Stakeholder Capitalism Model
The London Business School Centre for Corporate Governance

The mission of the Centre for Corporate Governance (CCG) is to use rigorous research to influence the practice of corporate governance. It provides a platform for two-way debate and the sharing of ideas between academics and practitioners. This includes holding a small number of high-quality events where leading academics, executives, investors, consultants, policymakers, and stakeholder representatives discuss topical corporate governance issues. These events are invite-only to ensure a high quality of discussion, interaction and networking.

On 10 May 2019, the CCG held an event on: “Who should run a company?” The event aimed to debate the fundamental concepts behind shareholder primacy and the current drive towards stakeholder capitalism. It addressed questions such as: Is shareholder primacy still desirable and efficient? (How) can purpose be pursued under a shareholder model? Are shareholders undermining the interest of other stakeholders or do shareholders actually increase total stakeholder wealth? Should employees or other stakeholders have formal decision rights? The conference explored these questions and provided perspectives from both academic research and business experience.

The event was organised by CCG Chairman Paul Coombes, Academic Director Alex Edmans, Executive Director Nicole Hergarten-Tucker, and Executive Fellow Tom Gosling, in conjunction with Clifford Holderness, Professor of Finance at Boston College. It was generously co-sponsored by Norges Bank Investment Management. We are grateful for the insights of all our participants, and to Freya Oehl, a student in the LBS MFA Class of 2019, for writing this report.
Conference Opening
Alex Edmans, Professor of Finance at London Business School and Academic Director of the CCG, opened the conference by stating that it aimed to discuss the fundamental questions of who should run a company and who should a company be run for. He argued that many political developments such as Brexit and populism are reactions to the perception that corporations are too focused on short-term shareholder returns at the expense of wider society. While most people agree that it is critical for business to regain the public’s trust, they disagree on how businesses should change to restore trust. The goal of the conference is to share both academic and practitioner perspectives on this important question.

Alex Edmans
Professor of Finance and Academic Director of the Centre for Corporate Governance at London Business School
Shareholder Primacy

Diane Denis
Katz Alumni Professor of Finance, University of Pittsburgh

Tom Gosling
Partner, PwC
Executive Fellow at London Business School

Mark Garratt
CFO, Harvey Nash Group

Conor Kehoe
Senior Partner Emeritus, McKinsey & Company

The first panel discussed shareholder primacy and started with a review of the academic research by Professor Diane Denis. Diane argued that there is less conflict between shareholder governance and societal goals than often perceived. Tom Gosling then introduced the panel discussion with Diane and two practitioners, Mark Garratt and Conor Kehoe. Tom asked the panellists a variety of questions related to how stakeholder needs are respected under the shareholder primacy model.

Diane opened her presentation by stating that “corporations have an image problem.” Many members of society, including politicians, view corporations as villains and hold them accountable for excessive market power, a lack of accountability and societal ills such as income inequality and environmental decay. Further, corruption and fraud seem to be endemic to corporations. However, she argued that many of those negative views stem from misinterpreting the traditional corporate governance model as assuming that only shareholders matter. Diane claimed that shareholder primacy is a “misnomer” – shareholder value maximisation does not imply that shareholders are more important than other stakeholders; indeed, shareholder and stakeholder models are less in conflict than often believed. She defended shareholder value maximisation by arguing that 1) shareholder wealth maximisation has positive implications for other stakeholders and 2) outside influences such as media and government can guide management to improve outcomes for society.

1) Implications of shareholder governance for other stakeholders
To buttress her claim that the stakeholder and shareholder models need not be in conflict, Diane used the example of employee compensation. Both shareholders and stakeholders have incentives to ensure that market wages are paid – shareholders wish to avoid underpayment to prevent low quality work and stakeholders wish to avoid overpayment to ensure long-term employment opportunities. Alex Edmans’ research indicates that firms with high employee satisfaction outperform their peers by 2.3-3.8%, giving shareholders incentives to treat their employees well.

In addition, both models are interested in long-term corporate success. Academic evidence suggests that the value of shares reflects long-term expected cash flows. For example, announcements of long-term investments increase the stock price, suggesting that the market looks beyond the short-term cost. Consequently, even short-term shareholders are interested
in the long-term. Further, even though shareholders have the flexibility to exit investments, this exit is rarely at no cost because market prices react quickly. She finished her argument by noting that shareholders are often portrayed as an exclusive group, but most stakeholders can easily become shareholders – again reducing the potential conflict.

2) Outside Influences
Diane’s second argument stressed that managers do not operate in a vacuum and are influenced by media and government. The media has indirect influence by shaping opinions and disseminating information – for example, it has strengthened the importance of CSR. The government has direct influence via taxes and regulations. Government intervention can address externalities, information asymmetries and corruption, but unintended consequences need to be considered.

Diane’s final point was that the shareholder governance model provides management with a clear decision rule – shareholder value maximisation. This rule protects stakeholders and shareholders from self-interested management actions and reduces agency problems. Importantly, Diane stressed that the shareholder governance model is far from perfect – it needs to be made more effective by companies understanding that treating stakeholders well is in shareholders’ interest, closely monitoring their societal impact, and transparently reporting on this impact. Diane closed her talk by highlighting how shareholder governance is crucial for corporate success, and how corporate success is crucial for societal success by providing employment and economic growth. She argued that “good of a corporation and good of society are not in conflict all that often.”

Tom, chair of the panel, opened the discussion by asking for reflections on Diane’s presentation. Mark replied that, throughout his career, working for a company that had a purpose other than profit maximisation has been crucial for him. Mark disagreed with Diane on several points. First, he claimed that it is inequitable for any increase in firm value to go entirely to shareholders, while stakeholders get just more than what they could get somewhere else. He suggested reward structures to distribute extraordinary profits more widely, for example through employee bonus schemes. Second, he argued that shareholder returns should be limited given shareholders’ ability to liquidate positions at any time. Third, it is not an advantage to have a single decision rule (shareholder value maximisation) because management is capable of optimising multiple objectives.

Diane addressed Mark’s first argument by stating that, under shareholder governance, investors only receive fair compensation for the risk they bear, not extraordinary compensation. It’s true that unexpectedly high profits flow to investors, but unexpected losses are suffered by investors, so on average they receive fair compensation. Further, she explained that the shareholder governance model doesn’t rule out a company having a purpose; it’s simply a rule to guide managers in discretionary decisions.

Conor agreed with Mark that a company with no social purpose will ultimately fail. However, purpose and surplus maximisation are compatible in his view. Most of the corporate surplus is reinvested by the company, thus allowing it to expand and shareholders to benefit at the same time. Conor also agreed on the criticality of a corporate purpose but argued that it is not in conflict with profit; instead, profit generation is a “happy consequence” of following the corporate purpose.
Conor highlighted the benefits of a shareholder-focused board. Ironically, while the UK and the US are questioning shareholder capitalism, Japan is currently encouraging it to improve its long-standing productivity problem. He pointed to how shareholder primacy has historically created value by breaking up unprofitable conglomerates in the US in the 1970s. The shortcomings of shareholder capitalism result from flaws not in the principle but in the execution, which he referred to as a “transmission problem” – under-resourced and undermotivated investors electing an disengaged board of directors. Many investors, including index funds and closet indexers, who often hold a significant share of corporations, are generally little involved in corporate decision making as they are spread too thinly to analyse each company in depth. Instead, they often delegate voting to proxy agencies. Conor quoted the Kingman Review, which concluded that investors are often too disengaged to supervise auditors – so other agents should undertake this duty.

A second problem is that boards tend to be under-resourced. Board members tend to spend little time on the company (less than 20 days per annum) despite research showing a significant positive relationship between director effort and corporate performance. Moreover, studies reveal that poor board engagement yields negative corporate outcomes. Conor suggested two market solutions to solve the transmission problem: shareholder activists and private equity. A shareholder activist on the board of a FTSE 100 company has significantly enriched board discussions, causing better company performance.

Tom asked the panel whether shareholder wealth maximisation leads to optimal social welfare or instead stakeholders being disregarded. Diane argued that, because companies have a better understanding of their operations, they – not the government – should make corporate decisions. Regulatory capture has shown that the government cannot protect stakeholder interests on its own. Instead, the market can do so with increased information availability such as ESG ratings.

Tom then asked Diane whether it was acceptable for companies to lobby aggressively against regulation that was clearly in the public interest, such as pollution restrictions. Diane said they should be entitled to express their views if the regulations would destroy value. Conor agreed, but cautioned that companies will face a backlash if they overdo it. A single-minded pursuit of shareholder wealth maximisation might be counterproductive when the public is expecting companies to take seriously their impact on society and the environment. Mark caveated that public backlashes against neglectful companies don’t always work, but Conor argued that the internet and social media has made consumers more powerful in enforcing backlashes.

An audience member asked the panel what exactly they mean by value. Conor replied that shareholder value maximisation refers to discounted cash flows, but feels to him more like a discipline than a goal. He argued that investment decisions are not driven by models showing that they will increase shareholder value. Instead, they are driven by ideas, such as the investment being consistent with the firm’s purpose. The model only comes later, to check that the investment will not destroy value. Thus, even if “the wording is” that board members optimise shareholder returns, many factors influence decisions in reality. Mark added that it is impossible to maximise shareholder value because the outcomes are always uncertain, and forecasting horizons are limited. Decisions are often made by considering the optimal choice from a portfolio and weighing each against the opportunity costs.
Shareholder Decision Rights

The second panel discussed which decision rights shareholders should reserve and how shareholder decision rights can increase returns. Professor Clifford Holderness opened the discussion with a review of the academic research on the effect of requiring shareholder approval for equity issuances and M&A. Will Hutton then introduced the panel discussion with Cliff and two practitioners, Daniel Godfrey and Carine Smith Ihenacho. Will asked the panellists a variety of questions related to shareholder rights and whether shareholders should vote on a company’s purpose.

Cliff started by explaining how, in any capitalist system, the main decision makers should bear the wealth effects of their decisions. Since shareholders are the residual claimants, they are affected by any changes in firm value and so should have primacy over other stakeholders. Thus, in the Anglo-American system, they elect the board of directors, which has the rights to manage a corporation. Cliff then compared shareholders to property owners. “A homeowner should put a new roof on his house when the increase in value for the renovated house exceeds the cost of the renovation.” Moreover, like shareholders, a homeowner will delegate certain decisions by selecting a contractor (the analogy of a board) to re-roof the house, but the homeowner may also maintain some veto rights on decisions, such as the choice of tiles. Shareholders elect a board of directors and delegate corporate decisions to it, but may similarly maintain veto rights. The question Cliff asked was: When should shareholders delegate decisions and when should they maintain veto rights?

Cliff introduced a spectrum of different shareholder decision making approaches:

*Spectrum of Decision Delegation*

| SH make all corporate decisions | SH engage in major corporate decisions | SH engage in acquisition decisions | SH only elect a board of directors (Republican) |

The right-hand side indicates a complete delegation of all decisions and is also referred to as the Republican approach. The left-hand side indicates that shareholders engage in a variety of corporate decisions from the recruitment of a CEO to the design of a company logo. This is
only feasible for a very hands-on investor, such as in private equity. For most public companies, this approach is not feasible. Thus, intermediate approaches allow shareholders to participate in major corporate decisions such as equity issuances. Cliff discussed recent academic research on the effect of 1) shareholder approval on equity issuance and 2) shareholder approval of acquisitions.

1) Shareholder Approval on Equity Issuance:
Cliff revealed that shareholder rights to approve equity issuances vary across countries. While shareholders have to approve equity issuances, for example, in Malaysia and Singapore, shareholder approval typically is not required in the United States. Based on those geographically different regulations, Cliff revealed that, in countries where shareholders vote on equity issuances, the average return is a positive 2%. In contrast, in countries where managers unilaterally issue equity, the return is minus 2%. Cliff further classified each country into five classes based on shareholder vote intensity with 1 being no shareholder vote and 5 requiring a supermajority vote. The higher the shareholder approval, the higher the market response.

A potential concern is that the differences in returns to equity issuances might stem from cross-country differences other than shareholder approval rights. Thus, Cliff investigated within individual countries. For example, in Hong Kong, he found positive returns to private placements and public offerings which must be approved by shareholders, but negative returns for rights offerings, which do not need shareholder approval. Another finding of Cliff’s paper is that managers try to avoid shareholder voting. In the US and Australia, private placements exceeding 20% and 15% respectively need to be approved by shareholders. Managers tend to avoid shareholder voting by clustering below 20% and 15%. Overall, Cliff concluded that allowing shareholders to retain veto rights on major equity issuances creates value.

2) Shareholder Approval of Bidding Company in Acquisitions:
Cliff presented research by Becht, Polo, and Rossi showing that, in countries where shareholders do not have the right to approve M&A, the returns to M&A are significantly lower than in countries where shareholders have veto rights. He used the post-merger performance of Kraft’s acquisition of Cadbury as an example of a bad merger that can occur when managers do not face shareholder scrutiny.

He concluded that the Republican approach does not seem to be ideal as data on equity issuances and acquisitions suggests that shareholders should maintain voting rights on those decisions. However, “one size does not fit all”. Shareholders, he claimed, are the owners of the company and have to be proactive like any property owner and must “engage at the right time in the right way.”

Will, chair of the panel, opened the discussion by asking for reflections on Cliff’s presentation and whether shareholders should vote on purpose.

Carine agreed with the importance of engaged shareholders reflecting on Cliff’s research and stressed that “we at NBIM take our decisions rights very seriously and our objective is to vote at all shareholder meetings.” Underlining her claim, she revealed that the fund voted on over 113,000 resolutions in more than 11,000 shareholder meeting last year. Further, she reflected
that 50% of the voting decisions were related to board member elections. Carine and Cliff agreed that, to allow the delegation of many decisions to the board, the election of an efficient board is crucial. Carine stated that NBIM focuses in board elections, in particular on 1) industry experience, 2) time commitment 3) and independence. Her second criterion was consistent with Conor Kehoe’s argument from the first panel claiming a positive relationship between board members’ engagement and corporate performance. Board members are further required to ensure sustainability by operating according to responsible business practices related to human rights, transparency, taxes and transparency, and environmental concerns.

Will then asked whether shareholders should vote on a company’s purpose. Carine responded that, as a long-term investor, sustainable business practices are crucial for long-term financial success and that NBIM holds a constant dialogue with the boards including issues related to the corporate strategy and purpose of companies. NBIM holds around 3,200 company meetings a year. Daniel expanded on Carine’s comment and argued that a clear purpose is crucial. However, he argued that shareholders should engage in a softer way with management, with regular meetings to discuss purpose matters, rather than through voting on purpose.

Daniel added that an objective board and proactive shareholders with veto rights are the right structures to create sustainable wealth. However, he stated that the system does not work in the absence of corporate governance. Daniel referred back to Conor’s argument of a transmission problem from the first panel. However, Daniel argued that Conor’s transmission problem – disengaged shareholders and board members - was a “symptom” of the deeper problem of short-term investment horizons. As a solution, he proposed long-term absolute, risk adjusted fund performance measures rather than short-term benchmark comparisons. Thus, “shareholder decision rights are appropriate to deliver the best outcome”, but the investment chain does not utilise those veto rights correctly.

Will then asked the panellists on which matters shareholders should maintain veto rights. Cliff and Carine acknowledged the current a trend towards more decision rights for shareholders, with the introduction of shareholder voting on executive remuneration in an increasing number of markets. In Cliff’s opinion, the idea of voting on social outcomes is increasing (referencing a recent paper by Hart and Zingales), and he argued that shareholders should vote on acquisitions. Carine, on the other hand, mentioned capital allocation matters as important voting items. She further stressed that investors often take many different considerations into account when taking their voting decisions, and the ultimate vote can reflect the overall satisfaction with the board rather than the performance on the specific voting item only.

An audience member asked Carine how NBIM ensures that board members are acting in investors’ interest. She replied that NBIM evaluates the performance of board members and owns a large data pool on individual board members and their attendance at board meetings.

Another participant asked whether purpose or profit should be the first consideration of a business model. Daniel argued that purpose should be first as a business can only be successful in the long-run when serving a societal need. He criticised the common practice of referring to sustainability issues as “non-financial”. He argued that, in the long-term, all sustainability issues have material financial impact since they affect corporate performance.
The afternoon panel discussed the advantages and disadvantages of board-level representation (BLER) and debated alternative ways for employee voice to be heard other than BLER. Professor Ernst Maug started by reviewing the academic evidence on BLER and concluded that it reached mixed findings. Professor Michael Parke then introduced the panel discussion with Ernst and two practitioners, Cynthia Gordon and Robert Welch, who shed light on how employee voice is represented in practice.

Ernst opened the discussion by describing two forms of employee representation, namely board-level and plant-level representation. He stressed that employee representation has become increasingly common since the 1970s. Today, plant-level representation is common among all OECD countries apart from the United States and Singapore and has helped to develop increasingly favourable employee terms.

Ernst summarised the academic research for and against employee codetermination. The model of Pagano and Volpin showed that codetermination could lead to management entrenchment, as workers protect underperforming managers from value-adding takeovers in return for high pay. Alchian criticised codetermination more heavily by labelling it a “wealth confiscation scheme.” Fauver and Fuerst, on the other hand, presented evidence suggesting that cooperation between management and employees can improve resource allocation.

Ernst then introduced his 2017 paper which argued that BLER may facilitate risk sharing in firms and enforce long-term agreements between workers and the firm. It is more efficient if diversified shareholders bear risk rather than undiversified employees and optimal agreements would provide workers with employment insurance against an insurance premium in the form of lower wages. However, workers run a risk: they may give up a portion of their wages in the hope for future employment insurance, but the firm may later decide not to honor the agreement. Thus, BLER has a role by being a way to commit the firm to long-term employment contracts.

To study whether BLER indeed does provide employees with insurance, it’s insufficient to compare firms with and without BLER, since these firms may differ in many ways, and it’s these differences - rather than BLER - that drive firing behaviour in a downturn. Thus, Ernst
and his coauthors make use of a law in Germany which “exogenously” affects whether firms have BLER – those with over 2,000 employees need to have 50% labour representation on the supervisory board (compared to 33% for those below). Whether firms are just above or just below the size threshold is essentially random, and uncorrelated with other differences. They found that companies without BLER decreased employment by 12% in times of extreme industry shocks, while those with had no change. However, BLER only protects white-collar and skilled blue-collar workers, not unskilled blue-collar workers. This difference stems from the identity of the employee representatives. None of the employee representatives in his sample of 142 firms had an unskilled blue-collar background, so they didn’t protect such workers.

Turning to the benefits to the firm, the study found that workers are willing to accept about 3%-3.5% lower wages in exchange for codetermination and thus long-term employment insurance. These lower wage costs have to be weighed against the inability to fire workers in downturn. So, what’s the overall effect of BLER on firm value?

Ernst and his co-authors looked at measures of firm valuation and profitability and found no evidence for an impact of BLER on either. Further, he reviewed a range of prior studies. E.g., a paper by Stefan Petry claiming that the introduction of codetermination laws in Germany reduced stock returns by 1.5%. However, he argued that the market reaction could be influenced by other variables and does not yield conclusive evidence against BLER. Further empirical studies analysing productivity and valuation multiples also had mixed results. Moreover, Ernst discussed how there is no clear evidence based on revealed preferences. Companies never opt to use BLER voluntarily, but they also don’t actively try to avoid BLER, because there is no clustering of firms just below 2,000 employees. This isn’t because it’s difficult for firms to manage their headcount – such clustering does exist for other regulations tied to employee numbers. Since managers neither adopt nor avoid BLER, this suggests that there is no clear effect on shareholder value.

Ernst further argued that employee representation only works if it is counterbalanced by strong shareholders. He used the example of the Volkswagen “Dieselgate” scandal. Over 70% of Volkswagen’s votes were held by the Porsche family and the State of Lower Saxony, neither of whom engaged in active governance. This allowed VW’s former CEO, Martin Winterkorn, to get strong support from the head of the works council who in turn obtained a huge salary of up to €750,000 – substantial for a mechanic. Thus, a combination of a weak ownership structure and strong employee representation can yield negative consequences.

Michael opened the panel by asking the practitioners for their experience with employee codetermination and their opinion on the effectiveness of BLER. Cynthia argued that employee representation is morally the right thing to do but practically not the most powerful tool. She considered the whistleblower approach to be superior in initiating controversial board discussions. Moreover, she claimed that board members have the responsibility to represent employees’ interests. They should develop a strong network in the company to gain a deep understanding of its employees and thus be able to represent them at board level.

Robert agreed that it’s the role of board members to represent the interests of employees – as well as other stakeholders. He favoured a non-prescriptive approach to employee representation due to the lack of empirical evidence on its effectiveness. Drawing on his
experience from FirstGroup, he claimed that employee board representation can work, but it is not the only way to achieve employee voice. At FirstGroup, BLER has a long-standing history and is viewed as a core strength of the company, but it required significant investment over a long period of time to get to this position. Tesco, on the other hand, seeks employee voice through a cascade approach from the store level to the national level, as well as speak-up helplines and an internal company platform similar to Twitter. In light of the 2018 UK Corporate Governance Code, Tesco will also be introducing regional colleague contribution panels to be attended by an independent non-executive director.

Michael asked for Ernst’s view on alternatives to BLER. He agreed with Cynthia that employee welfare is the responsibility of the full board and cautioned with it being delegated to an employee representative. Many representatives are professional managers with no close relationship to the shop floor. Labour representatives often come from the union and have no company specific knowledge. Thus, they may not necessarily represent the interest of employees of a particular company.

Michael then asked whether employees should be included in all decisions or only certain decisions. Cynthia and Robert argued for the former. Robert referred back to FirstGroup and claimed that their employee representative actively participated in all meetings and was often more engaged than other board members. Ernst disagreed and claimed that certain decisions such as executive pay should not be made by employee representatives. Robert, however, argued that including employee board representatives in executive pay decisions has been successful in his personal experience. It helped to communicate the rationale for executive pay across the corporation and led to better understanding by employees.

An audience member asked whether one employee board-level representative would be sufficient to represent employee interests. Robert argued that it can be if the workforce is homogenous, as in FirstGroup. If the workforce is more heterogenous such as at Tesco, it becomes more difficult.

Another participant asked how employee representatives should be selected and whether they should be appointed by the board. Robert argued that the success of FirstGroup’s employee representative was that he was appointed by the employees rather than management.
Professor David Yermack critically examined the stakeholder governance model and highlighted several drawbacks. Andrew Palmer then interviewed David on how shareholders and the government affect other stakeholders.

David opened his discussion on stakeholder capitalism by referring to Milton Friedman’s famous 1970 opinion piece, ‘The Social Responsibility of Business to Increase Its Profits’. This article claimed that the purpose of business is to “make as much money as possible by conforming to their basic rules of the society both those embodied in law and those embodied in ethical custom.” Drawing upon Friedman’s ideas, David argued that profitable businesses are crucial to achieving societal goals such as high income for workers, clean air and safe, high-quality products. Moreover, he argued that “business is not a shadow government” and that the political system is responsible for addressing issues such as unequal pay, pollution and safety. A business should only focus on profitability as it is the social outcome most within its remit.

David then discussed two examples of shareholder involvement in corporate governance to highlight the unintended consequences of pursuing social objectives. Two shareholders, a nine-year-old girl and a Roman Catholic nun, asked provocative questions during the annual general meetings of McDonald’s and General Electric, respectively. The nine-year-old girl addressed nutrition issues by telling the CEO that “it would be nice if [McDonald’s] would stop trying to trick kids into eating [their] food all the time.” The nun complained about GE’s pollution of the Hudson river. While the resolution of both claims might be in the interest of society, governments have established dedicated institutions to resolve such issues, e.g. the environmental protection agency or food and drug administration. Both shareholders were actually planted by stakeholders and asked to advance policies that would be against shareholder interest. If McDonald’s stopped selling food to children, sales would decline, ultimately hurting investors. Even though both cases created intensive media attention, they did not effectively resolve the problems raised. David concluded that it is the role of the government to mitigate externalities.

David provided an overview of the academic literature on the stakeholder model. Larry Summers and Andrei Shleifer first introduced this model in 1988, arguing that, in certain
circumstances, the government should allow corporations to implement takeover defences to protect employees from being fired post-acquisition. However, David pointed out that there was very little empirical evidence in support of this theory. Despite this, the paper turned out to be influential. For example, the French government made it illegal for corporations to increase their dividends unless employees’ compensation is increased at the same time. David explained that this law does not achieve its purpose of helping employees. In the long-run, it increases the cost of capital for French companies, reducing economic growth and thus job creation. While politicians accuse companies of being short-term oriented, such a law ironically yields short-term gains to employees yet costs them in the long-term.

He then highlighted two significant problems of stakeholder capitalism: an identification problem and a trade-off problem. He described stakeholder capitalism as “a situation where there are more unknowns than there are equations” and thus “there is no way to figure out what should be optimised”. David related to Diane’s presentation from the first panel and claimed that it is difficult to identify all relevant stakeholders. There is a long list of stakeholders, from obvious ones such as employees to less obvious ones such as tax collectors in other countries. Moreover, in the absence of guidelines on how to trade-off the interests of different stakeholder groups, the stakeholder model becomes unimplementable. Additionally, David argued that stakeholder capitalism can allow managers to be unaccountable, since they can always claim that they have helped one stakeholder group. For instance, if a firm has failed to control labour costs, profitability will suffer, but managers can always argue that they have pursued stakeholder value since employees have enjoyed above-industry wages. David concluded that it is a “nice idea to make everyone rich, but if firms fail to earn the same return on capital as their peers, they will eventually be driven out of business and workers will earn nothing”.

David then introduced the research of two Nobel prize winners to argue against increasing stakeholder returns at the expense of shareholders. Paul Romer highlighted how households supply both labour (as employees) and capital (by saving for retirement). If firms pay excessive wages, profits will fall, thus hurting the return on household savings. Oliver Hart argued that capital should earn a higher return than labour because labour is flexible – workers can leave a corporation any time while capital is permanent. Shareholders can only sell their shares if they can find a buyer, while workers can leave unilaterally.

David next discussed the academic evidence on the effects of codetermination. He referred back to Ernst’s presentation and Stefan Petry’s paper. As Ernst described, once a German company employs more than 2,000 workers, BLER increases from 33% to 50%. David pointed out that risk-taking behaviour drops, reducing economic growth, entrepreneurship and innovation. He then discussed unpublished research by himself and Jens Martin which concluded that “labour directors are completely marginalised on the supervisory boards and there is little evidence that they play any role in governance.” Ashwini Agrawal analysed the voting patterns of labour unions that are also shareholders. He found that unions supported 65% of director nominees, compared to 80-90% for other institutional shareholders. Moreover, unions accepted stock option proposals only 16% of the time and the auditor approval rate was only 38%. The voting results further showed that the union was pursuing narrow objectives only related to its own agenda, rather than that of other shareholders or even stakeholders. Board members were not selected objectively and based on performance, but based on whether they belonged to a union or non-union firm.
David concluded that power-sharing in a stakeholder model has been unsuccessful in the United States so far, citing failures such as United Airlines. He described little political support, even from left-wing politicians, to embrace such a model—it is no surprise that US has no BLER and is the strongest and best-performing economy. David closed his presentation by referring back to Friedman, claiming a need for profitable businesses to achieve positive outcomes for society. David argued that shareholders ensure profitable businesses due to their permanence, better incentives and better information. If shareholders don't have the last say, there won’t be productive businesses resulting in fewer jobs, lower wages, and unsafe products.

Andrew Palmer started the interview by questioning what would happen if shareholders’ objectives changed. He argued that Larry Fink, CEO of Blackrock, could make purpose instead of shareholder value the centre of Blackrock’s investment strategy. David explained that Larry Fink indeed wrote a letter to CEOs asking them to run their businesses in a sustainable manner. But he argued that it is not actually desirable for all businesses to be sustainable. He contended that Kodak, a film company, is no longer needed in society. It should have paid out high dividends to free up capital, which could have been reinvested elsewhere, instead of its failed attempt to reinvent its business model.

Andrew then asked David whether shareholders maximise long-term or short-term value. David disagreed with the frequent distinction between the long-term and short-term. He argued that there exists only long-term value maximisation, because the stock market takes long-term cash flows into account. For instance, Uber is valued at $70 billion despite making substantial losses. Thus, managers have no incentives to sacrifice long-term value for short-term gain. Instead, they have incentives to make long-term investments, such as improving the labour force and product quality, but such investments should be evaluated in a rational way by assessing their effect on shareholder value, rather than using vague notions of purpose.

Andrew questioned David’s claim that policy is the job of the government, arguing that companies influence governments by lobbying, or circumvent government policy via tax avoidance. David agreed that lobbying is generally undesirable, and stressed that it is a regulatory failure caused by the corruption of politicians and business leaders. He claimed that companies should only engage with the government by providing information, as they have better insights on their operations. He acknowledged that the government should tax any externalities, such as carbon emissions to ensure environmental protection.

Andrew then pointed out that the shareholder primacy model may itself suffer from a lack of clarity, since both Unilever and Kraft Heinz are shareholder-run companies yet operate quite differently. David attributed this difference to differences in their shareholders. Oliver Hart’s research assumed a single homogenous shareholder group, but in reality, there are heterogenous shareholder groups who may pursue different policies. For example, family ownership may prioritise having a family member as CEO even if this is not efficient.

An audience member asked David how we can ensure that board members represent employee interests. David argued for an increase in accountability of all corporate directors as board members are often underprepared and unengaged. Some board members free-ride
on others and, as board size increases, free-riding becomes easier. He pointed to one of his early papers showing a lower market valuation of companies with a large board of directors. Thus, he argued that it would be good if directors would be encouraged to engage and their impact tracked.

Alex Edmans agreed with David that capital is permanent while labour is flexible, but pointed out that many people argue that employees have longer-term horizons than shareholders. For example, Martin Wolf claims that markets are liquid and efficient and thus shareholders can easily sell capital whereas workers face relocation costs. David referred to the Romer model and argued the relocation problem is well known. People have the option to acquire skills to improve their human capital and their mobility. He argued that society should not pay for people’s failure to invest in their human capital.