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On the Purpose and Objective of the Corporation: Developments of an Evergreen Debate.

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INTRODUCTION

The public company is commonly deemed the idiosyncratic result of US managerial capitalism, embodying the core and dominant features of separation between property and control and large dispersed ownership. The corporation personifies the means through which the association of many produces a unique personality capable of pursuing policies and carrying out complex actions and operations towards the achievement of objectives. In doing so, it affects a multitude of actors, including shareholders, creditors, employees and communities, who realize their interests within the corporate entity, participate in the corporate life or at least have some concern in the corporation's stable endurance in the long-run. The need for an efficient realization of the business purposes has been shaping a model of corporate governance which lowers costs associated with the decision-making process by entrusting an intermediate directive body with the function of running the corporation. The corporate governance framework has been object of a series of positions concerning the priorities and the corporate constituencies which should be on top of the managerial agenda. Between 1970s and 1980s, the affirmation of the notion that corporate executives are agents accountable only to shareholders contributed to the rise of shareholder value as dominant doctrine and model, addressing shareholders as the owners of the corporation and corporate executives as fiduciaries in charge of accomplish their interests and welfare. Such views were vastly reinforced by a strong incentive system posited by the law and courts ruling in cases and became rooted to a wide degree in the culture of US executives, reflecting on a profit-oriented managerial conduct. Criticisms associated with the shareholder primacy dogma and short-term value creation have been basing their counterargument on the fact that multiple stakeholders converge in the corporation as an entity, therefore managerial priorities should be set in favor of a broader set of interests to be considered and of creating shared value for corporate constituencies in a more collective sense. The perception of the need of embracing more inclusive, sustainable and long-term oriented practice for the benefit of all those who are affected by the corporation and that corporations should adopt a perspective of social responsibility beyond shareholders' interests has been

recurring to a wider degree in the last two decades, due both to historical circumstances and to rich theoretical contributions. The articulation of the chapters of this analysis will be assessed as follows. Chapter I will examine the public company in its historical developments and parallel corporate governance transformations. Chapter II will provide an overview of the contemporary patterns regarding corporate purpose and the theoretical framework surrounding the last decades scenario within the corporate governance of public companies. Chapter III will draw a parallelism with the legal context on multiple levels and jurisdictions: state law, examining Delaware law's incentives and constraints; British law, in order to provide an insight of the Enlightened Shareholder Value approach; federal law, which will serve to illustrate the dichotomy between federalization and state law. Chapter IV will infer some final considerations.

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I. *The public company transformed.*

1. Introduction to the *Berle-Means corporation.*

The public company has been widely recognized as the product of managerial capitalism and, most crucially, as crowning jewel of corporate governance: the benefit of centralized authority reduces the inefficiencies associated with shareholders' decision-making and, consequently, the costs of coordination and internal information[1].

[1] Kenneth J. Arrow, *The Limits of Organization* 68–70 (1974) ("the centralization of decision-making serves to economize on the transmission and handling of information"); *See also* Michael P. Dooley, *Two Models of Corporate Governance*, 47 Bus. Law. 461, 487 (1992).

Notably, the *Berle-Means corporation*[2] (as the public company was called after the exquisite theorization of the homonymous authors) personifies "the dominant form of enterprise in the United States"[3], where separation of ownership and control has fragmented the nature of investments, shaping a group of rationally apathetic shareholders[4].
The public company, as it might be observed today, embodies a quintessential element of US corporate culture, nevertheless, in order to have an understanding of the contemporary patterns that it has been experiencing, it necessary to think of it dynamically and in line with the evolution of key features within the environment in which it has formed, namely the American market, regulatory context, role of internal components (boards and shareholders).
In fact, as can be inferred from the following extract by Brian Cheffins, the *Berle-Means corporation* has undergone a path of historical and economic vicissitudes, which legitimized its dominance over the second half of the 20th century:

> The transformation the public company has undergone since the mid-twentieth century is a fascinating one. There have been scandals, political controversy, wide swings in investor and public sentiment, mismanagement, entrepreneurial verve, noisy corporate "raiders," and various other larger-than-life personalities. Ascertaining how and why the public company has been transformed, however, is currently a challenging task[5].

The fervent enthusiasms for the golden era of corporate executives in 1950s and 1960s intersected controversial criticisms about managerial discretion and the role of corporations in the society. In parallel to the metamorphosis of the publicly traded corporation, a debate has surged, almost as a natural consequence, about the purpose and objective of the corporation: whether the pursuit of shareholder wealth should be deemed as the sole end of managerial discretion or if this is the case for broader values,

[2] *See e.g.,* Adolf A. Berle & Gardiner C. Means, *The Modern Corporation and Private Property* 110 (1932).
[3] *See e.g.*, Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 Columbia Law Review 10, 67 (1991); *See also* Brian R. Cheffins, *The Rise and Fall (?) of the Berle-Means Corporation,* 42 Seattle U. L. Rev. 445 (2019).
[4] Berle & Means, *supra* note 2.
[5] Brian R. Cheffins, *The Public Company Transformed* 2 (2018).

such as stakeholder or societal concerns, to emerge as new corporate priorities. This framework represents the "hot topic in corporate governance"[6].

This chapter will provide an insight of the most relevant highlights of public company and, along with it, of corporate purpose, transformation from the Managerial Capitalism era to the early 2000s, when a series of corporate scandals have called for the reassessment of corporate priorities and of the concept of corporate purpose.

Parallelly to the historical path, it will be examined how corporate governance has aligned to such transformation by setting a system of incentives and constraints for corporate internal environment.

Subsequently, in the second chapter, the object of the analysis will be shifted to the contemporary framework characterizing the *Berle-Means corporations* and how the evolutionary scenario has brought into being the basis for the latest theorical assessments and turned into the current governance paradigm.

2. *Managerial Capitalism*[7]: the myth of the "organization man".

Public companies were widely provided with a plethora of stimuli leading major changes in their key features during the middle decades of the 20th Century: the "age of management" , as it was emblematically depicted[8].

The term "managerial capitalism" has been coined *ad hoc* by the business historian Alfred DuPont Chandler in order to encapsulate the sentiment and the nature of that time[9].

The salient traits of managerial capitalism are to be examined in light of extremely encouraging circumstances, which revealed auspicious for public companies: the absence of significant competitors on the market left a few main dominant firms acting undisturbed and proliferate, since the entrance in many industries was either subjected to barriers or subordinated to regulatory approval[10].

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[6]Jill E. Fisch & Steven D. Solomon, *Should Corporations have a Purpose?*. U of Penn, Inst for Law & Econ Research Paper No. 20-22; European Corporate Governance Institute - Law Working Paper No. 510/2020 101,102 (2020).

[7] Alfred D. Chandler Jr., *The Emergence of Managerial Capitalism,* 58 Bus. Hist. Rev. 473 (1984) ("In the late 19th and early 20th centuries, a new type of capitalism emerged. It differed from the traditional personal capitalism in that basic decisions concerning the production and distribution of goods and services were made by teams, or hierarchies, of salaried managers who had little or no equity ownership in the enterprises they operated.").

[8] Cheffins, *supra* note 5 at 40.

[9] Chandler, *supra* note 7.

[10]Cheffins, *supra* note 5 at 40. ("Corporate "first movers" from the late nineteenth and early twentieth centuries dominated numerous key sectors of the US economy").

Furthermore, the relationship between ownership and management was extremely aseptic, so that the *Berle-Means corporation* could express its full potential: corporate managers running large enterprises had almost no limit to the discretion they could exercise, "making nearly all operating and strategic decisions"[11] within the corporation. On the other hand stockholders did not show any interest in being involved in corporate governance and this contributed to augment managerial power. Partially the cause of this passive attitude was rooted in the fact that shareholders in 1950s and 1960s lacked enough coordination, expertise, information and, most relevantly, incentives to monitor executives performance. The most efficient way for a shareholder to show his "dissatisfaction with how a corporation was being run" was to disinvest, so that the market would be most likely to allocate maladministration and inefficiencies[12].

Moreover, further inquiry and scrutiny from the board was not a very strong constraint to managerial wrongdoing. Contrarily to what might be thought, abuse on behalf of corporate executives was rare during the heyday of managerial capitalism despite the vast internal disengagement[13].

Unquestionably, a big contribution was coming from the external constraints imposed on managerial discretion (since the internal constraints were scant, as we have seen), that functioned as a check on a potentially unlimited authority. A meaningful check was, in fact, supplied by organized labor and governmental regulation, the former being a source of opposition and placing a potent veto on excessive managerial discretion, the latter influencing directly the market competition, its participants, its price and production[14].

The result was that despite the *laissez-faire* style of the "apathetic bunch"[15] of shareholders, significant malfeasances were not perpetrated, essentially because

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[11] Alfred D. Chandler, *The Competitive Performance of US Industrial Enterprises since the Second World War*, 63 Bus. Hist. Rev. 1, 13–16 (1994).

[12] Cheffins, *supra* note 5 at 40.

[13] *Id.* at 41 ("Nevertheless, the vast majority of executives refrained from taking improper personal advantage of their positions and the predominant managerial style was modest and unassuming.").

[14] Cheffins, *supra* note 5 at 41-42 ("Organized labor, for instance, was a force to be reckoned with in many industries. Post–World War II unions had been fortified by growing membership, legal reform, and substantial public acceptance. […] Government constituted another important source of countervailing power. The federal government's role in the economy expanded in the 1930s due to the New Deal Franklin Roosevelt launched in response to the Depression, and remained significant during World War II.").

[15] *See* Peter B. Greenough, *Stockholders Lax as Voters*, Bos. Globe, Mar. 19, 1964, 20; *See also* Cheffins, *supra* note 5 at 76. ("Shareholders in the managerial capitalism era were described as 'passive,' and 'an apathetic bunch' that played 'no active role at all').

corporate executives were not "seeking ruthlessly to capture market share and maximize profits", instead they attempted to nurture long-term growth, to achieve stability and health and, most remarkably, to respect the interests of all corporate constituencies such as labor, consumers, and the public at large"[16].

This stewardship was the result of "an intense loyalty to the company", which was inherent with the role of managers. A leadership study of 1945 confirmed this attitude, underlining the fact that extensive discretion during managerial capitalism would not be used with the intention of extracting value or private gain from the corporation to the detriment of other constituencies[17].

What is more important, the concern was not strictly for shareholders as the main constituencies to privilege, but for corporate interests in a broader sense[18].

Responsiveness to a multitude of needs, regard for *tout court* instances, subordination of "personal aspirations to foster the pursuit of corporate goals" shaped the archetypal "organization man", the 1950s and 1960s recognized figure of corporate executives, personifying all the cited key features[19].

In fact, being in charge of keeping "the machinery oiled"[20], the "organization man" exemplifies the entrusted steward of large corporations, "faithful to responsibilities"[21] and to ethical values. Moreover, to complete the framework, the scarce accountability to shareholders and the absence of any performance-related reward component in the professional managers' salaries provided that maximization of shareholder's returns was "a governance afterthought" (attempts to trigger an active interest in corporate affairs were vane)[22].

[16] Cheffins, *supra* note 5 at 41. *See* also Lynne L. Dallas*, Is There Hope for Change? The Evolution of Conceptions of Good Corporate Governance*, 54 San Diego L. Rev. 491, 506 (2017). ("In earlier periods in U.S. business history, the central purpose of corporate governance was not to maximize stock prices, but to achieve growth, with survival and profit mainly as constraints.").

[17] Robert A. Gordon, *Business Leadership in the Large Corporation* 173 (1945).

[18] *Id.* (Amidst considerable corporate success, the dominant image of public company leadership during the managerial capitalism era was that executives were exercising corporate power in a self-restrained and socially responsible manner").

[19] William Whyte, *The Organization Man* (1956). *See also* Amanda Bennett*, The Death of the Organization Man* 13–14 (1990).

[20] *Not to Pioneer, But to Mesh . . .*, Forbes, Nov. 15, 1957, 27; *See also* Cheffins, *supra* note 5 at 66. ("The head of the giant corporation today is quite the antithesis of the order-barking, sweeping decision-maker of yesteryear. He is more aptly described as the man who keeps the machinery oiled, makes sure its working parts are kept going at top efficiency and that the machine itself is completely up-to-date.").

[21] Daniel J. Baum & Ned B. Stiles, *The Silent Partners: Institutional Investors and Corporate Control* 7 (1965).

[22] Richard Eells, *The Government of Corporations* 241–42 (1962); *See also* Cheffins, *supra* note 5 at 76.

The existing incentives driving managerial work ended up to spur socially desirable goals and deliver welfare to stakeholders, even if the notion of stakeholder itself was still very far from the connotation it would take some decades onwards.

As stated by Edward Freeman "the term 'stakeholder' first appeared in management literature in an internal memorandum at the Stanford Research Institute (SRI) in 1963. The term was meant to generalize the notion of stockholder as the only group to whom management need be responsive. Thus, the stakeholder concept was originally defined as 'those groups without whose support the organization would cease to exist'"[23].

The evolution of the stakeholder notion is quintessential to draw a parallelism with the "organization man", in order to investigate what was the intrinsic metric of evaluating corporate performance in large public corporations during the zenith of managerial capitalism.

The paradigm of "organization man" shows that "managers functioned as teams to sustain the firm and to promote social welfare"[24] for the very good reason that they "possessed special expertise for negotiating contracts among the firm's stakeholders and organizing mass production and mass distribution processes into a flawless social operation […] aligning these various constituents' interests with the firm's new wealth-creation objective"[25].

Furthermore, this is consistent with the statement that E. Merrick Dodd proposed in 1932 to answer the question: "For Whom Are Corporate Managers Trustees?", alleging that "they should be accountable to the firm's various stakeholders". American leadership, commented D. Donham, was experiencing a great need to embrace social responsibility, by regarding interests of employees and customers as well .[26] Unfortunately, it is problematic to reconcile this standpoint with the traditional view that the corporation is a legal fiction and a distinct entity, and, consequently, that officers are trustees for the "aggregate of stockholders" who chose them as agents and not for acting in a public-spirited way.[27] One year earlier, Adolf Berle himself had

[23] Edward R. Freeman, *Strategic management: A Stakeholder Approach* 31-32 (1984). (Originally, identified stakeholders' categories were "shareowners, employees, customers, suppliers, lenders and society".)

[24] Ernie Englander & Allen Kaufman, *Managerial Fiduciary Duty and Social Responsibility: The Changing Nature of Corporate Governance in Post-War America* 6 (2003).

[25] Committee for Economic Development, *Social Responsibilities of Business Corporations*. Washington DC: Committee for Economic Development. 971; and The Business Roundtable, "Statement on Corporate Responsibility," 1981*; See also* Englander & Kaufman, *supra* note 24.

[26] E. Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, 45 Harvard Law Review 1145,1156 (1932).

[27] *Id* at 1159,1160.

expressed that extensive powers conferred on management should be "necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears"[28].

Berle's idea was not isolated. In 1919, ruling in *Dodge v. Ford Motor Co.*, where Michigan Supreme Court had held that the purpose of the process of business incorporation is primarily the profit of its stockholders, clarified that corporate executives should act with fulfillment of shareholder's interests in mind[29].

Despite the fact that Berle's arguments in favor of shareholders seemed very solid, during 1950s and 1960s, the traditional notion that management should advance exclusively stockholder's welfare appeared mitigated in a significant way. In 1954, Berle acknowledged that Dodd's vision had collected considerable support by the law at that time, resulting in a wider perimeter for managers to achieve interests other than those of stockholders[30].

The corporation, during the heyday of managerial capitalism, was regarded as what Dodd emblematically described to be an holistic system, distinct from its various working parts:

> The traditional view of our law is that a corporation is a distinct legal entity. Unfortunately, its entity character has been thought of as something conferred upon it by the state which, by a mysterious rite called incorporation, magically produces '*e pluribus unum*'. The present vogue of legal realism breeds dissatisfaction with such legal mysteries and leads to insistence on viewing the corporation as it really is. So viewing it we may, as many do, insist that it is a mere aggregate of stockholders; but there is another way of regarding it which has distinguished adherents. According to this concept any organized group, particularly if its organization is of a permanent character, is a

[28]Adolf A. Berle, *Corporate Powers as Powers in Trust*, 44 Harvard Law Review 1049 (1931).

[29] *Dodge v. Ford Motor Co.*, 204 Mich. 459, 170 N.W. 668, 1919 Mich. LEXIS 720, 3 A.L.R. 413 (Supreme Court of Michigan February 7, 1919, Decided; Rehearing Denied May 1, 1919).

[30] Adolf A. Berle, *The 20th Century Capitalist Revolution* (1954).

> factual unit, 'a body which from no fiction of law but from the very nature of things differs from the individuals of whom it is constituted'[31].

Managerial discretion did in fact recognize the corporation as an entity whose objectives and aspirations were distinct from those of the individual constituencies. The job of corporate executives was to seek a balance between multiple groups by choosing which objectives to pursue and prioritize.

Carl Kaysen (1957) offered a further insight by ascertaining that the modern corporation was undergoing deep changes in its behavior: firstly, "growth and technical progress" were adopted as the best "measures of achievement" for the corporation and this purpose concretized in long-term planning. Secondly and more importantly, an evolving feature was the range within which responsibility undertaken by corporate executives was widening[32].

Because management started acting by adopting this new approach, it no longer assessed the maximization of return on investments as the only relevant aim, on the contrary, it considered itself accountable "to stockholders, employees, customers, the general public, and, perhaps most important, the firm itself as an institution." The firm became a place where a multitude of interests could intersect and multiple categories of people could realize themselves. Customers would be granted "an improving product, good service, and fair dealing", employees would benefit from this managerial turn in terms of "high wages, pensions and insurance systems, medical care programs, stable employment, agreeable working conditions, a human personnel policy", the public would have various advantages, among which stand "leadership in local charitable enterprises, concern with factory architecture and landscaping, provision of support for higher education, and even research in pure science", and, lastly, the corporation "as an institution" would receive a both a preservation insurance and "the expansion of its long-run position; in other words, sustained and rapid growth"[33].

Therefore, it may be concluded from those arguments that, during the heyday of managerial capitalism, corporate purpose was acknowledged as being the benefit of

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[31] Dodd, *supra* note 26 at 1160.
[32] Carl Kaysen, *The Social Significance of the Modern Corporation*, 47 The American Economic Review 311,313 (1957).
[33] *Id.*

the corporation as a whole, which did not automatically result in the benefit for stockholders, nevertheless this objective could be reached by corporate executives in combination with a series of other objectives, having to do with satisfaction of the plain community of the corporation to a broader level.

This constituency-oriented framework never denies that shareholders should be a concern for corporate executives, even if it rejects its aprioristic maximization.

3. The *Deal Decade*[34] and the rise of shareholder primacy.

Public companies experienced a unique and unprecedented "disruptive effect" during *the Deal Decade*, which brought about a significant amount of macroscopic changes in corporate life. As may be assumed by the determinant figure of hostile takeovers, market for corporate control was "operating at an unprecedented level of intensity"[35] and, from a market competition perspective, solid corporations that once dominated entire sectors and were already settled in the market were much more exposed to new entrants, making incumbents extremely vulnerable and under the pressure of the market forces and impinging upon managerial priorities and incentives[36].

The frenetic takeover activity registered in 1980s solicited a response of the policymakers, which occurred in form of an anti-takeover state legislation in 1985, with the decision of the Delaware Supreme Court to uphold a shareholder rights plan for the first time: a poison pill, as a defensive tactic, in the case *Moran v. Household*.[37]

Nevertheless, Takeover activity, declined markedly as soon as the 1980s ended, to soar again in the mid-late 1990s[38].

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[34] *See* Margaret M. Blair*, The Deal Decade: What Takeovers and Leveraged Buyouts Mean for Corporate Governance* (1993); Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005*: *Of Shareholder Value and Stock Market Prices*, 59 Stanford L. Rev. 1465, 1521 (2007). *See also The Best and Worst Deals of the 1980s*, Bus. Wk., Jan. 15, 1990, 52 ("Decade of the Deal") ; See also Cheffins, *supra* note 5 at 155.

[35] *See* Cheffins, *supra* note 5. ("takeover-related activities preoccupying executives, commentators, and the public to an unprecedented extent. Merger and acquisition (M&A) activity would, in statistical terms, be more robust at various points during subsequent decades. For public company executives and their firms, however, the disruptive effect during the 1980s would remain without peer. Public companies were confronted to a unique extent by uninvited acquirers prepared to make generous offers directly to the shareholders to gain control. Executives who had enjoyed considerable autonomy from stockholders correspondingly found themselves under a novel, heavy onus to respond to shareholder preferences.").

[36] *See Id.*

[37] Moran v. Household International, Inc., 500 A.2d 1346 (Del. 1985). *See also* Robert N. McCauley, Judith S. Rudd & Frank Iacono, *Dodging Bullets: Changing US Corporate Capital Structure* 46,117 (1999) ("Delaware enacted in 1988 what was referred to as a "business combination" provision as part of the Delaware General Corporation Law) *; See also* Cheffins, *supra* note 5 at 177.

[38] Cheffins, *supra* note 5 at 177-179.

As a consequence for those facts, executives lost partially "autonomy from stockholders" which had been a core feature of their relationship over the course of the previous decades[39].

In fact, the disciplinary function, proper of the market for corporate control, provided that fear of displacement by means of takeover put pressure on executives, determining that they felt exposed to a greater extent to their responsibilities towards shareholders.

Another factor deserving attention is the rise of institutional investors, especially of public pension funds, that enabled shareholder group to move from a completely passive attitude to an attempt to gain control and negotiating power over the large firms.[40] Share ownership by institutional investors was an ascending trend in 1970s and sustained over the course of *the Deal Decade*, when the percentage of shares owned by institutional investors rose to a figure of 36% from the previous 26%. By 1988 institutions owned a proportion of 49% in the 1,000 largest public corporations[41].

Boards improved their function in corporate governance, as they underwent a process of reform by initiative of the American Law Institute (ALI), which undertook to canvass the draft of board restructure. A relevant change occurred as concerns board composition, as it was required that boards of large corporations should be made up prevalently of independent directors and form entirely independent committees for audit and nomination subjects[42].

Despite reforms at a shareholder and board level, a significant active role in monitoring corporate executives was not performed by either of them. Internal constraints were still too weak to provide a meaningful incentive for executives, compared to external constraints, that, on the contrary, contributed the most to the wide change that was occurring in governance perspectives[43].

In this historical phase a product of corporate governance was the engagement of corporate executives in maximizing the value of the firm: interests and wealth of shareholders' class prevailed over those of other corporate constituencies[44].

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[39] Cheffins, *supra* note 5 at 155-156.
[40] Englander & Kaufman, *supra* note 24 at 4.
[41] Mary O'Sullivan, *Contests for Corporate Control: Corporate Governance and Economic Performance in the United States and Germany* 156 (2000) *; See also* Cheffins, *supra* note 5 at 191.
[42] Cheffins, *supra* note 5 at 180-181.
[43] *See Id.*
[44] Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 Journal of Financial Economics (JFE), 306,308 (1976). (1976); Michael C. Jensen, *A Theory of The Firm: Governance, Residual Claims and Organizational Forms*, Harvard University Press (December 2000) ("That literature focuses almost exclusively on the normative aspects of the agency relationship; that is how to structure the contractual

It was alleged that managers "found themselves under a novel, heavy onus to respond to shareholder preferences. Managerial capitalism had been taken over."

In fact, "while the 1970s emphasis on balancing the interests of corporate constituencies continued to prevail in the early 1980s, prioritization of shareholders was beginning to gain momentum"; shareholder value became gradually the "best measuring stick" for the evaluation of the targeted corporate aims and, consequently, of the overall corporate performance, orienting considerably managerial work and reshaping the notion of corporate objectives[45].

The main characteristic on which shareholder value doctrine is centered is "the idea that management's objective is, or should be, maximizing value for shareholders", in terms of enhancing their financial returns and their welfare within the corporation[46].

This new framework was initially theorized by Milton Friedman, who had already espoused the shareholder primacy principle in 1962 in *Capitalism and Freedom* and subsequently exposed his theory in a 1970's New York Times Magazine article:

> There is one and only one social responsibility of business — to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud[47].

Parallelly, contributions to this doctrine also arose from the 1970s renowned studies of William Meckling and Michael Jensen, which remarked that the relationship between a stockholder and a manager is founded upon the concept of agency, being the "justification for permitting the corporate executive to be selected by the stockholders". Therefore a necessary condition for the existence of this relationship is "that the executive is an agent serving the interests of his principal"[48].

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relation (including compensation incentives) between the principal and agent to provide appropriate incentives for the agent to make choices which will maximize he principal's welfare given that uncertainty and imperfect monitoring exist."). *See also* Milton Friedman, *Capitalism and Freedom*. University of Chicago Press (1962). *See also* Cheffins, *supra* note 5 at 155.

[45] Leslie Wayne, *A Look at New Corporate Tactics*, NY Times, Feb. 26, 1984, F6 *; See also* Cheffins, *supra* note 5 at 189.

[46] Joseph L. Bower & Lynn S. Paine, *The Error at the Heart of Corporate Leadership,* Harv. Bus. Rev., May–June 2017.

[47] Milton Friedman, *A Friedman Doctrine: The Social Responsibility of Business is to Increase Its Profits,* NY TIMES, Sep. 13, 1970.

[48] *Id. See also* Jensen & Meckling, *supra* note 44.

Since shareholders are commonly identified as the owners of the enterprise, according to this theory they would be legitimized to demand that the firm is conducted according to a profit-making objective in order to determine a return on their investments. As a consequence, the idea of pursuit of social responsibility is entirely rejected and leads to some remarkable criticisms, most relevantly, that focusing on a social purpose other than that of shareholders would make the figure of corporate executive equal to that of a "civil servant" or a "public employee" in a "private enterprise"[49].

Moreover, Friedman deemed a "lack of rigor" or "analytical looseness" to think of business as having responsibilities on a par with individuals, because as an artificial person it cannot be conceived as having a factual duty towards some group, community or individuals[50].

It is interesting to notice that in the early 1980s influences from previous decades continued to hold the prior positions, claiming that long-term stability should prevail over the sole market value concerns[51].

Of this account was Business Roundtable, which affiliates opinions of major U.S corporations' CEOs, by developing a stewardship dogma in the 1981 "Statement on Corporate Responsibility". Managers acknowledged that their fiduciary duty had to be owed to the firm itself and to stakeholders ensuring its going concern, in addition to a collective and shared responsibility that consisted in ensuring a democratic stability towards society and in contributing to its economic efficiency and well-being. Expectations falling onto managers combine the accomplishment of public interest-related objectives with the fulfillment of shareholders' claims, upholding the idea that the profit-making nature of the corporation is not incompatible with the achievement of parallel objectives targeting other groups within the corporation, namely, according to Business Roundtable, customers, employees, and society at large[52].

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[49] Friedman, *supra* note 47. ("On grounds of political principle, it is intolerable that such civil servants—insofar as their actions in the name of social responsibility are real and not just window-dressing—should be selected as they are now. If they are to be civil servants, then they must be selected through a political process. If they are to impose taxes and make expenditures to foster 'social' objectives, then political machinery must be set up to guide the assessment of taxes and to determine through a political process the objectives to be served.").

[50] *Id.* ("The discussions of the "social responsibilities of business" are notable for their analytical looseness and lack of rigor. What does it mean to say that "business" has responsibilities? Only people can have responsibilities. A corporation is an artificial person and in this sense may have artificial responsibilities, but "business" as a whole cannot be said to have responsibilities, even in this vague sense").

[51] Gordon Donaldson & Jay W. Lorsch, Decision Making at the Top: The Shaping of Strategic Direction 7 (1983) ; See also Cheffins, *supra* note 5 at 187.

[52] *Id. See also* Englander & Kaufman, *supra* note 24 at 4.

Later during *the Deal Decade* the managerial priority list was overturned, as demonstrate a 1985 survey in which 51 percent of the interviewed CEOs declared that "creating shareholder value was their top priority", against only a 18 percent who affirmed that "becoming the market leader in their industry was the primary objective"[53].

Even the term "shareholder value" was much more cited and mentioned in journals, reports to shareholders, articles and reviews[54].

A connection may be found between shareholder value and executive remuneration incentive system: before the *Deal Decade,* it was structured so as to ensure that senior management pursued a "technocratic ideal" within the corporation. Stock options, in particular "gained popularity in the 1950s after gaining capital gains tax status", nevertheless before the late 1980s they would not be largely diffused as managers preferred non-salary rewards in order to lessen their tax burden[55].

Criticisms associated to their subsequent use as remuneration incentive emerged because "reward system depended heavily on stock options that were accompanied by downside risk- protection", providing that "corporate bureaucratic teams broke up into tournaments in which managers competed for advancement toward the CEO prize" for the simple reason that managers were turned "into a special class of shareholders" and, therefore, they "sought to maximize their individual utility functions".

The causal relationship would depend on the fact that as soon as managers became accustomed to the new regime of remuneration, their priorities and "technocratic, stakeholder creed" would drastically and easily be turned into a "proprietary" ideology[56]:

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[53] Pat Choate & J.K. Lenger, The Quest of a Quick Return, Hartford Courant, July 13, 1986, B1*; See also* Cheffins, *supra* note 5 at 187.

[54] Cheffins, *see supra* note 5 at 188. ("Business publications reflected the growing attention shareholder interests were attracting. The term "shareholder value" was rarely mentioned in the daily Wall Street Journal prior to 1980 and was only referred to in 10 articles between 1980 and 1982. Usage increased to 13 articles in 1983, 26 in 1984, 76 in 1985, and 113 in 1986.295 With the bimonthly Harvard Business Review the pattern was similar. "Shareholder value" was first mentioned in 1955, referred to again in 1981, and then mentioned nine times between 1986 and 1989.").

[55] Englander & Kaufman, *supra* note 24 at 19-20.

[56] *Id* at 3. ("Tax reform, which favored stock options over salary, spurred corporate boards to reconfigure managerial compensation packages, substituting options for salary. Fortune favored managers by pushing the stock market up at an unprecedented rate and, with it, their compensation packages which reinforcing incentives that rewarded higher stock prices without any concern for relative company performance. This incentive system, which allegedly aligned managers' interests to shareholders, turned managers into a special class of shareholders.").

> These circumstances persuaded managers to revise their fiduciary doctrine of corporate social responsibility. Where managers once spoke about their discretionary powers, they now spoke of market constraints; where they once spoke about balancing stakeholder claims, they now spoke about shareholder wealth maximization; where they once spoke about their responsibility to enhance productivity and improve living standards, they only considered productivity to be their responsibility, leaving issues of income disparity to others. And, where managers once considered themselves members of a profession that served a large social good, they now thought of themselves as technocrats employed to maximize shareholder wealth[57].

This period of U.S. business history is characterized by a "the central purpose of corporate governance" consisting in the maximization of share prices and returns to the owners, contrarily to the previous growth achievement orientation, "with survival and profit mainly as constraints"[58].

During the *Deal Decade,* profit dictates the rules and imposes the standards to accomplish for corporate executives, who have passed from implementing the most diverse organizational forms and economic strategies to a mere shareholder value maximization path. Criticisms regarding new strategies adopted to ensure this standard are based on the negative effects and consequences that shareholder value as a dogma for corporate priorities can have, namely short termism and "problematic managerial incentives"[59].

This becomes a problem when shareholder value becomes an "entire thought system" and is embraced by a multitude of economic agents, reflecting on managerial culture and on every aspect of corporate life, as it can have harmful effect on "corporate strategy and resource allocation"[60].

[57] *Id* at 7.
[58] Dallas, *supra* note 16.
[59] *Id.*
[60] Steve Denning, *The 'Pernicious Nonsense' Of Maximizing Shareholder Value,* Forbes, Apr. 27, 2017.

4. From the 1990s to the 2000s corporate scandals.

By the 2000s there was a general consensus that executives should be charged with the obligation to manage in favor of shareholders[61].

The reasons of this attitude and of such shareholder value orientations, which favored a new set-up of corporate interests, are rooted in a series of changes occurring in the previous years, relating both to society and to policy making decisions. An historical overview may provide an insight of the passage between the era of entrepreneurial acumen, which had put executives under the onus to please and regard the interests of shareholders as a top priority, to the era of corporate scandals, which resulted in part from the abuse of managerial discretion[62].

Firstly, the most relevant features regarding market incentives include the reduction in leveraged buyouts activity and a marked preference for IPOs in 1990s, with more than 3800 companies going public and joining the stock market. In fact, "due to the robust IPO market, the number of public companies grew steadily from 1990 to 1996"[63].

Market for corporate control, which had experienced a fertile period and had been largely preoccupying executives for its intense operations, strikingly slowed down at the beginning of the new decade "creating a corporate governance vacuum boards", which "shareholders seemed to be filling to a significant degree"[64].

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[61] Cheffins, *see supra* note 5 at 6. ("during the 1990s, managerial compensation became primarily equity-based, largely in the form of stock options. Executives correspondingly focused intently on the expectations of investors who could send share prices tumbling in the event of an unwelcome earnings surprise. As of 2000, there was a general consensus 'that managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders'").

[62] *See Id.* (In terms of internal constraints: "The Deal Decade and increased emphasis on governance-related internal constraints coincided with a reorientation of managerial priorities in favor of shareholder interests […] The Deal Decade helped to prompt a switch back in a shareholder-friendly direction." And external constraints: "The surge in the number of hostile bids meant that the fate of publicly traded companies hinged on shareholder perceptions of the capabilities of the incumbent management team to an unprecedented extent." By contrast: "hostile takeovers subsided in the 1990s" and "many thought increased shareholder activism would counteract the marginalization of the market for corporate control as a disciplinary mechanism". Parallelly "high hopes for a meaningful governance contribution by institutional shareholders went largely unfulfilled" as "pension funds and mutual funds refrained from intervening in the affairs of public companies".). *See also* Peter F Drucker, *Corporate Takeovers—What Is to Be Done?*, Public Int., Winter 1986, 3. ("The market for corporate control was playing" a "pivotal role" and "reshaping the public company". "The new wave of hostile takeovers […] has become a dominant force—many would say the dominant force—in the behavior and actions of American management.") *; See also* Cheffins, *see supra* note 5 at 162.

[63] Cheffins, *see supra* note 5 at 228.

[64] Cheffins, *see supra* note 5 at 234 ("During the 1980s, the market for corporate control overshadowed boards and shareholders as a constraint on the discretion of public company executives. As the 1990s began hostile takeovers fell into abeyance, creating a corporate governance vacuum boards and share- holders seemed to be filling to a significant degree. In the mid- and late-1990s, corporate governance, though by no means theoretically ideal, was apparently operating effectively, as evidenced by the outstanding returns public companies were delivering for investors").

Therefore, external constraints appeared to be overcome in favor of more promising corporate governance mechanisms, which were starting to deliver their first apparently efficient results "though by no means theoretically ideal"[65].

Because the disciplinary function of takeover market "as a mechanism for replacing weak managers with superior managers, and for giving managers greater incentives to perform better" was an acknowledged trait at the beginning of the decade, a decline in takeovers and weakening of market for corporate control was largely deemed likely to reduce managerial accountability. Commentators argued that this governance vacuum could have been filled thanks to the intervention of either boards or institutional shareholders[66].

An adaptive internal response came in form of institutional ownership: in fact, over the nineties, institutional ownership had started affirming as "one of the most startling power shifts in American history"[67], as stated by Peter Drucker.

Institutional shareholders were highly speculated to be a beneficial factor, as "stockholder involvement was not the primary factor motivating public company executives to treat the promotion of shareholder value as the top corporate priority"[68].

Later, during the 2000s, the evolution of the financial system and, along with it, of financial institutions, established "the emergence of hedge funds as a corporate governance force"[69], which operated functionally to ensure "that shareholder pressure became a more potent check on public company executives"[70].

Hedge fund activism became a new form of pressure for corporate America, augmenting the prominence of shareholder value and enhancing the focus on corporate performance. This happened mainly because, while pension funds and mutual funds engaged in shareholder activism "defensively" *ex post*, that is, to the extent to which it served as a protective measure for existing investments, hedge funds acted "offensively" presuming already *ex ante* that the company was underperforming and

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[65] *Id* at 234.

[66] *Id* at 235-236.

[67] Ellen Neuborne & Michelle Osborn, *Shareholders Revolt at Sears*, USA Today, May 15, 1992, B1. *; See also* Cheffins, *supra* note 5 at 242.

[68] *See Id. See also* Mark S. Mizruchi, Linda Brewster Stearns & Christopher Marquis*, The Conditional Nature of Embeddedness: A Study of Borrowing by Large US Firms,* 71 Amer. Soc. Rev. 310, 329 (2006). ("In the 1980s shareholder value emerged as a pivotal measuring stick of executive achievement primarily because top management feared anemic shareholder returns would prompt an unwelcome takeover bid.") *; See also* Cheffins, *supra* note 5 at 242.

[69] Cheffins, *supra* note 5 at 311.

[70] *See Id*. at 306 ("There was some evidence that boards were upping their game and, largely due to the rise of activist hedge funds, shareholders grew in prominence as a check on public company management.").

needed consequently to maximize returns. Accordingly, hedge funds "have historically taken advantage of exclusions and regulatory "safe harbors" to operate largely outside statutory rules on investment companies and investment advisers"[71].

Another factor contributing significantly to the 1990s and early 2000s governance framework is the rise of stock options as method of rewarding executives. In fact, in 1990s the affirmation of an equity based system of executives' pay in form of stock options and the correlation between pay and performance was firmly encouraged by institutional investors. This is consistent with the greater role played by institutional investors in shifting executives' top priorities on the agenda [72].

Executive compensation related issues, along with the institutional investors twist, contributed to accelerate the process of short-termism already begun during *Deal Decade* along with the shareholder value doctrine[73].

As internal constraints enlarged their role in determining corporate purposes and objectives, along with the affirmation of the institutional shareholders, also tendencies regarding boards' composition continued to change significantly, encouraging a larger number of independent directors compared to the "proportion of inside directors […], which declined in both the 1970s and 1980s", decreasing to a broader level in the

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[71] *See* Marcel Kahan and Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021 (2007). ("Mutual fund and public pension fund activism, if it occurs, tends to be incidental and ex post: when fund management notes that portfolio companies are underperforming, or that their governance regime is deficient, they will sometimes be active (footnote omitted). In contrast, hedge fund activism is strategic and ex ante: hedge fund managers first determine whether a company would benefit from activism, then take a position and become active.") *; See also* Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. Corp. L. 51, 7 (2011).

[72] James E. Heard, *Executive Compensation: Perspective of the Institutional Investor*, 63 U. Cin. L. Rev. 749, 749, 751 (1995). ("Institutional investors were much more concerned about the configuration of executive pay than the amounts involved, believing a much stronger relationship between pay and performance would result in better management.") *; See also* Cheffins, *supra* note 5 at 245. *See also* Randall Thomas*, Explaining the International CEO Pay Gap: Board Capture or Market Driven*, 57 Vand. L. Rev. 1171, 1247 (2004); Brian J. Hall*, Six Challenges in Designing Equity-Based Pay,* J. App. Corp. Fin., Spring 2003, at 21, 23.; Parthiban David, Rahul Kochhar & Edward Levitas*, The Effect of Institutional Investors on the Level and Mix of CEO Compensation*, 41 Acad. Mgmt. J. 200, 205 (1998) *; See also* Cheffins, *supra note* 5 at 245 ("Institutions successfully pushed a pay-for-performance agenda in the 1990s. In large public companies, the proportion of CEO compensation that was equity based, primarily in the form of stock options, rose from under 20 percent in 1990 to 60 percent by 1999. The fact that the proportion of a public company's shares owned by institutional investors was a strong predictor of the extent to which 1990s executives were paid using stock options indicates institutional shareholder preferences contributed to the shift.").

[73] *See* Michal Barzuza and Eric L. Talley*, Short-Termism and Long-Termism* (February 15, 2016). Virginia Law and Economics Research Paper No. 2; UC Berkeley Public Law Research Paper No. 2731814; Columbia Public Law Research Paper No. 14-503; Columbia Law and Economics Working Paper No. 526; 6 ("Critics of activism, for example, have struggled to articulate the reasons behind the short-termist frenzy they perceive to imperil responsible stewardship (Roe 2015). Why, for example, wouldn't more patient, long-horizon investors have strong incentives to neutralize short-termism by retaining their shares (and even increasing their holdings) whenever long-term projects have greater overall value?).

1990s[74]. However, multiple factors (among which stand corporate scandals) at the beginning of the 2000s “indicated that oversight of public company executives by boards and shareholders in fact left much to be desired in the 1990s.”

Policy making decisions played a pivotal role as well. In fact, as expressed by Richard H.K. Vietor: “Deregulation began in earnest in the late 1970s and gained momentum in the 1980s, meaning that as the 1980s ended governmental oversight was a less potent constraint on public company executives than it had been in living memory”[75]. Furthermore, some commentators regard the 1990s as “the decade of deregulation”[76], meaning that by 2000s a *laissez faire* environment was established both by the market and governmental constraints.

All the internal and external factors provided that by 2000s CEOs and shareholders had undergone profound transformations: the CEO conception had passed from the “organization man” to the transformational leader, then to an entrepreneurial and imperial figure. At the end of the twentieth century, the CEO were conceived as having an iconic status, which they lost in 2000s[77].

The market itself had undergone a change: the consistent innovations provided a ready access to resources that once were a prerogative of specialized incumbents as a competitive advantage and deregulation improved access to capital[78].

The corporate scandals occurring in the early 2000s, of which the most representative and mentioned were Enron, Tyco and WorldCom, arose as a *speculum* of such developments in corporate governance. They would mark a turning point in evaluating priorities for corporations, because of their similar pattern consisting in bankruptcy, dubious related party transactions, and accounting deception, usually after a period of prosperity and growth.

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[74] Cheffins, *supra* note 5 at 240.
[75] Pub. L. 95-504; 92 Stat. 1705; Richard H.K. Vietor, *Contrived Competition: Regulation and Deregulation in America* 57 (1994) *; See also* Cheffins, *supra* note 5 at 140.
[76] Charles R. Geisst, *Undue Influence: How the Wall Street Elite Puts the Financial System at Risk* 241 (2005); Alexander Styhre, *The Making of Shareholder Welfare Society: A Study in Corporate Governance* 146, 150 (2018) *; See also* Cheffins, *supra* note 5 at 254.
[77] Cheffins, *supra* note 5 at 277 (“The chapter then canvasses an early 2000s retreat by chief executive officers from quasi-iconic status secured as the 1990s drew to a close.”) *See* also Alan Elsner*, The Era of CEO as Superhero Ends amid Corporate Scandals,* Globe & Mail, July 10, 2002, C1*;* Arthur Levitt, *The Imperial CEO Is No More*, Wall St. J., Mar. 17, 2005, A16 418–19 *; See also* Cheffins, *supra* note 5 at 281 (“Arthur Levitt, former chairman of the SEC, proclaimed in 2005 “(t)he imperial CEO is no more.” […] “(t)he first decade of the twenty-first century has seen a striking backlash against the cult of the superman CEO”).
[78] Cheffins, *supra* note 5 at 6.

Emblematically, Enron had been listed seventh in the Fortune 500 in 2000 and was the world's largest trader of electricity and natural gas, operating in multiple sectors as telecommunications and financial services[79].

Enron's collapse has been defined a clarifying event by lots of commentators claiming that it should serve as an alarm bell for managers to revise their top priorities. It demonstrated that executives had been misled by the myth of shareholder value, to a point in which they focused only on boosting the share prices up, that is, on the short term value maximization. In light of those events, a structural regulatory response and a step back from deregulation was desirable[80].Nevertheless, it arrived in the legislative form of the Sarbanes-Oxley Act[81] (July, 2002), which was "intended to address the scandals and restore confidence in the securities markets"[82].

However, there was not only one unanimous opinion on the matter, as emerge from this extract:

> Two schools thought show up prominently in discussions of the meaning of Enron's collapse. On one side stand supporters of deregulation […] On the opposite side stand those, including this Article's author, predisposed to draw regulatory inferences from business disasters[83].

In particular, the previous decade had contributed to the idea of a "self-regulatory regime of corporate governance" achievement "due to proliferating good practices and sophisticated institutional monitoring"[84].

Therefore, the excessive exaltation of shareholder value primacy, which had been object of cult and pursuit on behalf of CEOs, as Enron case suggests, would have led

[79] Michael Frontain, *Enron Corporation*, Texas State Historical Association (June 12, 2010).

[80] Cheffins, *supra* note 5 at 322.

[81] United States. (2002). Sarbanes-Oxley Act of 2002: Conference report (to accompany H.R. 3763). Washington, D.C.: U.S. G.P.O.

[82] William W. Bratton, *Enron, Sarbanes-Oxley and Accounting: Rules Versus Principles Versus Rents,* 48 Villanova Law Review 1023 (2003).

[83] *See e.g.,* William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 Tul. L. Rev. 1275-1281 (2002).

[84] *See Id.* ("This Article addresses the self-regulatory regime of corporate governance, to which Enron comes as a considerable shock. In the 1990s corporate self-regulation had been widely thought to have reached a high plateau of evolutionary success due to proliferating good practices and sophisticated institutional monitoring.").

to a "behavioral bias of successful entrepreneurs", the effort of achieving "heroic short term growth numbers" and "immediate shareholder value"[85].

The Sarbanes-Oxley Act, by introducing a Public Company Accounting Oversight Board, engaged in the effort of enhancing independent auditing.[86] The rationale behind this Act is the belief "that Enron exemplifies the abuses of rules-based accounting under GAAP"[87], consistent with the thesis of the supporters of the passage to a "principles-based accounting"[88].

The Enron scandal suggests another side of the story, rooted in the evolution of corporate American history. In fact, during 1990s, shareholder value maximization was a globally demanded obligation on behalf of executives, who responded to a market requirement and unanimously enacted a behavior in order to achieve what the common conception considered to be the corporate objective[89].

In conclusion, the validity of agency theory remains incontrovertibly true to set the terms under which the corporate executives operate and the typical trait of separation between ownership and control "remains a hallmark of large public corporations in the United States"[90], nevertheless the recent years have challenged public corporations, ultimately stressing the urgency to shift the corporate priority.

The post-Enron evolution of debates in corporate governance has stressed interesting conclusions concerning shareholder value and the reconsideration corporate purpose.

Because such conclusions, along with post-corporate scandals scenario, are part of a broader contemporary context they are to be assessed more deeply in the next chapter, which will draw a parallelism between the transformation of the public company that

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[85] *Id.* ("They overemphasized the upside and lacked patience. They pursued heroic short term growth numbers that their business plan could not deliver. That pursuit of immediate shareholder value caused them to become risk prone, engaging in levered speculation, earnings manipulation, and concealment of critical information.").

[86]United States. (2002). Sarbanes-Oxley Act of 2002: Conference report (to accompany H.R. 3763). Washington, D.C.: U.S. G.P.O.

[87] Bratton, *see supra* note 82 at 1023. The author ultimately does not support the efficacy of the Act. In fact ("Under this analysis, the drafters of Sarbanes-Oxley were right in thinking that the absence of principles has contributed to the crisis, but wrong in diagnosing the problem as legislative. […] It is instead a problem of professional practice in a regulatory system." Additionally the author reckons that "The Act goes on to address the substance of Generally Accepted Accounting Principles (GAAP). It does this first in section 108(d), which requires the SEC to study the accounting system to ascertain the extent to which it is "principles-based," as opposed to "rules-based").

[88] *See Id.*

[89] *See Id*. *See also* Bratton, *supra* note 83 at 79 ("there is an aspect of the Enron story shaped by its time and place. Enron and associated actors reenacted these old pathologies on a stage set by the contemporary shareholder value maximization norm." So it is indispensable to look at Enron as the product of shareholder value exaltation, as in the 1990s "Managers internalized the norm, building resumes as shareholder value maximizers. Stock options better aligned their incentives with those of their shareholders." Up to a point in which: "pressure to maximize and a culture of winning combined to draw a huge firm into risk prone decision-making").

[90] Cheffins, *supra* note 5 at 52.

we have seen until this point and the contemporary trends that might be observed in the form of theories and academic debates characterizing corporate governance.

II. *Shareholderism versus Stakeholderism.*

1. An introduction to the New Century scenario and to contemporary themes.

As shown in the previous chapter, those after the corporate scandals have been considered transition years for the public company, mostly concerning the way in which the governance paradigm has been conceived.

On the one hand, the *Berle-Means corporation,* emerging as a result of the transformation it underwent over the years, is to "remain a crucial element in the American economy" and will continue to evolve in light of changes imposed by environment and by social, political, economic circumstances[91].

On the other, the early 2000s have highlighted some evident fragilities inherent with the structure of large public companies and have consequently stimulated a wide spectrum of reflections, having as poles the concepts of *stakeholderism* and *shareholderism*, as will be explained more in detail over the following paragraph.

As the 20th Century ended, managerial incentives have been increasingly shaping a shareholder-centric corporate governance, in which CEOs have diverged from the emblematic figure of the "organization man" and have focused mostly on the preservation of a status quo made up of "prestige of office and financial perks, […] satisfactory annual retainer and meeting fees"[92].

This issue has been worsened by the fact that the law has addressed directors' accountability towards only one constituency: the shareholders[93].

As a consequence, an adoption of a broader stakeholder-minded approach on behalf of executives would be "in violation of their agency relationships to their principals and represent potential theft of shareholder property"[94].

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[91] Cheffins, *supra* note 5 at 400.

[92] Douglas Branson, *Enron - When All Systems Fail: Creative Destruction or Roadmap to Corporate Governance Reform*?. 48 Villanova Law Review 989, 992 (2003).

[93] Colin Mayer, *Ownership, Agency and Trusteeship* European Corporate Governance Institute - Law Working Paper No. 488/2020, 2.

[94] *Id* at 4. *See also Id* at 2 ("The association of shareholding with property is by analogy. Shareholders invest in companies in a similar way to how they purchase cars, houses and washing machines. They therefore have similar claims over both the benefits and employment of the assets of a firm. Their influence is mediated by the boards of directors who are

In other words, according to this creed, even the pursuit of outcomes which are harmful for society and community of which the corporation is member would be justified so long as the management realizes the financial return of the owners, even if there is "an inevitable 'or' in choosing between societal and shareholder benefits"[95].

As the Enron story has suggested, it is not a sustainable approach to consider corporations as monads, completely isolated from the context in which they operate and from the range of constituencies "who have an interest not only in their wealth but also their health, survival, descendants and security – namely their prosperity and wellbeing"[96]. Instead, there are suggestions that they should operate with a view of corporate citizenship in mind[97].

Starting from the post-corporate scandals, which have enthused a series of criticism to the view that corporations "should be managed with the primary goal of pursuing economic value for shareholders"[98], in particular, last decade has been particularly rich of tangible evidences that corporate governance is undergoing a substantial transformation.

As Mark Benioff, CEO and Chairman of the Board of Salesforce Inc. stated

> There's a shift going on. When I went to U.S.C., it was all about maximizing value for shareholders. But we're moving into a world of stakeholders. It's not just about shareholders. Your employees are stakeholders, so are your customers, your partners, the communities that you're in, the homeless that are nearby, your public schools[99].

In fact, commentators are advocating a change, alleging that contemporary patterns have revealed the unsatisfactory effect of a corporate governance whose sole basis is

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appointed as their agents, but ultimate authority resides with shareholders as providers of capital. Impediments to the exercise of those rights is an intrusion on liberty equivalent to that on any other form of property.").

[95] *Id* at 4 ("The problem that this sweeps under the carpet is what happens if there is an inevitable 'or' in choosing between societal and shareholder benefits, and companies do well by doing bad not good, as arguably the 'sin stocks' of alcohol, tobacco, gambling, arms manufacturing and fossil fuels do all the time. Put differently, businesses should, and directors have a duty to, avoid paying taxes, pollute the environment, minimize their labour costs, source from the cheapest global suppliers to the extent that these do not fall foul of the law or impose reputational costs that outweigh the savings they make by so doing – what might be regarded as enlightenment in the eye of the beneficiary but no one else.").

[96] *Id* at 5.

[97] Aisha Saad, *Pitching the Big Tent of Corporate Citizenship: Reconciling Kent Greenfield's Humanist Corporate Personhood with an Enlightened Shareholder Primacy*, New England Law Review (2020).

[98] Fisch & Solomon, *See supra* note 6 at 104.

[99] Interview with Marc Benioff, USC Start-up News (Jun. 15, 2018) available at https://incubate.usc.edu/marc-benioff-of-salesforce-are-we-not-all-connected/. *See also* Fisch & Solomon, *supra* note 6 at 102.

that of "solving the agency problem of aligning managerial interests with shareholders"[100], ignoring the instances to renew perspectives in line with an evolving society.

Such perspectives include the reallocation of priorities over currently relevant and sensitive themes, namely the accomplishment of a "positive human, social and environmental impact"[101] on behalf of the corporate action. In this regard, "repurposing large corporations offer the only practical solution to persistent regulatory failures in addressing societal problems such as wealth inequality and climate change"[102].

The reframing of the traditional corporate object has become more articulated as the 21st Century began, as will be illustrated hereafter.

In fact, this chapter will draw an outline of the following matters.

Firstly, how the historical assessment provided hitherto has shaped a contemporary governance framework within the *Berle-Means corporation*.

Secondly, a theoretical framework about the debate concerning *stakeholderism* and *shareholderism* orientations will be examined, in order to have a tangible insight of how the perceived need for a renewal in the purpose of the corporation has been translated into schools of thought. Lastly, some implications (and criticism) stemming from the reassessments of the cores of corporate objects will be drawn.

2. The Governance Paradigm and the Corporate Purpose in the Contemporary *Berle-Means corporations*.

The governance framework since early 2000s has been subjected to internal and external forces which revealed that "the imperial CEO who held court during the late 1990s will not be returning anytime soon, nor will an updated version of managerial capitalism." Meaningful internal constraints which have emerged over the course of decades are unlikely to weaken or disappear, with hedge fund activism upholding its

[100] Mayer, *see supra* note 93 at 6.
[101] *Id* at 5.
[102] Fisch & Solomon, *supra* note 6 at 104.

role of putting pressure on corporate executives, even though it will have to be established to what extent[103].

State intervention seems to have prevailed over deregulation and will persist as a constraint on corporate life, despite some discontent, in light of a strong need for public company oversight[104].

According to Cheffins' opinion "the promotion of shareholder value will likely continue to be the top priority of public company executives, to the disappointment of those hoping for the sort of balancing of interests frequently associated with managerial capitalism".

Managerial capitalism era still offers a multitude of insights and nostalgic food for thought concerning corporate executives attitude of balancing various group's interests instead of fostering the exclusive pursuit of shareholder welfare. It is much debated whether this constituency-oriented approach was merely a product of "the mood of the times" and it may be recreated artificially today.

From the *Deal Decade*, when "promoting shareholder value was widely recognized as the primary goal of public companies" to the early 2000s, when, according to Business Week CEOs' undertaking could be summarized in few word: "Get the stock price up. Period"[105] corporate governance has been matter of substantial theorizations concerning the purpose of corporations.

As primary reason for this corporate governance debate stand the belief that shareholder primacy orthodoxy, though being a leitmotif of American corporate life and rooted in the agency relationship between shareholders and managers, cannot be decisive in determining the purpose for which corporations exist in economic environment.

In fact, decades fostering and applying this dogma have been triggering harmful mechanisms for society and for shareholders themselves, namely accounting fraud and deceptions, myopic short termism with deleterious implications for long-term value and managerial wrongdoing[106].

For this reason "doubts grew about corporate prioritization of shareholder value" skepticism turned into concrete studies seeking to find a valid alternative to the

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[103] *Id* at 344.
[104] *Id.*
[105] Anthony Bianco & Louis Lavelle, The CEO Trap, Bus. Wk., Dec. 11, 2000, 86 *; See also* Cheffins, *supra* note 5 at 367.
[106] *See* chapter 1 at 13, *note* 57.

affirmed Friedman doctrine[107]. As a consequence, corporate governance has been experiencing a frenetic turmoil in the attempt to revise priorities and objectives.

Criticisms arose even from proclaimed "pioneers of shareholder value movement", such as the former chief executive officer of the General Electric (GE), who affirmed that "shareholder value is a result, not a strategy", that is why forcing it to be the main strategy of corporations would have been "the dumbest idea in the world". Moreover, he suggested that "managers and investors should not set share price increases as their overarching goal… Short-term profits should be allied with an increase in the long-term value of a company"[108].

The view of the large public corporation in the latest years has been fragmented in two: as a "legal fiction" the purpose of incorporation would consist merely in a "private agreement among shareholders", while as "real entity", the corporation would be "enabled by the law to serve the needs of society" and a *locus* of interconnection of multiple constituencies' interests[109].

The dominance of either ideology over the other will, however, depend on a series of variables and on the capacity of influencing concretely executives' behavior. In fact, postulating theoretically more ethic alternatives to shareholder value maximization is one thing, providing incentives which would significantly alter the perception and behavior of corporate executives is completely another.

Corporate governance mechanisms are subtly determined by an incentive-based influencing process in which what matter is which party will succeed in influencing the other, to what extent, and, in particular, what party will have its interests arise as core business strategy[110].

Practice would suggest that the path to change is tortuous, despite the copiousness of studies and scholarships grouping around this subject, for a series of reasons.

In first place, CEOs "have been taught that maximizing shareholder value is their sole responsibility" as a constant from *the Deal Decade* on and even if they found

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[107] Cheffins, *see supra* note 5 at 368.

[108] Steve Denning, *Making Sense Of Shareholder Value: 'The World's Dumbest Idea*, Forbes, Jul 17, 2017.

[109] Lynn S. Paine and Suraj Srinivasan, *A Guide to the Big Ideas and Debates in Corporate Governance*, Harvard Bus. Rev. (October 2019).

[110] *See* Frank Dobbin & Dirk Zorn, *Corporate Malfeasance and the Myth of Shareholder Value*, *Political Power and Social Theory*, 17 Political Power and Social Theory 179,194 ("Increasingly, power depends on the capacity of one group of business experts to alter the incentives of another. and on the capacity of one group to define the interests of another (Roy, 1997). What takeover specialists. institutional investors, and securities analysts managed to do was to change the perceived interests of both corporate executives and shareholders. Executives were now convinced that it is in their interest to manage share price.").

themselves under the onus to please stakeholders or to foster a social purpose they might well "privately resent pressure to deliver for shareholders"[111].

Of this account is the legal academic Margaret Blair, according to whom "maximizing share value has become so deeply instilled in the culture of corporate boardrooms that challenging this notion is like swimming upstream against a strong current"[112].

Secondly, since the "homo economicus"[113] model is deeply rooted in the culture of corporations (in particular of public ones) it is still much debated whether the value-based management style can be substituted by an equally valid alternative, delivering proper economic results also to shareholders. In fact, shareholder value has been criticized to the extent to which it was made an objective and a strategy for the entire economic activity of the corporation, nevertheless the preservation of its integrity remains a responsibility for management and is to be included in the greater purpose of delivering value to every participant in the corporate microcosm[114].

Finally, if shareholder value is judged "flawed in its assumptions, confused as a matter of law, and damaging in practice"[115] or "pernicious nonsense"[116], it is also true that it has pervaded much of "the financial community and much of the business world"[117] and it has determined behavioral incentives , "from performance measurement and executive compensation to shareholder rights, the role of directors, and corporate responsibility"[118] for years and denying it or eradicating it from those realms may require time and efforts.

Professor and scholar Lynn Stout has offered an important theoretical contribution to the governance framework as well as criticism to shareholder value thinking, claiming that human action is not driven exclusively in a single-minded way nor solely oriented in favor of self-interested purposes and of rational choice theory. Contrarily, corporations should seek to "pursue long-term, open-ended projects that benefit multiple human generations".

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[111] Cheffins, *see supra* note 5 at 368.

[112] Margaret M. Blair, *What Must Corporate Directors Do? Maximizing Shareholder Value versus Creating Value through Team Production,* Center for Effective Public Management at Brookings, June 2015, 2 *; See also* Cheffins, *supra* note 5 at 368.

[113]John Stuart Mill & Daniel M. Hausman, *On the Definition and Method of Political Economy, in The Philosophy of Economics: An Anthology* 41–58 (3 ed. 2007). *See also* Joseph Persky, *Retrospectives: The Ethology of Homo Economicus.,* 9 The Journal of Economic Perspectives 221 (1995).

[114] *See* p.21, note 96.

[115]Bower & Paine, *supra* note 46.

[116]Denning, *supra* note 60.

[117] *Id.*

[118] *Id.*

Furthermore, misconceptions of shareholder primacy strengthened by false assumptions on rational choice theory would have acted as harmful constraints for myopic executives. In conclusion, according to Stout, large public corporations should be insulated from the perspective of being profit machines for shareholder returns, but, in a drastic break with the past, exist to address "intergenerational equity and efficiency"[119].

Not only a significant break has occurred in terms of academic work, but also with a pragmatic twist.

Firstly, in a famous letter issued by BlackRock's head Larry Fink to all CEOs it was stated:

> Without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders. It will succumb to short-term pressures to distribute earnings, and, in the process, sacrifice investments in employee development, innovation, and capital expenditures that are necessary for long-term growth... Companies must ask themselves: What role do we play in the community? How are we managing our impact on the environment? Are we working to create a diverse workforce? Are we adapting to technological change? Are we providing the retraining and opportunities that our employees and our business will need to adjust to an increasingly automated world?[120]

Shortly after in August 2019, 181 chief executive officers of major U.S. corporations signed the "Statement on the Purpose of a Corporation" of the Business Roundtable, which firmly expressed an explicit intention of "moving away from shareholder primacy".

Business Roundtable has been committed since the late 1970s to issue Principles of Corporate Governance, giving and sharing common guidelines to design the managerial path for corporate executives. From 1997 on, statements issued have

[119] *See e.g.,* Lynn A. Stout, *The Corporation as Time Machine: Intergenerational Equity, Intergenerational Efficiency, and the Corporate Form*, 38 Seattle University Law Review 685,708, (January 28, 2015). *See also* Diogo Magalhaes, *Ethical Capitalism and the Next Paradigm Shift in Corporate Governance* (March 28, 2020). Retrieved from: https://www.ssrn.com/index.cfm/en/.

[120] Larry Fink, A Sense of Purpose, Harv. L. Sch. F. on Corp. Governance (Jan. 17,2019).

mostly "endorsed principles of shareholder primacy – that corporations exist principally to serve shareholders." In a famous statement dated 1997 in which Business Roundtable acknowledged that "the principal objective of a business enterprise is to generate economic returns to its owners"[121].

The 2019 document witnesses a mentality shift among the most relevant US corporation's executives, as it admits the need to overcome the previous dogma and adopt a "modern standard for corporate responsibility", which would fit the times[122]. CEOs gathering around this subject have expressed shared opinions about the necessity of the modern employer to invest "in their workers and communities" and "to push for an economy that serves all Americans"[123].

In fact, the two schools of thought, shareholder-oriented and stakeholder-oriented, have always shared two common features: the objective of being successful over the long-term and the rationale of agency theory[124] according to which a certain degree of protection against potential executives' abuse ought to be ensured to shareholders[125]. Accordingly, Chief Executive Officers of the Business Roundtable who welcomed the new standard stated that they did so in the firm conviction that it will have affected positively long-term value creation. Other motives include embracing "the essential role corporations can play in […] society", committing to nurture "the needs of all stakeholders", "taking a broader, more complete view of corporate purpose"[126].

The "Statement on the Purpose of a corporation" makes the premise that:

> Businesses play a vital role in the economy by creating jobs, fostering innovation and providing essential goods and services. Businesses make and sell consumer products; manufacture equipment and vehicles; support the national defense; grow and produce food; provide

[121] *See, e.g.*, Jim Ludema & Amber Johnson, *The Purpose Of The Corporation? Business Roundtable Advances The Conversation, Now We All Need To Contribute*, Forbes, Aug. 20, 2019. *See also* Business Roundtable, *Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans*', Aug. 19, 2019. *See also* THE BUSINESS ROUNDTABLE, *Statement on Corporate Governance*, September 1997.
[122] *Id.*
[123] *See* Id.
[124] *See* Chapter 1 at 19, note 89. *See also* Jensen & Meckling, *supra* note 44.
[125] *See* Denning, *supra* note 108. ("Both agree that generating long-term value for shareholders is a good thing. If firms serve customers well and organize employees in ways that allow them to express their talents in service of customers, the company and shareholders will prosper and society will be better off.").
[126] *Supra* note 121.

> health care; generate and deliver energy; and offer financial, communications and other services that underpin economic growth[127].

Therefore, it makes the point that corporations are not insulated from society but nevertheless are integrated in it. For this reason, their action should be consistent with their role, delivering value, as the Business Roundtable document mentions, to the groups with which they interact and which contribute to their going concern. Among the groups cited stand employees, who entirely depend on the corporation and make firm specific investment, consequently, they should be nurtured "through training and education that help develop new skills for a rapidly changing world" cultivating parameters of "diversity and inclusion, dignity and respect".

Other categories are suppliers, customers, communities, to whom the corporation must engage in a fair dealing and treatment, fostering work ethic and good practices .

Only at the end the Statement refers to engagement towards shareholders group who, as capital supplier, enables corporations to "invest, grow and innovate".

The Statement has established challenging posits by alleging as metric of evaluation of corporations' performance the creation of "good jobs, a strong and sustainable economy, innovation, a healthy environment and economic opportunity".

It is important to underline a substantial distinction: stakeholder engagement has made its way as a shared vision and shared principle, nevertheless it should be seen not as an end but as a path through which corporations can serve their purpose individually[128].

From criticisms to shareholder primacy to alternative theoretical frameworks, the governance proposition which has been gradually emerging in the last years is the result of multiple academic debate and intersection of schools of thought and has indeed many components. Over the next chapters it will be given an insight of *stakeholderism* and it will be assessed whether it has a chance to stand against *shareholderism* as dominant model in corporate governance.

[127] *Id.*

[128] *Id* ("While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders").

3. Stakeholder governance: an illusory promise?

Stakeholderism is a complex concept into which a multiplicity of perspectives merge. Firstly, it might be observed by an historical angle, which finds as main reference the already mentioned R. Edward Freeman, "the so-called father of modern day stakeholder theory"[129], according to whom, originally, an understanding of fundamental concerns and expectations of stakeholder groups was quintessential for the survival of the corporation as it served to gather support and information in "the SRI corporate planning process"[130].

Therefore, stakeholders and stakeholder approach served the function of improving the corporate strategy and supporting the definition and implementation of corporate objectives. They were not seen as part of the corporate objective, but as a means to achieve corporate objective, in fact, Freeman refers to stakeholders as "those groups who can affect or are affected by the achievement of an organization's purpose"[131].

By contrast*, stakeholderism* can be thought as a true "alternative to the principal-agent approach", as it emerged about a decade later. Emblematically, academic support was provided by Lynn Stout and Margaret Blair, who affirmed as main advocates of stakeholder governance, making the robust point that "a variety of pivotal doctrines in corporate law […] have proven difficult to explain using agency theory"[132].

For that time, it was highly controversial to affirm that "public corporations are little more than bundles of assets collectively owned by shareholders (principals) who hire directors and officers (agents) to manage those assets on their behalf", in so doing challenging one of the most undiscussed bastions of corporate law[133].

In fact, a consequence of this view was that the necessity to align managers interests with those of shareholders, which has been a central and recurring theme in the economic realm, disappeared. When corporate governance is relieved by the burden

[129] Andrew Keay, *Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and More: Much Ado about Little*, 22 European Business Law Review 8 (2011).
[130] Freeman, *see* chapter 1 at 5, note 22.
[131] *Id* at 49.
[132] Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law,* 85 Virginia Law Review 247,249 (1999). (The theory suggests that the following doctrines cannot be explained through the agency theory nor justified by the agency relationship: "the requirement that a public corporation be managed by a board of directors rather than by shareholders directly; the meaning and function of a corporation's 'legal personality' and the rules of derivative suit procedure; the substantive structure of directors' fiduciary duties, including the application of the business judgment rule in the takeover context; and the highly-limited nature of shareholders' voting rights").
[133] *Id.*

of those doctrines, a *team production approach* arises as method of "explaining both the distinctive legal doctrines that apply to public corporations and the unique role these business entities have come to play in American economic life", which could be resumed in the essential economic function of providing a vehicle for stakeholders to invest firm-specific resources for a joint benefit[134].

Law professor Andrew Keay has suggested that, despite the abundance of approaches that have contributed to make *stakeholderism* an influential orientation and a corporate governance ultimate debate, it is challenging to seize a "mainstream" stakeholder theory. In fact, during the transition from shareholder primacy to a stakeholder-centered conception, a lot of theoretical work emerged, but it was more a "genre of theories" than "one basic theory". For this reason, Keay engaged in a reconstruction of the very general terms of stakeholder approach[135].

Combining Keay's work with the previous authors', cited at the beginning of this paragraph, three typical components on which *stakeholderism i*s premised can be inferred:

Inclusion, which purports to endorse "the full potential of all contributors" and is resumed by the ideal that all constituents work together towards the achievement of common objectives and of "shared benefits". To implement the inclusion standard corporations have been *de facto* working out their own environmental, social and governance (ESG) oriented purpose[136], with which stakeholders can identify to the extent that "consumers increasingly expect brands to have a social purpose beyond mere functional benefits. As a result, companies are taking social stands in very visible ways"[137].

Moreover, inclusion has been a tangible incentive for corporations and managers to the extent to which they have been exposed to crescent pressure to enhance internal CSR norms[138]. Corporate Social Responsibility is characterized as private self-regulation "developed by the private, for profit sector in the form of explicit formal

[134] *Id.* ("an essential but generally overlooked 'contract' fundamental to the nature of public corporations is the 'pactum subjectionis' under which shareholders, managers, employees, and other groups that make firm- specific investments yield control over both those investments and the resulting output to the corporation's internal governing hierarchy").
[135]Keay, *see supra* note 129 at 6-7.
[136]Fisch & Solomon, *supra* note 6 at 103.
[137] *See* Omar Rodríguez Vilá & Sundar Bharadwaj, *Competing on Social Purpose*, Harvard Bus. Rev. (Sept.-Oct. 2017).
[138] Sanjai Bhagat & Robert Glenn Hubbard, *Should the Modern Corporation Maximize Shareholder Value?* 1 (March 3, 2020).

rules, usually codified in some type of code of conduct" and "voluntarily adopted by a group of enterprises or on an industry wide basis"[139].

Following this line of conduct, firms have started to deliver voluntarily reports to disclose sustainability practices, with 93% of Fortune Global 250 firms having provided such reports by 2013[140].

The second standard defining stakeholder orientation is the creation of value for all stakeholders. This is a controversial part for stakeholder-centered orientation, as the process of value creation is regarded as unlikely to be extended to shareholders in a sustainable way for corporate performance and profitability in the long run. Therefore, if the value creation pillar fails *ex hypothesis*, the stakeholder approach will inevitably remain confined into theoretical limits.

However, studies and observation carried out between financial performance of high-sustainability and low sustainability companies over a long period of time found evidence that found that corporations having a "culture of sustainability" and fostering stakeholder-friendly policies and practices are able to create effective value in the long run[141].

The value creation theme have been also enriched by the M. Porter and M. Kramer's "shared value" notion, according to which corporations should pursue operational practices seeking to enforce competitiveness as well as to improve social and economic conditions of the community they are part of. Value creation is rethought according to the dual perspective of economic value and social value coexisting contemporarily and interdependently for the progress of corporations[142].

Endorsing the principles of shared value, corporations "create economic value in a way that also creates value for society by addressing its needs and challenges"[143].

Shared value is massively important as it serves the function of connecting the inclusion pillar with the value creation pillar, implementing and applying CSR norms and practices in the core business strategy.

The third pillar inferred from *stakeholderism* is accountability to all stakeholders.

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[139] *See e.g.*, Benedict Sheehy, *Understanding CSR: An Empirical Study of Private Regulation*, 38 Monash University Law Review 103,105 (2011).

[140] Dallas, *supra* note 16.

[141] *Id.*

[142] *See e.g,* Michael E. Porter & Mark R. Kramer, *Creating shared value*, Harvard Bus. Rev., jan/feb 2011.

[143] See Michael E. Porter & Mark R. Kramer, *Creating Shared Value: How To Reinvent Capitalism—And Unleash a Wave of Innovation and Growth*, Harvard Bus. Rev., Jan.–Feb. 2011, at 1, 4, 8, *; See also* Dallas, *supra* note 16 at 554.

In this regard, mandating social disclosure has proven particularly efficient, because if we assume that firms have to disclose sensitive information to their employees, " such as the percentage of employees covered by their pension plans and the amounts firms contribute to them on their employees' behalf", they will be more likely to take those stakeholders' interests and concerns into account and respond for nonconformity[144].

In order to have a stakeholder-centered governance succeed, stakeholders should be enabled to provide inputs and to participate effectively to the business strategy and to the decision making process. Some schools of thought have been suggesting to emulate the German case, which directly endorses employees participation to corporate life by means of a codetermination system, or Mitbestimmung, "that includes employee representatives on the supervisory board and internal firm works councils" and has been analyzed by several authors as a possible role model for US. Work councils have been also effective in enhancing communication between executives and employees representatives in several European countries, where corporations have acknowledged the need for bodies who could provide a countervailing balance by representing workers and keeping them informed on any significant subject or decision concerning the corporation[145].

The three parameters of inclusion, value creation and accountability to stakeholders provide a clearer overview of *stakeholderism* and how it can enhance the effectiveness within the firm.

It is a matter of fact that the concept of corporate purpose has been undergoing substantial transition toward stakeholderism, partially due to diffusion on a large scale of influential opinions.

However, there has been an important criticism by Lucian A. Bebchuk and Roberto Tallarita, claiming that the proposition of stakeholder governance is a mere illusory promise and conceptually wrong[146].

Their thesis is articulated according to the following highlights.

In first place, *stakeholderism* is deemed as not beneficial for stakeholders and even harmful for the corporation's normal activities and operations, because costs would be

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[144] Dallas, *supra* note 16 at 557.

[145] Bennet Berger & Elena Vaccarino, *Codetermination in Germany – A Role Model for the UK and the US?,* Bruegel Blog (Oct. 12, 2016). *See also Employee Involvement – European Works Councils,* European Commission, *; See also* Dallas, *supra* note 16 at 558.

[146] Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance* (February 26, 2020). Forthcoming, Cornell Law Review, December 2020.

imposed on shareholders/capital suppliers without an adequate benefit in return (only a marginal benefit, to the extent that they form only one of the multiple categories of stakeholders). Shareholders would, according to Bebchuk, bear the cost of *stakeholderism* while subjected to insulation from corporate executives, to the detriment of accountability[147].

A second point is the bipartition between the two conceptions of *stakeholderism,* which are "instrumental" and "pluralistic", depending on whether the stakeholder-centered governance is intended as an end or as a means towards a broader objective.

The former intends the welfare of stakeholder constituencies worth pursuing as long as it will be instrumental for the ultimate purpose of benefitting shareholders and includes the *enlightened shareholder value* approach, which will be deeply analyzed in the following chapter. By contrast, pluralistic approach is founded upon the idea of stakeholders' welfare as an autonomous end, having a value "independently of its effect on the welfare of shareholders"[148].

Directors are consequently exposed to the responsibility of choosing among "a plurality of independent constituencies" the weight to assign each and are relied upon to define whose interest deserve the most to be taken into account.

An expression of pluralistic stakeholderism is represented by the so called "constituency statutes", which have been adopted by several US states between late 1980s and early 1990s[149].

Bebchuk and Tallarita claim that the task of selecting interests to privilege and pursue is "Herculean" and is further aggravated by a scarce system of motivational incentives.

The last point concerns the structure of law of corporation in the State of Delaware, where most US companies are incorporated, which reveals a clear insight of the fact that historically directors have addressed their discretionary powers to shareholders

[147] *Id* at 58 ("The reduced accountability to shareholders would not be accompanied by the introduction of a novel accountability to stakeholders: stakeholderism does not advocate granting stakeholders the right to vote or to sue unfaithful directors and officers, but rather relies […] on well-meaning corporate leaders using their discretion to incorporate stakeholder interests into their objectives.) *See also* Lucian A. Bebchuk*, The Myth That Insulating Boards Serves Long-Term Value,* 113 COLUM. L. REV. 1637, 1673-86, (2013).

[148]*Id* at 11-17.

[149] *Id* at 8-9 ("These statutes—commonly known as stakeholder statutes, constituency statutes, or other constituency statutes—are often presented as a clarification of the 'interests of the corporation' that directors have the duty to serve. The interests of the corporation, the law makes clear, include the interests of employees, customers, suppliers, and sometimes creditors, local communities, or even the whole economy or nation").

and implicitly engaged for the purpose of shareholders' value[150]. The relationship between Delaware law and shareholder value is to be examined in the next chapter in a wider legal framework.

Concerning the key points on which Bebchuk and Tallarita base their analysis, it is interesting to notice some counterarguments suggested by Colin Mayer, whose paper "Shareholderism versus Stakeholderism – A Misconceived Contradiction. A Comment on 'The Illusory Promise of Stakeholder Governance' by Lucian Bebchuk and Roberto Tallarita" serves the important function of dissipating any doubt on the viability of stakeholder governance and, what is more important, carries out a lucid reflection on corporate purpose devoid of aprioristic verdicts.

What in Bebchuk and Tallarita's view is depicted as an "anathema", that is, directors having to make judgements and assign weights on their own, is described by Mayer as a pervasive and recurring condition in corporations, as "directors have the right to act with judgment – business judgment", which implies that "trade-offs and judgements are […] ubiquitous". The real problem would have been, according to Mayer, myopically misconceived[151].

In fact, the ubiquity of trade-offs implies that the question passes from whether or not they should be made to "what purposes and values should underpin them, and who should determine and implement them". Therefore, if it is true that executives, or generally, directors do have to make choices among many interests and stakes, it is also true that in any case they have had "carte blanche" to act arbitrarily, for the reason that "(t)hey act according to the reasons why the company was created and exists and what it is there to do, namely its purposes"[152].

The latter should be the primary concern for management and the basis of an entity, instead of a shareholder primacy (that Bebchuk and Tallarita allege as sole end of management) which programs and mechanizes executives as value maximizers[153].

If executives are to value costs and benefits which are non-monetary, then Mayer brilliantly suggests that the best way in which they can do it is not doing it at all, mainly

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[150] *Id* at 30. *See also* 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 Law Review 761 (2015).

[151] Colin Mayer, *Shareholderism Versus Stakeholderism – a Misconceived Contradiction. A Comment on 'The Illusory Promise of Stakeholder Governance' by Lucian Bebchuk and Roberto Tallarita* (June 3, 2020). European Corporate Governance Institute - Law Working Paper No. 522/2020.

[152] *Id* at 3.

[153] *Id.*

for two reasons: because the object of evaluation is non-monetary, the terms and parameters assumed for evaluation should be non-monetary too. In fact:

> A shareholder perspective presumes that money is the sole objective. It is not. It is not the corporate purpose. It is a product of it, not the defining motivation. Just as we are steadily coming to realize that the pursuit of happiness is not the source of it, and on the contrary potentially a cause of psychological distress, so we are increasingly appreciating that the pursuit of profit is not its source but the cause of much dysfunctional conduct[154].

The paradigm would shift from attaching financial value to every outcome, to defining values according to which the corporation should be run and using them as weights for corporate actions[155]. The failure of *shareholderism* has been "seeking to translate everything into monetary terms", purporting to privilege one absolute idea and objective over all the others and struggling to find one standard to evaluate even what is by its own nature incommensurable. That is the acme of the critique Mayer addressed Bebchuck and Tallarita, who describe merely an economic reality where shareholder value is presumed *ex ante* and carry out their analysis and conclusions according to a "status quo illusion"[156].

The relationship between shareholders and managers is still a quintessential element of corporations, albeit with significant differences. Shareholders do not embody the purpose, they set the purpose which defines the corporation and which will be delivered by directors[157].

Mayer concludes his reflection by clarifying the real object of the debate in corporate governance, which is not the rivalry between *stakeholderism* and *shareholderism* and

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[154] *Id* at 5.

[155] *Id* at 1.

[156] *Id* at 8 ("all that BT do is to demonstrate that shareholder interests prevail in a world in which the superiority of shareholder value is presumed: incentives are aligned to shareholder interests; threats of takeovers, shareholder activism and proxy votes are motivated by shareholder value enhancement; corporate law imposes fiduciary responsibilities on directors to uphold shareholder interests; and regulation is used to align corporate with societal interests where competitive markets fail to do so").

[157] *Id* at 6 ("Where there are owners in the sense of shareholders who hold significant blocks of shares then those shareholders are in a position to determine a company's purposes and values").

the question would have been drastically misconceived by Bebchuck and Tallarita accordingly[158].

In fact, if the premise is that corporations should be able to "solve problems […] profitably" then both approaches can coexist according to "which delivers the best outcomes" and to what the corporate purpose is. This complementarity enriches economic world in general and corporations in particular, providing an intuition that there is not a true need for considering the divergence between the two orientation a contradiction[159].

III. From ESV to Federal Incorporation.

1. Implementing corporate purpose in a controversial legal framework.

The macro-framework of *shareholderism* versus *stakeholderism* is massively shaping the latest corporate governance debates from a conceptual perspective, fueling influential opinions and ideas about the best way in which the *Berle-Means corporation* should be run, by expressing its potential in American environment to the full, while embodying a *locus* where multiple constituencies can realize their own potential.

Without doubt the theoretical outline is vast and composed by plenty of theories and to some degree shared initiative has been enthusiastically embraced, as has been the case for Business Roundtable Statement.

However a rich debate has to keep an eye on the law in order to draw an accurate and realistic picture and acknowledge what the situation is and if (and how) changes can be implemented.

In fact, an instance of new corporate priorities for corporations may be founded upon a solid theoretical basis and be more or less shared among the public and law scholars,

[158] *Id* at 10.

[159] *Id* at 11 ("The shareholder/stakeholder contradiction is not a contradiction at all. They are neither always one and the same, nor are they always in conflict. They are in general complementary ways of delivering the plurality of outcomes that we should be seeking of our economic systems, particularly in an era where the dire consequences of promoting one at the expense of the other has become all too clear").

but nevertheless mismatch a series of consolidated practices and instances within the legal context.

This was the case for Delaware General Corporation Law (DGCL), the most prominent law of incorporation among all American jurisdictions, which embraced shareholder primacy since this doctrine arose as predominant ideology during the 1980s[160].

This brought two fundamental consequences: the first, that academics, lawyers, economists, scholars and judges have considered DGCL a *trait d'union* and so shareholder value, which incontrovertibly ended up shaping the entire judicial system, laws, ruling in cases and corporate executives' behavior, culture and mind-set. The second, that "whenever new rules of governance have been considered, they have been seen through a single prism: How does this rule affect stockholders?"[161].

It is problematic to deviate from an original doctrine after decades in which it has been permeating corporate culture and judiciary system so deeply, as every discussion and issue raised in corporate governance has been intended addressed to executives, directors and shareholders, while stakeholders would be very unlikely to participate[162].

For this reason, to the question whether it is time to reconsider the traditional view of stockholders' primacy, it is dubious that the path-dependent system in the State of Delaware would enact substantial change[163].

The divergence between States' approaches to this theme gets more evident and tangible in light of "constituency statutes", adopted by some States (not Delaware though). Such statutes enable the pursuit and promotion of interests other than shareholders' and, at least in theory (in practice there has been scarce attempt to enhance the social responsibility of corporations), allow directors to exercise their discretion for the purpose of allocating value between constituencies as "mediating hierarchs"[164].

However, directors operating in entities incorporated in "pluralistic approach" jurisdictions, have been still employing their discretion mostly to benefit shareholders and indeed they "have made little use of their bargaining power to secure protections

[160] *See* David J. Berger, *Reconsidering Stockholder Primacy in an Era of Corporate Purpose* (February 2, 2019).
[161] Strine, *supra* note 150 at 8; *See also* Jonathan D. Springer, *Corporate Constituency Statutes: Hollow Hopes and False Fears*, 1999 ANN. SURV. AM. L. 85, 123 (1999).
[162] *Id.*
[163] Berger, *see id.* at 22 (The effect of stockholder primacy ideology on employees, income inequality, short-termism and a number of other issues has been the topic of substantial debate for several years. Less developed has been how the dominant ideology of stockholder primacy impacts the government's effort to regulate corporate behavior.")
[164] Blair & Stout, *supra* note 132. *See also supra* note 150 *and accompanying text*.

for stakeholders", proving that even when directors are enabled to do so, they are unlikely to pursue the benefit of all the constituencies[165].

Delaware has diverged from "pluralistic" tendencies, even though § 101(b) of the DGCL, which allows a corporation to pursue "any lawful purpose," has been interpreted by many as "an expression of Delaware's commitment to a constituency-based approach"[166].

This argument fails immediately as the structure of corporate law is examined carefully: it cannot be ignored that, especially under Delaware law, incentives are generated so as to retain managerial power from making stakeholders' welfare the end of corporate governance and a direct consequence of this fact is that boards are not free, nevertheless they are constrained by their perception of authority created by the law[167].

Delaware law has granted directors a wide discretion to the extent that they considered "stockholder welfare their sole end" and took other interests in consideration "only as a means of promoting stockholder welfare"[168].

Leo Strine, former Chief Justice of the Delaware Supreme Court, stated the necessity to observe DGCL with a "clear-eyed look" in order to derive some essential features proving the fact that such system is deliberately shareholder-centric; in this respect, he alleged that:

> (T)he contention that it proves directors are free to promote interests other than those of stockholders ignores the many ways in which the DGCL focuses corporate managers on stockholder welfare by allocating power only to a single constituency, the stockholders. Under the DGCL, only stockholders have the right to vote for directors[169]; approve certificate amendments[170]; amend the bylaws[171]; approve certain other transactions such as mergers[172], certain asset sales and

[165] Bebchuk, *supra* note 146 at 4.
[166] Strine, *supra* note 150 at 6.
[167] *Id.*
[168] *Id*. at 10.
[169]Del. Code tit. 6, § 211(b) (2009) *; See also* Strine, *supra* note 150 at 6.
[170] *Id*. § 242.
[171] *Id.* § 109.
[172] *Id.* § 251.

> leases[173]; and enforce the DGCL's terms and to hold directors accountable for honoring their fiduciary duties[174]. In the corporate republic, no constituency other than stockholders is given any power[175].

Also the ruling in case-law cannot be ignored, as demonstrate the landmark decision of *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* of the Delaware Supreme Court, in which it emerges clearly that the pursuit of other constituencies' interests is possible, but it has to be subordinated to those of shareholders or to the condition that there are related benefits to shareholders[176]. In other words, it has to be instrumental, "as a means to the end of increasing stockholder welfare […] and not an end"[177].
The decision in Revlon has been based on a solid (and dual) foundation.
Firstly, directors' scope of authority is underpinned by the fiduciary duty of loyalty and, consequently, in undertaking any action or decision they cannot ignore that they are acting as fiduciaries for the corporation and preferring a third party over shareholders would put directors in breach. The nature of the fiduciary relationship between the directors and shareholders is flanked by the nature of the relationship with stakeholders, which is, by contrast, contractual. Contractarianism assumes that stakeholders' protection is implicit in the contract with the corporation and therefore any further protection by the law is unnecessary[178].
Another fundamental case in which Delaware Court of Chancery has remarked that directors are bound by the duty of loyalty is *eBay Domestic Holdings, Inc. v. Newmark*[179].
Chancellor Chandler made a clear statement which can be thought as resuming Delaware's position as shareholder-centric jurisdiction:

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[173] *Id.* § 271.
[174] *Id.* § 327.
[175] Strine, *supra* note 150 at 6-7.
[176] 506 A.2d at 182 *; See also* Strine, *supra* note 150 at 8. ("[T]he Revlon board could not make the requisite showing of good faith by preferring the noteholders and ignoring its duty of loyalty to the shareholders. The rights of the former already were fixed by contract. The noteholders required no further protection, and when the Revlon board entered into an auction-ending lock-up agreement with Forstmann on the basis of impermissible considerations at the expense of the shareholders, the directors breached their primary duty of loyalty").
[177] Strine, *supra* note 150 at. 16
[178] Revlon, 506 A.2d at 182. *See also* Strine, *supra* note 150 at 12.
[179] 16 A.3d 1 (Del. Ch. 2010). *See also supra* note 150 at 18 .

> The corporate form in which craigslist operates, however, is not an appropriate vehicle for purely philanthropic ends, at least not when there are other stockholders interested in realizing a return on their investment. Jim and Craig opted to form craigslist, Inc. as a for-profit Delaware corporation and voluntarily accepted millions of dollars from eBay as part of a transaction whereby eBay became a stockholder. Having chosen a for-profit corporate form, the craigslist directors are bound by the fiduciary duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders[180].

It would be nevertheless a naïve misrepresentation to insist on the fact that corporate purpose has been totally overturned in a jurisdiction deeply permeated by stockholder primacy idea.

If incentive systems are structured, as it is evident, so as to reward share's price maximization and returns to shareholders and if power to displace is allocated only to one constituency, it will be a natural consequence that corporate executives please that one constituency[181].

It is a matter of fact that this incentive system leads to a dysfunctional behavior and to long-term suboptimal outcomes, as executives will concentrate efforts in a short-sighted attempt to increase the value of shares, however, according to Strine, acknowledging the *status quo* for what it is, is a crucial step for implementing some form of change[182].

Furthermore, Strine claims that "advocates for corporate social responsibility" are ignoring incentives and constraints imposed to directors by the "corporate law of the most important American jurisdiction"[183].

In order to enhance the social responsibility of the corporation properly and to empower other constituencies "then statutes should be adopted giving those constituencies enforceable rights that they can wield", protection should be ensured by

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[180] *See Id*. at 34. *See also supra* note 150 at 18-19.

[181] Berger, *see supra* note 160 at 24.

[182] Strine, *supra* note 150 at 6.

[183] *Id.* at 6.

means of externality regulation and incentives should be provided consistently with the purpose[184].

The legal framework under DGCL appears in practice more complex and less incline to radical reforms than the theory would suggest and supporting stakeholder governance may not be enough in an inflexible and impermeable jurisdictional realm. In fact, it seems that defining a governance paradigm on corporate purpose is one thing, implementing a model which does not remain a mere abstraction is completely another. Two fundamental approaches which are based on pieces of legislation will be examined throughout the next chapters.

2. Enlightened Shareholder Value.

Enlightened Shareholder Value approach originated from a provision of UK corporate law, namely section 172(1) of the Companies Act 2006 and defines a paradigm in which "a director of a corporation must act in the way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of the members as a whole"[185].

The section then lists a number of factors, which directors have to consider in order to ensure the achievement of the purpose of success, improving the quality of the decision-making process. Such factors are so stated by the section:

> (a)The likely consequences of any decision in the long term;
> (b)the interests of the company's employees;
> (c)the need to foster the company's business relationships with suppliers, customers and others;
> (d)the impact of the company's operations on the community and the environment;
> (e)the desirability of the company maintaining a reputation for high standards of business conduct; and
> (f)the need to act fairly between the members of the company[186].

[184] *Id.* at 9.
[185] Companies Act (UK) §172(1).
[186] Companies Act (UK) §172(1).

The section provides *prima facie* the basis for a dual result: firstly, it obliges directors to consider stakeholders' interests to a wider degree when taking any decision related to the benefit of the members. Secondly (this point is recommended mostly to large public corporations), the requirement to be more inclusive leads to a series of desirable behaviors such as more disclosure of material information to outsiders and production of non-financial reviews relevant to stakeholders, which "address the need in a modern economy to account for and demonstrating stewardship of a wide range of relationships and resources, which are of vital significance to the success of modern business, but often do not register effectively, or at all, in traditional financial accounts"[187].

Without doubt, he "stakeholder-friendly terminology" introduced by section 172(1) of the Companies Act 2006 has left much room for opinions and interpretations concerning the relationship between a corporation and its constituencies, which is based on mutual advantage and reciprocal enrichment: in fact, corporations benefit from stakeholders for contributions in terms of human capital, reputational capital, financial proceeds, production, distribution and supply of goods and services and social recognition in the environment in which they operate. Stakeholders rely on the corporation for "jobs, salaries, sale orders, products and services, loan payments, and positive spillover effects"[188].

Since it is implicit in the nature of corporation to carry out some form of transaction with third parties, it is a natural consequence that they will, to some degree, bear a stake and be concerned about how corporate executives will run the corporation.

Even most of the advocates of *shareholderism* have acknowledged that, in order to achieve the purpose of "maximizing long-term value for shareholders", it is necessary to have some regard for stakeholders and on how the operations affect their position[189].

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[187] Sabrina Bruno, *The 'Enlightened Shareholder Value' in UK Companies Ten Years Later: What the European Directive N. 2014/95/EC Can Do,* Volume in Memoria di Claude Ducouloux-Favard, Il Diritto Comparato nel XXI secolo. Scienza, Arte e Passione Civile, Bruylant, Larcier, Minerva Bancaria, Forthcoming (2015) ("the Final Report for the Reform - drafted by the Company Law Review Steering Group – had provided for all companies (including private companies) the duty to publish the Operating and Financial Review (OFR), as part of the financial statements, to disclose, among other, also information on the company policies towards employees, environment, community, social issues and any other information material for the company's reputation").

[188] Bebchuk & Tallarita, *supra* note 146 at 14.

[189] *Id* at 11 ("For example, how the company treats employees could well affect its ability to attract, retain, and motivate the members of its labor force; how the company deals with customers could affect its ability to attract and retain them; and how the company deals with local communities or the environment could well affect its reputation and standing in ways that could be important for its success. Thus, it is undeniable that, to effectively serve the goal of enhancing long-term shareholder value, corporate leaders should take into account stakeholder effects—as they should consider any other relevant factors.")

The *enlightened shareholder value* approach has been interpreted as an "instrumental stakeholderism" approach, as the stakeholder concern is not recognized as an end in itself, nevertheless is instrumental to the "benefit of the members as a whole"[190].
Bebchuk and Tallarita have reckoned that such instrumentality is still to be addressed to the purpose of shareholder value, explicitly stating that all the factors expressed in section 172(1) "are meant to be non-exhaustive examples of potentially relevant stakeholder effects" and that directors have to include stakeholders' interests in the decision-making process "as a means to the end of shareholder welfare"[191].
Moreover, they claim that, even though the connotation "enlightened" would seem to confer a lighter meaning on the traditional view of shareholder value, the conceptual difference between the two approaches would not exist at all:

> Whenever treating stakeholders well in a given way would be useful for long-term shareholder value, such treatment would be called for under either enlightened shareholder value or shareholder value. And whenever treating stakeholders well would not be useful for long-term shareholder value, such treatment would not be called for under either enlightened shareholder value or old-fashioned shareholder value.
> In other words, enlightened shareholder value is only a particular articulation of shareholder value. Maximizing long-term shareholder value would sometimes call for closing plants, and other times for improving employment terms. Such stakeholder-favoring decisions, however—exactly like their stakeholder-disfavoring counterparts—would only be as good as their instrumental value to shareholders[192].

However, as the Company Law Review Steering Group (CLRSG) commented, the ESV approach preserves the directors' alignment with the interests of shareholders consistently with the incentive system, eliminating at the same time some undesirable effects of shareholder value maximization such as short-termism focus. In fact, directors are called under the ESV to assess the sustainability of their decisions according to time

[190] *Id* at 14-15.
[191] *Id* at 12.
[192] *Id* at 12-13.

horizon and the effect that a certain balance of interests will determine on corporation's vital relationships with stakeholders[193].

Therefore, according to this view, though preserving some core characteristics of shareholder value, ESV improves significantly the flaws of the previous approach which had been criticized.

For this reason, when interpretations of section 172 (1) arose generously, enthusiastic comments defined ESV approach "the development which would see a major economy move out of one of the two mainstream approaches and head to the centre ground"; in short, it was highly believed to be a pioneer establishing a compromise between two opposite ends[194].

By contrast, the extent to which the provision has determined the affirmation of a new hybrid approach over the previous ones is widely left to the application of the courts.

Lord Goldsmith underlined that under ESV approach directors are required to form a bona fide judgement about "what is to be regarded as success for the members as a whole" and in doing so they "have to determine the extent to which the promotion of the shareholders' interests requires the company to be generous in relation to non-member interests"[195].

This statement witnesses that since it is up to directors (not to courts) to assess a judgement about the interests and strategy to pursue and evaluate the convenience of any undertaking in light of their own parameters it is rather difficult that directors are found in breach under this provision, especially if good faith is presumed[196].

The ability of section 172 (1) to be effective is undermined by the lack of enforceability, which appears conferred exclusively on shareholders. Even though the section states a number of interests that directors should take into account, should they disregard those interests or ignore to take them in consideration, a remedy is not provided by the law and "a right without a remedy is worthless"[197].

Moreover, should shareholders be damaged or suffer a loss caused by a failure of directors to promote the success of the company, they could initiate a derivative

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[193] Keay, *supra* note 129 at 24 ("So, while the provision ensures the maintaining of the shareholder-centred paradigm, at the same time, it is asserted by some, it permits, in appropriate circumstances, consideration being given to a wider range of interests").

[194] *Id* at 20.

[195] *Id* at 25.

[196] *Id* at 27 ("it is very difficult to demonstrate that the directors have breached their duty of good faith").

[197] M. McDaniel, *"Bondholders and Stockholders"* (1988) 13 Journal of Corporation Law 205 at 309 *; See also* Keay, *supra* note 129 at 38.

proceeding on behalf of the company to seek recovery for the company itself, whose assets have been compromised. Shareholders "might be willing to take action if directors fail to promote the success of the company or to act fairly as between members […] it is unlikely they might be prompted to sue directors when different stakeholders are prejudiced: derivative claims involve costs while the recovery in litigation goes to the company itself"[198].

Therefore, if stakeholders do not have the power to seek a remedy under this provision, the question whether the attempt to enhance directors' stewardship and accountability will lose consistency remains.

The contrast between the intention of enhancing social responsibility within corporations and the absence *de facto* of an "enforcement mechanism" to ensure coherency and compliance with the objective of the provision have conveyed some controversial criticism and doubts about whether the section intends to bring a *stakeholderism* twist in corporate governance[199].

It has been underlined by Sabrina Bruno that "(s)ection 172 was meant to show a different model of public company overriding the nexus of contracts approach and aiming at recognising a corporate social responsibility by involving the consideration of various stakeholders' interests and needs within the public company", nevertheless it would be erroneous *ex ante* to define such governance paradigm *stakeholderist*[200].

The explicit reference to stakeholders' interests in the section certainly has its importance in the legislative context and constructive impact on the process of corporate decision-making, but directors are required to ensure *in primis* the success of the corporation for the members and only secondly and "in so far as they enhance the value of the company and its shares" consider stakeholders' concern[201].

In light of these considerations, Bebchuk and Tallarita's interpretation of ESV as conceptually equivalent to shareholder value theory seems to be confirmed by the scarcity of enforcement and accountability mechanism.

However, there is another side of the story which is to be considered in order to gain a full insight of the significance of the provision, the intention of the legislator in

[198] Bruno, *supra* note 187 at 3.
[199] Keay, *supra* note 129 at 48.
[200] Bruno, *supra* note 187 at 1.
[201] *Id* at 5.

introducing it and the mechanism through which the provision can effectively be endorsed[202].

There are, in fact, other provisions in the Companies Act according to which the instrumentality of *stakeholderism* under section 172 has been interpreted by Sabrina Bruno with an educational connotation[203].

Firstly, section 417 (2) provides the requirement for listed companies to report "the business review", whose statutory function is to address an informative analysis to members in order to determine whether they have complied with their obligations under Section 172[204].

In 2013 the Business Review was substituted by The Strategic Report under section 414A ff., introducing some changes such as the report of "risks and uncertainties facing the company", "information about environmental matters (including the impact of the company's business on the environment)", "employees, social, community and human rights issues" and related adoption of policies[205].

In light of these provisions one could infer the educational function of section 172 suggested by Professor Bruno in securing that directors materially apply the criteria of stakeholders' interests in the phase of decision-making through an affiliation strategy. In fact, the strategic report functions as a disclosure requirement for directors, so that they will automatically be induced to comply with section 172 in order to be able to provide explanation to their assessment of stakeholders' interests in their decisions *ex post*[206].

In conclusion, as stated by S. Bruno:

> The disclosure regime […] through sec. 414A ff. CA 2006 (the strategic report) - fosters this educational function serving as monitoring for its compliance in listed companies […]. Therefore directors may breach the duties stated under sec. 172(1) whenever they do not give adequate attention to any of the factors therein addressed and consequent decisions are clearly unsuccessful in business terms. This may well happen, for example, if the company fails to put in place adequate

[202] Bebchuk & Tallarita, *supra* note 146 at 3.
[203] Bruno, *supra* note 187 at 6.
[204] *Id* at 5.
[205] *Id* at 5-6.
[206] *Id* at 6.

environmental protection, controls or engages in illicit business practices against competitors which may lead to loss of consumer confidence, bad publicity etc. A damage to the company's assets however shall always occur to enforce the breach of section 172(1)[207].

ESV approach marks a turning point in evaluating the impact of non-financial information on the corporate environment and decision-making process, as it defines a paradigm in which the success of the corporation and the benefit of members is driven by a global and holistic vision of components involved in corporate life, "by combining long-term profitability with social justice and environmental protection"[208].

3. Federalization: towards a paradigm of Accountable Capitalism.

While the ESV approach is a relatively new interpretation stemming from a modern provision, Federalization is a process which somehow can be seen as parallel to the development and history of the American corporation and corporate governance[209].
Over the course of history of corporate America, State legislation and Federal legislation have been embodying a duality of domains: in general corporate affairs are left to the former, nevertheless federal intrusion in the state corporate law serves the function of oversight in order "to remediate state shortcomings, particularly during times of crisis"[210].
In other words, federal legislation comes "as a poignant reminder to the states" whenever a negligence of "fiduciary conduct" occurs within the state domain and an intervention may seem justified[211].
It is appropriate to clarify that Federalization of corporate governance is not to be regarded as an idea which manifested at a defined, stationary moment in history, instead it is an evolutionary itinerary "commenced well over a century ago" and regulating various aspects of corporate life[212].

[207] *Id.*
[208] *Id.*
[209] Marc I. Steinberg, The Federalization of Corporate Governance—An Evolving Process (2019). 50 Loyola University Chicago Law Journal 539, 541 (2019).
[210] *Id* at 542.
[211] *Id* at 542.
[212] *Id* at 541.

In particular, there are some areas in which federal legislation has been more pervasive, in order to ensure investor protection and safety of securities transaction, as has been the case with the Securities Act (1933)[213] and the Securities Exchange Act (1934)[214] when "the federal government became the premier overseer of the multifaceted aspects of securities regulation"[215].

In fact, the Securities Exchange Commission, instituted by the Securities Exchange Act, is able to prevail over state law, as demonstrated by the All-Holders rule, which mandates that, in the eventuality of a tender offer, all holders of a same class of stocks are to be ensured equal treatment (the offer must be made available to all holders).[216]

Moreover, matters particularly relevant to federal legislation and in which a strong presence has been remarked have been board composition, audit and compensation committees, and shareholder advisory vote, exhibiting a clear intention to confer a degree of uniformity to given areas of corporate governance, where a tendency of states towards a careless and dysfunctional conduct emerges[217].

An intense process of federalization of corporate governance involves "the enactment of federal legislation and the presence of vibrant SEC regulation" and has emerged more evidently during periods of economic distress or recession, when a step back from deregulation was highly desirable[218].

This was the case in two landmark Acts in which federal legislation interfered significantly with corporate governance: the Sarbanes-Oxley Act of 2002[219] and the Dodd-Frank Act of 2010[220], both enacted in response to a threat to the soundness of financial system[221].

The Sarbanes-Oxley Act (commonly known as SOX) occurred in an extremely delicate period, namely in the post-Enron and post-corporate scandals years, when, as already mentioned in Chapter One, accounting fraud and deception practices had

[213] 15 U.S.C. § 77a et seq.

[214] 15 U.S.C. § 78a et seq. ("To provide for the regulation of securities exchanges and of over-the- counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes").

[215] Steinberg, *supra* note 209 at 542.

[216] *Id* at 551.

[217] *Id* at 546.

[218] *Id* at 551.

[219] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010) (codified at 15 U.S.C. § 78o).

[220] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, H.R. 3763, 107th Cong.

[221] Bengt R. Holmström & Steven Neil Kaplan, *The State of U.S. Corporate Governance: What's Right and What's Wrong?* (September 2003). ECGI - Finance Working Paper No. 23/2003.

proven that areas such as oversight of boards of directors and auditing were extremely weak and required a regulatory maneuver in order to ensure adequate investors' protection and confidence[222].

Most importantly, this Act "established the Public Company Accounting Oversight Board, to oversee the audit of public companies that are subject to the securities laws, and related matters" and further mandated new standards for auditor approval, required additional and accurate disclosure, demanded more accountability for fraudulent financial activities enhancing criminal penalty[223].

Similarly, the Dodd-Frank Act (Dodd–Frank Wall Street Reform and Consumer Protection Act) adopted enforcement actions in the "aftermath […] of the financial crisis, declaring the intention "(t)o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes"[224].

Those pieces of legislation serve as an example in order to show in which case, for which purpose and to what extent the feral legislation opts for an intensified regulation and an intrusion in the corporate governance affairs, enhancing the federalization process[225].

The echo of federal law in the last few years has come back in the spotlight, in the shape of a new paradigm represented by the federal bill called the "Accountable Capitalism Act" (ACA), which has been proposed by Senator Elizabeth Warren in August 2018. It acknowledges that there is a "urgent need to return to the era when American corporations produced broad-based growth that helped workers and shareholders alike", thus bringing back motives and impressions seemingly recalling Managerial Capitalism era. The ACA bases this reflection on a list of many factors which have fueled the divergence from the ideal paradigm of equal benefit and shared growth among different categories of corporate constituencies, specifically it focuses

[222] *See Id* ("To a casual observer, the United States corporate governance system must seem to be in terrible shape. The business press has focused relentlessly on the corporate board and governance failures at Enron, WorldCom, Tyco, Adelphia, Global Crossing, and others. Top executive compensation is also routinely criticized as excessive by the press, academics, and even top Federal Reserve officials. These failures and concerns, in turn, have served as catalysts for legislative change").

[223] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, H.R. 3763, 107th Cong.

[224] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010) (codified at 15 U.S.C. § 78o).

[225] Steinberg, *see supra* note 209 at 560.

on the rise of shareholder primacy and on the undesirability for American economy of the fact that wages of median American workers have barely risen compared to earnings devoted to shareholders, which skyrocketed to 93% in just ten years.[226]

Since when the legitimate purpose of the corporation was ascertained to be the generation of return to owners, the Act states, the concentration of wealth and richness has yielded itself to the point that "making the richest Americans even richer at all costs" has become the sole commitment[227].

However, while the criticism addressed to shareholder value maximization is not a new point, as shareholder primacy has knowingly produced a series of shortfalls, the new and at the same time most controversial theme has been represented by the fact that, in order to achieve the above-stated purpose, large public corporations would be required to obtain a federal charter, which will confer them the status of "United States corporations"[228]:

> The new federal charter obligates company directors to consider the interests of all corporate stakeholders – including employees, customers, shareholders, and the communities in which the company operates. This approach is derived from the thriving benefit corporation model that 33 states and the District of Columbia have adopted and that companies like Patagonia, Danone North America, and Kickstarter have embraced with strong results.
>
> […] The boards of United States corporations must include substantial employee participation: Borrowing from the successful approach in Germany and other developed economies, a United States corporation must ensure that no fewer than 40% of its directors are selected by the corporation's employees[229].

[226] Accountable Capitalism Act, S. 3348, 115th Cong. (2018).

[227] Accountable Capitalism Act, S. 3348, 115th Cong. (2018).

[228] Accountable Capitalism Act, S. 3348, 115th Cong. (2018).

[229] Accountable Capitalism Act, S. 3348, 115th Cong. (2018) (Other standpoints of the Act are stated as follows: "Sales of company shares by the directors and officers of United States corporations are restricted: Top corporate executives are now compensated mostly in company equity, which gives them huge financial incentives to focus exclusively on shareholder returns. To ensure that they are focused on the long-term interests of all corporate stakeholders, the bill prohibits directors and officers of United States corporations from selling company shares within five years of receiving them or within three years of a company stock buyback […] United States corporations must receive the approval of at least 75% of their shareholders and 75% of their directors before engaging in political expenditures. This ensures any political expenditures benefit all corporate stakeholders. […] A United States corporation that engages in repeated and egregious illegal conduct may have its charter revoked").

A claim mandating federal chartering and requiring incorporation to be federal might raise a series of general and public discontents: firstly, as underlined by Forbes, a federal charter implies something new compared to the American experience, in which "the states have chartered corporations according to their various views of how companies should organize and conduct themselves"[230].

Parallelly, corporations have historically tended to allocate among American states according to the most favorable legislative framework and, as a consequence, states have been attempting to design sets of corporate laws which could best respond to corporations' instances and needs.

In a letter written in support of Elizabeth Warren's Accountable Capitalism Act, a group of law scholars emphasized how there has been a process of gradual losing sight of the real nature of corporation, tracking the "original purpose of the Corporate privilege" in America and the landscape in which American corporation have found fertile ground. If the institution of the corporation as it is known today is ubiquitous, originally "legal entities authorized to act and hold assets in their own names while shielding their owners from legal accountability" were conceived for the purpose of public benefit[231].

In fact the law created the device of "corporate privilege" in the form of a "legal fiction specifically in order to ensure and stimulate efficiently the construction of public facilities, infrastructures and "supply of widely needed public goods" and such privilege had been conceived to be strictly conditional to the purpose of utility function assigned[232]:

> The corporate privileges were also, again, meant solely to encourage the owners of scarce capital to organize and finance projects for the public good, during a time when capital was indeed scarce and reliable public revenue was correspondingly hard to come by. For this very

[230] Milton Ezrati, *Senator Warren's Accountable Capitalism Bill Has Big Problems*, Forbes (Feb 5, 2019).

[231] Letter to Senator Warren from Cornell University Law School, August 15, 2018. Retrieved from: https://www.warren.senate.gov/imo/media/doc/Federal%20Corporate%20Charter%20Letter%20of%20Support.pdf.

[232] *Id.* ("That method was to permit – solely for specific and well-defined public purposes – the chartering of legal entities whose owners could not be held liable for losses inflicted or caused by those entities, and which could not be sued by creditors of their owners, so long as the losses occasioning suit were inflicted by the entity only in its authorized course of operation. This is all that "the corporation" was – and remains all that the corporation should be").

> reason, the privileges were operative only insofar as the incorporated entity was actually pursuing such projects.
> Incorporated entities that strayed from their publicly defined purposes were said to have acted "ultra vires" – that is, outside of their limited powers – and thereby forfeited their privileges.
> Fail the purpose of the privilege, the thinking went, and you forfeit the privilege[233].

As the corporation became subsequently more common and a dominant institution in the American economy, the conditionality of the corporate charter began to fade and attention was shifted to the interstate competition aimed at attracting corporations within the national statutes in order to benefit from the "franchise tax"[234].
The race mentality stemming from this mechanism is rooted in corporate culture and nowadays it is difficult to think of corporations as privileged entities serving public good.
On the one hand, a federal intrusion in this discipline would seem unjustified given the prototypical target of financial stability which has normally activated a federal response. On the other, the long-standing argument that corporations should have an object and role in society transcending those they have in the economy might find a relief in the position of the Accountable Capitalism Act, which stems from the urgency to redirect corporate purpose so as to deliver "broadly inclusive, sustainable prosperity" and to enhance federal and state dialogue[235].
To make Capitalism more "accountable" does not simply mean to choose which interests to privilege among either shareholders' or stakeholders' and which one should be instrumental to the other. It is instead about the complex and evolutionary vision of a sustainable Capitalism, capable of adaptively enacting changes called for by contingent needs and driven by large public companies, that historically have personified the result of the transformation of US Capitalism over time.

[233] *Id.*
[234] *Id.*
[235] *Id.*

IV. Rethinking Corporate Purpose

Over the previous chapters it was illustrated how the paradigm of corporate purpose and, along with it, of managerial priorities, evolved in line with historical conditions, theoretical stimuli, conceptual debates and in light of the dichotomy between legislative status quo and momentums of change.

Here some final assessments will be drawn.

As can be inferred from the first chapter, the public company, in its emblematic connotation of *Berle-Means corporation,* has been undergoing a path of continuous transformations, for this reason, the notion of corporate governance and corporate object should be thought not as static paradigms, but as an image reflecting the changes occurring in the corporate environment.

When we think of corporate purpose, it appears that there is not a univocal meaning, instead there are a multiplicity of nuances surrounding this concept, according to the perspective from which it is observed.

The corporate status was originally conferred as a “privilege to employ a legal concept to construct an artificial entity that has the potential to produce untold wealth, prosperity, inequality and misery in equal measure”[236] and, consequently, it should be “used wisely not only for the benefit of its creators and owners but for all who engage with and are affected by it”[237].

Nevertheless, as observed in chapter one, the “intrinsic conceptualization”[238] of the corporation did not remain static, but was employed in different manners according to contingent instances.

The managerial capitalism delivered a scenario in which “the dominant image of public company leadership was that executives were exercising corporate power in a self-restrained and socially responsible manner”[239], while the *Deal Decade* offered a

[236] Mayer, *supra* note 93 at 5.
[237] *Id* at 5 (“The failure to embed this responsibility in the intrinsic conceptualization of the firm as against its extrinsic regulation from the introduction of freedom of incorporation in the 19th century was a fundamental error of omission for which we are now paying the true costs.”).
[238] *Id* at 5.
[239] Judd F. Sneirson, *The History of Shareholder Primacy, from Adam Smith through the Rise of Financialism*, Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability 84-85 (2019). *See* also Brian R. Cheffins, *Stop Blaming Milton Friedman!* (March 11, 2020). University of Cambridge Faculty of Law Research Paper No. 9/2020; European Corporate Governance Institute - Law Working Paper No. 523/2020.

different idea of "profit-conscious"[240] corporations which espoused a view of shareholder primacy.

It can be inferred that corporations, playing a crucial role as economic actors, are a *speculum* of society.

Either shareholder value doctrine or more stakeholderist approaches are not to be regarded as conceptually wrong to be adopted as basis for the governance framework, nevertheless they are consistent with the times in which they formed, as an adaptive response to specific and peculiar circumstances.

The way in which the law disciplines corporations and structures the incentive system, responding to their instances, influences them to enact a given behavior and to privilege a set of priorities rather than others and, in turn, reflects on social transformation through individual and consumers behaviors.

The issue arises when incentives produce a dysfunctional conduct because unequal societies will come as a result of inequality generated by corporations whenever managerial focus is exclusively and myopically on profit and wealth created is increasingly more concentrated in few hands.

In other words:

> The corporation is the creator of wealth, the source of employment, the deliverer of new technologies, the provider of our needs, the satisfier of our desires, and the means to our ends. It clothes, feeds, and houses us. It employs us and invests our savings. It is the source of economic prosperity and the growth of nations around the world. At the same time, it is the source of inequality, deprivation, and environmental degradation, and the problems are getting worse. They are getting worse because the corporation is getting bigger to a point where in some cases it is larger than nation states[241].

Therefore, the question shifts from "what should be the purpose of corporation" on absolute terms, to "what should corporation attempt to address according to the contingent needs of the times that we are living". This matter cannot be reduced to the

[240] Peter F. Drucker, *The Responsibilities of Management*, HARPER'S, Nov. 1954, 67, 68. *See also* Cheffins, *supra* note 239 at 13.

[241] Colin Mayer, *Prosperity, Better Business Makes the Greater Good* (2018).

simplistic question of what interests should be on the managerial agenda as top priorities, nevertheless it attains the broader key of understanding of what direction are modern corporations leading towards and what are they effectively achieving or will achieve in future[242].

In this sense, nowadays we observe a "shift"[243] which is "more than semantic"[244] in the corporate governance paradigm, stemming from the need to redirect corporations towards sustainability practices and to raise broader concerns for environmental harms, reinforcing the argument in antithesis to overconcentration on profits.

Such change might be tangible in the Statement on Corporate Purpose of the Business Roundtable, ESG oriented purpose and CSR practices, the BlackRock's Annual letter and Warren's proposed legislations, which are all pieces of a new "constituency-minded"[245] and societal value attitude and commitment, which undeniably demonstrate that there has been a change in the way in which corporate object is conceived.

Crescent emphasis on a new corporate behavioral code has shaped *ad hoc* incentives and constraints mostly in the form of reputational standards to comply with or public expectations to meet.

New ways of measuring and evaluating corporate performance include companies' approach to human capital, levels of inclusivity and cooperation, attitude and sensitivity with respect to community issues, witnessing a substantial divergence from the narrow profit-seeking perspective[246].

These evolving trends have canvassed a reconsideration of corporate purpose and, in general, of the role that corporations should have within society as plain members, given their capability of being determinant in it.

A purpose is a multifaceted idea and, as specified above, it would be complicated to find a universal resolution independently and ubiquitously valid.

Consistently with the contemporary theoretical background, a definition of purpose can be found in this statement by Martin Lipton:

[242] Martin Lipton et al., *On the Purpose and Objective of the Corporation*, Harv. L. Sch. F. on Corp. Governance (Aug, 5, 2020).
[243] Fisch & Solomon, *supra* note 6 at 103.
[244] *Id.*
[245] *Id. See also* chapter II at 28-32. *See also* chapter III at 52.
[246] Lipton et al., *supra* note 242.

> The purpose of a corporation is to conduct a lawful, ethical, profitable and sustainable business in order to ensure its success and grow its value over the long term. This requires consideration of all the stakeholders that are critical to its success (shareholders, employees, customers, suppliers and communities), as determined by the corporation and its board of directors using their business judgment and with regular engagement with shareholders, who are essential partners in supporting the corporation's pursuit of its purpose. Fulfilling purpose in such manner is fully consistent with the fiduciary duties of the board of directors and the stewardship obligations of shareholders[247].

This articulation encloses important acknowledgments: it recognizes an holistic vision of the corporation as a system, in which the path to "success"[248] reconciles both ethics and profitability not as antithetic alternatives, but as complementary solutions and in which the orientation towards creating long term sustainable growth and value is to prevail over short-term fluctuations and patterns[249].

Importance is attached to stakeholders as drivers towards achievement of success, in a model according to which each is a "partner" instrumental for a common objective and no constituency's interests are a means to another constituency's benefit. In fact, shareholder value is not aprioristically denied in order to promote the affirmation of another class of interests, nevertheless it is to remain a core feature of the corporation, though the idea of "primacy" is replaced by a co-engagement with the board of directors in the accomplishments of objectives and long-term value.

Beyond theoretical elegance, implementation of this paradigm relies on the application of the business judgment rule, "which justifies almost any allocation of corporate surplus having an articulable connection to the best interest of the enterprise, subsumes all other platitudes posing as rules of law"[250].

This idea enhances the role of shareholders as stewards of the corporations, who enter an implicit contract with the directors in order to achieve the corporation's success in

[247] *Id.*
[248] Companies Act (UK) §172(1).
[249] Lipton et al., *supra* note 242.
[250] Jeffrey M. Lipshaw, *The False Dichotomy of Corporate Governance Platitudes*, Journal of Corporation Law (2020).

their interests and, to minimize the transactions costs associated with decision-making process, directors are accorded the “widest possible discretion”[251].

From this perspective, directors are under the fiduciary onus to consider “all the other necessary factors (customers, suppliers, employees, communities, reputation, etc.)” for the purpose they are given power for. Therefore, consistently with Berger and Strine’s views, shareholders are constituencies on whom power is allocated by the law[252], nevertheless a new suggestion is that in turn they allocate power on corporate executives to realize the broader and holistic objective of success, with the business judgement rule supporting “the authority of the board in the interest of efficient governance over judicial second-guessing in the interest of greater accountability”[253].

In conclusion, the debate over corporate purpose in its generosity of theories, academic study, scholar engagement delivered a new and at the same time reconciling proposition, even though its intrinsic force and validity is still to be established and supported by future evidence.

This paradigm embraces a vision which is fully consistent with the spirit of current times and serves as *trait d’union* between past and present role of the corporation within society: as a real entity, the corporation is the *locus* in which “interdependencies of multiple stakeholders”[254] shape values and a shared culture for long-term stability and growth according to coexisting variables of sustainability and profitability.

[251] *Id* at 23.
[252] *See* chapter III at 41-42.
[253] Lipshaw, *supra* note 250 at 31.
[254] Lipton et al., *supra* note 242.

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