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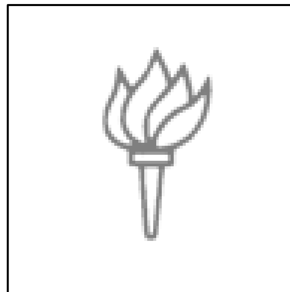

Corporate Governance Welfarism

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Electronic copy available at: https://ssrn.com/abstract=4328626

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The Emergence of Welfarist Corporate Governance

Law Working Paper N° 683/2023
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Corporate Governance Welfarism

Marcel Kahan & Edward Rock

May 3, 2023

Abstract

Corporate governance is on the verge of entering a new stage. After the managerialism that dominated the view of the corporation into the 1970s and the shareholderism that supplanted it, we are witnessing the emergence of a new paradigm: corporate governance welfarism. Welfarism rejects the faith that market forces will promote general welfare and lacks confidence in the government's ability to set proper boundary constraints. By looking to corporations to internalize externalities directly, welfarism thus offers an alternative way to deal with social problems that the political system has failed to address.

Welfarism comes in three strands—portfolio welfarism, shareholder welfarism, and direct social welfarism—two of which are consistent with shareholder primacy. The important distinction between welfarism and shareholderism, rather, is that welfarism, by embracing goals that are much broader than shareholder value as a means to promote overall welfare, reflects a departure from the classical liberal economic theory that underpins shareholderism. Welfarism, in turn, departs from managerialism in looking beyond the single firm, in relying on shareholder and stakeholder pressure rather than on managerial discretion to balance firm value maximization and broader objectives, and in embracing a wider set of potential stakeholders.

Welfarism is on the rise ideologically. While it is unclear how much welfarism has already affected operations at individual firms, the underlying drivers of welfarism are likely to remain or grow. There are therefore good reasons to believe that the push towards welfarism will take hold, grow, and, over time, generate a welfarist turn in corporate governance.

Welfarism, however, is subject to two inherent limitations. First, welfarism has its greatest traction for publicly traded companies with dispersed shareholders. By contrast, for companies with a single shareholder, a controlling shareholder or a small group of shareholders, the welfarist prescriptions will have only a limited impact. Second, the very lack of consensus that impedes political solutions reemerges under and constrains welfarism by generating disagreements among shareholders, impugning its legitimacy, and imposing political barriers to its implementation.

We would like to thank Jennifer Arlen, Ryan Bubb, Stephen Bainbridge, Emiliano Catan, Michal Gal, Chris Hampson, Rob Jackson, Peter Lewisch, Allan Miller, Michael Ohlrogge, Adam Palmiter, Elizabeth Pollman, Holger Spamann, Eric Zolt, two anonymous referees, and the participants in the NYU Law and Economics Workshop, the 2023 BYU Winter Deals Conference, and the Western University Business Law Symposium for helpful comments.

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Introduction: A capsule history of corporate governance

The governance of public corporations changes over time. In this Article, we argue that corporate governance of U.S. public corporations is on the verge of entering a new stage as it increasingly seeks to make corporations internalize the effects of their decisions on broader concepts of welfare. We examine this emerging orientation on its own terms, contrast it with prior stages, and consider its limitations.

A generation ago, Bob Clark argued that the financial side of capitalism has passed through stages.[1] The first stage was the age of the promoter-investor-manager who launched large scale business organizations in corporate form. The iconic figures of that stage were the likes of Andrew Carnegie and John D. Rockefeller, who both owned and managed great enterprises.

The second stage arose with the separation of management and ownership. As the entrepreneurial function was split between those who ran large enterprises and those who financed them, public corporations grew in number and size. This necessitated the development of a legal infrastructure to govern the relationship between professional managers and investors.[2] The corporate governance ideology that emerged during this period was "managerialism," the idea that the best way to run the corporation is to ask, and empower, managers to build great companies by pulling together the efforts of all the participants.[3] In doing so, managers were analogized to trustees, charged with balancing the interests of all participants as they built great companies[4]—an objective that often entailed sacrificing profits to achieve

[1] Robert Charles Clark, The Four Stages of Capitalism: Reflections on Investment Management Treaties, 94 Harv. L. Rev. 561 (1981).

[2] Id. at 563 ("The second stage required the legal system to develop stable relationships between professional managers and public investors, ostensibly aimed at keeping the former accountable to the latter, but also at placing full control of business decisions in the managers' hands.")

[3] We use the term "ideology" primarily in its descriptive sense. As Raymond Geuss summarizes this sense of the term, "[T]he 'ideology' of the group will be more or less extensive, but typically it will include such things as the beliefs the members of the group hold, the concepts they use, the attitudes and psychological dispositions they exhibit, their motives, desires, values, predilections, works of art, religious rituals, gestures, etc." Raymond Geuss, The Idea of a Critical Theory: Habermas and the Frankfurt School (CUP 1981) at 5.

[4] E. Merrick Dodd, Jr., For Whom are Corporate Managers Trustees?, 45 Harv. L. Rev. 1145 (1932) (expressing the view that a corporation "has a social service as well as a profit-making function"); Brian Cheffins The Public Company Transformed (2019) at 37 (noting that managers "took pains to emphasize the good citizenship of the firms they ran."); Dorothy S. Lund & Elizabeth Pollman, The Corporate Governance Machine, 121 Colum. L. Rev. 2563 (2021) ("The vision of corporate managers as socially responsive trustees came to fruition as the economy recovered after World War II."); Jeffrey N. Gordon, The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices, 59 Stan. L. Rev. 1465, 1511 - 14 (2007); Raymond C. Baumhart, How Ethical Are Businessmen?, Harv. Bus. Rev., July-Aug. 1961, at 6, 10 (reporting survey finding of 1700 executives in which Harvard Business Review survey of 1700 executives about 83% of the respondents agreed that "[f]or corporation executives to act in the interests of shareholders alone, and not also in the interests of employees and consumers, is unethical.").

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growth.[5] Managerialism dominated the corporate landscape into the 1970s and continues to have vigorous adherents to this day.[6]

The third stage of capitalism was marked by the rise of the institutional investor and the portfolio manager.[7] Through the 1980s and into the 1990s, share ownership kept moving from highly dispersed individual investors to more concentrated control by institutional investors. Over that period, the dominant ideology shifted from "managerialism" to "shareholderism."[8] This transformation is exemplified by the Business Roundtable 1997 statement proclaiming that:

> the paramount duty of management and of boards of directors is to the corporation's stockholders; the interests of other stakeholders are relevant as a derivative of the duty to stockholders. The notion that the board must somehow balance the interests of stockholders against the interests of other stakeholders fundamentally misconstrues the role of directors.[9]

Many commentators saw shareholderism, and its endorsement of shareholder primacy, as the final stage, the pinnacle in the evolution of corporate governance in a market economy.[10] But the 2008 financial crisis started to raise fundamental concerns about shareholderism.[11] More recently, climate change and social issues have emerged as pressing

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[5] See Victor Brudney, Dividends, Discretion, and Disclosure, 66 Va. L. Rev. 85 (1980); William Baumol, Business Behavior, Value and Growth 15-79 (rev. ed. 1967); Robin Marris, The Economic Theory of "Managerial" Capitalism (1964); R. Joseph Monsen & Anthony Downs, A Theory of Large Managerial Firms, 73 J. Pol. Econ. 221 (1965); Robin Marris & Dennis C. Mueller, The Corporation, Competition, and the Invisible Hand, 18 J. Econ. Literature 32 (1980) (surveying the relevant literature).

[6] For a comprehensive and nuanced recent history of the rise and decline of "managerial capitalism," see Cheffins, supra note 4.

[7] Clark, supra note 1, at 564 ("As the second stage split entrepreneurship into ownership and control, and professionalized the latter, so the third stage split ownership into capital supplying and investment, and professionalized the investment function."). To Clark, writing in 1981, this third stage reached "young adulthood" in the 1960s, yet it has continued to grow in significance. Clark predicted a fourth stage, the age of the savings planner, which we will not discuss.

[8] Cheffins, supra note 4, at Chapters 4-5; Wachtell, Lipton, Rosen & Katz, ESG, Stakeholder Governance, and the Duty of the Corporation, Sep. 16, 2022 ("For several decades, the predominant view among corporate leaders, practitioners, academics, investors, and asset managers was that the role of the corporation was solely to maximize profits for shareholders."); Gordon, supra note 4, at 1514 - 1530.

[9] Business Roundtable, Statement on Corporate Governance (September 1997) at 3-4. (available at http://www.ralphgomory.com/wp-content/uploads/2018/05/Business-Roundtable-1997.pdf)

[10] Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law, 89 Geo. L.J. 439 (2001) ("There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."); for a more recent expression of a similar view, see Lund & Pollman, supra note 4.

[11] Martin Lipton, The American Corporation in Crisis—Let's Rethink It, Boston Rev. (Oct. 2, 2019), http://bostonreview.net/forum/american-corporation-crisis%E2%80%94lets-rethink-it/martin-lipton-new-paradigm; Joseph Bowers & Lynn Paine, The Error at the Heart of Corporate Leadership, Harv. Bus. Rev., May-June 2017, available at https://hbr.org/2017/05/the-error-at-the-heart-of-corporate-leadership; Lenore Palladino & Kristina Karlsson, Towards Accountable Capitalism: Remaking Corporate Law through Stakeholder Governance (Roosevelt Institute 2018) available at SSRN: https://ssrn.com/abstract=3309431; The Aspen Institute, American Prosperity Project: A Non-Partisan Framework for Long Term Investment, Dec. 2016 https://www.aspeninstitute.org/programs/business-and-society-program/american-prosperity-project/; Steven

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challenges. Political paralysis in dealing with these challenges has pushed many to look to the corporate sector for solutions.

In this Article, we argue that we are seeing the emergence of a new conception of corporate governance that differs significantly from both managerialism and shareholderism. Managerialism focuses attention on making individual firms thrive, with managers holding the power to choose both strategy and tactics as well as the discretion to balance the interests of shareholders and other stakeholders. Shareholderism places the value of a firm to shareholders at the center. With a simpler metric, it grants far less deference to managers on questions of strategy and tactics, and even less on balancing the interests of shareholders and stakeholders. The emerging ideology—an ideology we tentatively dub corporate governance "welfarism"—focuses on corporate governance as a means of promoting activities that generate positive externalities and controlling those that generate negative ones.

In Part I, we describe and characterize three strands of welfarism—portfolio welfarism, shareholder welfarism, and direct social welfarism. Two of these strands are consistent with shareholder primacy—the view that corporations should be managed for the benefit of shareholders, and not of other stakeholders. What ties these strands of together is that they are looking to the corporate sector to deal with social problems that the political system has failed to address effectively. The important distinction between welfarism and shareholderism is thus that welfarism—by embracing goals that are extraneous to, and much broader than, shareholder value as a means to promote overall welfare—departs from the classical liberal economic theory that underpins shareholderism. Welfarism, in turn, departs from managerialism in looking beyond the single firm, in relying on shareholder and stakeholder pressure rather than on managerial discretion to balance firm value maximization and broader objectives, and in embracing a much wider set of potential stakeholders.

In Part II, we analyze the various market and political drivers of the emerging turn to welfarism, including the change in ownership structure, the growth in pro-social preferences among shareholders, the re-emergence of stakeholderism, and the trend towards "welfarist" regulation of public corporations.

In Part III, we argue is that welfarism is subject to two inherent limitations. First, the recent push towards welfarism has its greatest traction for publicly traded companies with dispersed shareholders. By contrast, for companies with a single shareholder, the welfarist prescriptions will have only a limited impact. Second, the very lack of consensus that impedes political solutions reemerges under and constrains welfarism. Just as voters disagree, so will shareholders and corporate decision-makers. And just as political actors will sometimes pass laws that foster welfarism, they will at other times pass laws that hinder it. We close with a brief conclusion.

Pearlstein, Social Capital, Corporate Purpose and the Revival of American Capitalism, Brookings Report (January 10, 2014) https://www.brookings.edu/wp-content/uploads/2016/06/BrookingsPearlsteinv5_Revised-Feb-2014.pdf.

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I. "Welfarist" Corporate Governance

Managerialism, shareholderism and welfarism all agree that the ultimate justification of the corporate form—with its distinctive characteristics of limited liability, centralized management, transferable shares, indefinite life, and entity status—must be that it promotes some broader notion of general welfare, rather than merely the financial value of a corporation for its shareholders. For managerialism, welfare is best promoted by giving managers of individual firms broad discretion to run the firm, including choosing business strategy and tactics, making commitments to internal and external stakeholders, and ultimately striking a balance between shareholder and stakeholder interests, all in an effort to produce great firms. From the managerialist perspective, responsible corporate conduct will further both general and private welfare, while minimizing the need for governmental intervention.

For shareholderism, the link between shareholder value and general welfare is generated by classical liberal economic theory.[12] As famously described by Adam Smith, the "invisible hand" of the market will assure that social welfare is promoted if everyone acts to maximize their own self-interest.[13] Shareholderism starts with the importance of property rights to promote the efficient use of resources and views shareholders as the owners of the corporation (and not just owners of their shares).[14] Managers are merely agents with a duty to promote the interests of their shareholder-principals, an interest typically equated with maximizing the value of the property entrusted to them (firm value maximization). Shareholderism generally distrusts managers who may try to promote their own interests rather than shareholders' (or, for that matter, any other stakeholders') interests,[15] thus giving rise to "agency costs."[16] Moreover, shareholderism views managers as lacking the legitimacy to balance shareholder and stakeholder interests. Protecting stakeholder interests, if market forces are insufficient, or dealing with externalities more generally, is the role of government, which can mandate and enforce generally applicable boundary constraints: environmental law, labor law, antitrust law, etc., and not the immediate goal of corporate law and corporate governance. For shareholderism, the goal of corporate law and corporate governance is to minimize agency costs and to induce managers to maximize the value of the firm for the benefit of shareholders subject to these external

[12] For a spirited defense of shareholder primacy, see Stephen Bainbridge, The Profit Motive: Defending Shareholder Value Maximization (Cambridge U. P. 2023).
[13] Adam Smith, The Wealth of Nations.
[14] Harold Demsetz, Towards a Theory of Property Rights, 57 Am. Econ. Rev. 347-59 (1967); Ronald H. Coase, The Problem of Social Cost, 3 J.L. & Econ. 1 (1960).
[15] This is a contingent rather than essential part of shareholderism as the potential divergence of interests of managers can be controlled through institutions (disinterested directors or controlling shareholders) and contracts (incentive compensation). To the extent that managers' interests are tightly yoked to shareholder interests, shareholderism is consistent with greater managerial discretion. The success of private equity is evidence of this.
[16] Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, agency costs and ownership structure, 3 J.F.E. 305 (1976).

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constraints. Through the invisible hand of the market, this will tend to promote general welfare.[17] Broadening the corporate goal to include objectives extraneous to the firm is not only unnecessary for a properly functioning market, it is affirmatively undesirable because it enables managers to pursue their self-interest in the guise of pursuing these objectives.[18]

Welfarism rejects the faith that market forces will promote general welfare and lacks confidence in the government's ability to set proper boundary constraints. Because it rejects these underpinnings of shareholderism, it also departs from the focus that shareholderism places on firm value. Instead, it embraces a corporate purpose that includes objectives that are extraneous to the corporation. As the political system has proven itself ineffective in addressing major social problems, welfarism thus looks to corporations to internalize externalities, and promote social welfare, directly.

Welfarism comes in three strands, portfolio welfarism, shareholder welfarism and direct social welfarism, with direct social welfarism representing the starkest departure from shareholderism. Portfolio welfarism and shareholder welfarism are consistent with shareholder primacy—the view that corporations should be managed for the benefit of shareholders, and not for the benefit of other stakeholders.

For us, the principal divide revolves around classical liberal economic theory. The acceptance or rejection of this traditional foundation distinguishes between shareholderism and managerialism, on one side, and the three strands of welfarism on the other. In locating portfolio welfarism and shareholder welfarism on the other side of the dividing line from shareholderism, and on the same side as direct social welfarism (which is not consistent with shareholder primacy), this Article departs from the traditional taxonomy of corporate governance paradigms that identifies the principal fault line as running between shareholder primacy and stakeholderism.

A. Portfolio Welfarism

Portfolio welfarism starts from the observation that shareholders' economic interest lies in maximizing *portfolio* value not *firm* value.[19] In the current capital market, many of the largest shareholders (or manager) own (or manage) portfolios that include a large number of public

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[17] See Kenneth J. Arrow and Gerard Debreu, Existence of an Equilibrium for a Competitive Economy, 22 ECONOMETRICA 265, 268 (1954).

[18] See Lucian A. Bebchuk, Kobi Kastiel & Roberto Tallarita, For Whom Corporate Leaders Bargain, 94 S. CAL. L. REV. 1467 (2021).

[19] Robert G. Hansen & John R. Lott, Externalities and Corporate Objectives in a World with Diversified Shareholder/Consumers, 31 Journal Of Financial and Quantitative Analysis 43 (1996) ("If shareholders own diversified portfolios, and if companies impose externalities on one another, shareholders do not want value maximization to be corporate policy. Instead, shareholders want companies to maximize portfolio values. This occurs when firms internalize between-firm externalities.")

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companies. For those highly diversified investors, negative externalities from one company may harm other companies in their portfolios. When this is the case, the value maximizing strategy, from a portfolio perspective, may be to push companies to refrain from activities that generate negative intra-portfolio externalities even if those activities would raise firm value.[20] As Shareholder Commons asked in its 2022 shareholder proposal, BlackRock should

> adopt stewardship practices designed to curtail corporate activities that externalize social and environmental costs that are likely to decrease the returns of portfolios that are diversified in accordance with portfolio theory, even if such curtailment could decrease returns at the externalizing company. … [A] company's externalities harm its diversified shareholders, even if they do not harm the company itself. [21]

For Shareholder Commons, the fact that highly diversified shareholders own a wide range of companies means that intra-portfolio externalities are typically also social externalities. Portfolio welfarism would thus increase general social welfare at the same time as it increases shareholder economic returns. Indeed, the motivating force for Shareholder Commons is the concern that market forces, left to their own devices, do not sufficiently protect social interests and that, contrary to the postulates of shareholderism, effective governmental regulation is not forthcoming.[22]

But there is also a dark side to portfolio welfarism. Intra-portfolio externalities do not always align with social externalities. Consider, as an example, externalities among competing firms. By raising output, a firm may harm its competitors. While doing so may maximize the value of the firm, it may reduce the value of a portfolio held by an owner with stakes in the firm's competitors.[23] If competing companies took account of intra-portfolio externalities by, for

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[20] The theoretical arguments were developed by Julio J. Rotemberg, Financial Transaction Costs and Industrial Performance (Mass. Inst. of Tech., Alfred P. Sloan Sch. of Mgmt., Working Paper No. 1554-84, 1984); Ariel Rubinstein & Menahem E. Yaari, The Competitive Stock Market as Cartel Maker: Some Examples (London Sch. of Econ., Suntory and Toyota Int'l Ctrs. for Econ. and Related Disciplines, Theoretical Econ. Paper Series 84, 1983); Timothy F. Bresnahan & Steven C. Salop, Quantifying the Competitive Effects of Production Joint Ventures, 4 Int'l J. Indus. Org. 155 (1986) and Steven C. Salop & Daniel P. O'Brien, Competitive Effects of Partial Ownership: Financial Interest and Corporate Control, 67 Antitrust L.J. 559, 559–614 (2000). Recent legal scholarship that advocates such an approach include Madison Condon, Externalities and the Common Owner, 95 Wash. L. Rev. 1 (2020) and Jeffrey N. Gordon, Systematic Stewardship, 47 Colum. Bus. L. Rev. 627, 629 (2022).

[21] According to Shareholder Commons, BlackRock's stewardship strategy, by focusing only on improving individual company performance, does not address "practices of a company that harm the global economy unless those practices also harm that company's financial performance." In its supporting statement, it argued further that

> Given its market position, BlackRock's stewardship activities—engaging with portfolio companies and voting their shares—could significantly improve beta by discouraging corporate practices that externalize costs. This would increase the portfolio value of BlackRock's clients, and also increase the value of the assets it manages, thereby improving the returns of both its clients and shareholders.

[22] See https://theshareholdercommons.com/ ("THE SHAREHOLDER COMMONS IS TACKLING CAPITAL SYSTEM FAILURES THAT ARE ENDANGERING OUR FUTURE" headline on site's landing page)

[23] See supra note 20; Jose Azar, Martin Schmalz and Isabel Tecu, Anticompetitive Effects of Common Ownership, 73 J. Fin. 1513 (2018); for other examples of financial intra-portfolio externalities that do not align with social externalities, see, e.g., Joseph Gerakos & Jin Xie, Institutional Horizontal Shareholdings and Generic Entry in the

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example, lowering output and raising prices, portfolio values may increase—but, in this case, social welfare would decline.[24]

Although portfolio welfarism, like shareholderism, accords primacy to shareholder interests, it represents a fundamental departure from shareholderism. Under shareholderism, corporate law and corporate governance are focused on the individual firm. Within this "single firm focus," directors and managers are to promote the value of their particular corporation which, intermediated by the invisible hand of the market, will promote overall welfare. Corporate governance, according to shareholderists, should therefore seek to align managers' financial interests with the financial interests of shareholder in their particular firm. For shareholderism, doing so benefits the company's shareholders because shareholders are the residual beneficiaries. In this paradigm, the common injunction that "a corporation should maximize shareholder value" is actually shorthand for a longer, more correct, statement, namely, that when share value is an accurate proxy for firm value (as it generally will be), promoting share value will promote firm value.[25]

By including extraneous interests of shareholders and privileging portfolio value maximization over firm value maximization, portfolio welfarism departs from the single firm focus of shareholderism in favor of a multi-firm focus.[26] But portfolio value, even if a plausible proxy for general welfare, is not a plausible proxy for the value of any individual firm. Each firm acting to maximize the portfolio value of their shareholders, moreover, is a significant departure from the classical liberal economic paradigm. This departure is best illustrated by the dark side of portfolio welfarism. If competing firms in an industry are all owned by index funds, portfolio welfarism implies that they should act like a cartel—a result that is anathema to classical liberal economics.

Pharmaceutical Industry 15-16 (Tuck Sch. of Bus., Working Paper No. 3285161, 2019), https://ssrn.com/abstract=3285161 [https:// perma.cc/Q4SA-QEMA], which examines whether common ownership between brand name and generic drug makers increases the likelihood of settlement of patent litigation between the two or Melissa Newham, Jo Seldeslachts & Albert Banal-Estañol, Common Ownership and Market Entry: Evidence from the Pharmaceutical Industry 7-8 (DIW Berlin Discussion Papers, Paper No. 1738, 2018), https://ssrn.com/abstract=3194394 [https://perma.cc/M8KD -2ZHR], which examines whether common ownership decreases the likelihood of generic entry.

[24] Indeed, in practice, portfolio welfarism targeted at reducing social and environmental externalities cannot easily be distinguished from portfolio welfarism for the purpose of increasing industry profits. In particular, when it comes to goods and services that generate environmental harm—such as fossil fuels or air transportation—curtailing production would at the same time tend to benefit the environment and to increase industry profits and for both of these reasons generate positive intra-portfolio externalities. See Matt Levine, Anti-ESG Antitrust, Bloomberg Opinion: Money Stuff, Nov. 14, 2022.

[25] Thus, for example, when a firm is insolvent, the beneficiary of management discretion shifts to the creditors. In an insolvent firm, seeking to maximize share value is no longer consistent with seeking to maximize firm value.

[26] Marcel Kahan & Edward Rock, Systemic Stewardship with Tradeoffs, forthcoming __ J. Corp. L. ___ (2023); https://clsbluesky.law.columbia.edu/2020/09/29/the-conflict-between-blackrocks-shareholder-activism-and-erisas-fiduciary-duties/

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Portfolio welfarism marks an even more substantial departure from managerialism. First, it rejects the single-firm focus common to managerialism and shareholderism. Second, while both portfolio welfarism and shareholderism accord primacy to shareholder interests, managerialism is comfortable granting managers great discretion in making tradeoffs among shareholders and stakeholders so long as doing so promotes firm value, loosely understood.

B. Shareholder Welfarism

In a series of recent papers, Oliver Hart and Luigi Zingales have argued that the board of a company should promote the welfare of the company's actual shareholders even when those interests are not homogeneous and not financial, and even when doing so reduces the value of the firm.[27] Their first paper in this series captures the essence of their claim in its title: "Companies should maximize shareholder welfare not market value."

Shareholder welfarism resembles portfolio welfarism in that both, while accepting the primacy of shareholder interests, give weight to shareholder interests other than firm value. While portfolio welfarism goes beyond firm value by taking into account shareholders' portfolio financial interests, shareholder welfarism goes beyond firm value by also including shareholders' *non-financial* interests.

As Hart and Zingales put it,

> [If] consumers and owners of private companies take social factors into account and internalize externalities in their own behavior, why would they not want the public companies they invest in to do the same? To put it another way, if a consumer is willing to spend $100 to reduce pollution by $120, why would that consumer not want a company he or she holds shares in to do this too?[28]

The similarities continue in that both portfolio welfarism and shareholder welfarism rely on shareholders' self-interest in promoting social welfare. While portfolio welfarism relies on shareholders' interest in maximizing portfolio value to induce portfolio firms to internalize

[27] Oliver Hart & Luigi Zingales, The New Corporate Governance, 1 U. Chi. Bus. L. Rev.195 (2022); Oliver Hart & Luigi Zingales, Companies Should Maximize Shareholder Welfare Not Market Value, 2 J. L. Fin. and Accounting 247 (2017); see also Ann M. Lipton, What We Talk About When We Talk About Shareholder Primacy, 69 Case W. Rsrv. L. Rev. 863 (2019); LoPucki, Lynn M., The End of Shareholder Wealth Maximization (November 15, 2022). UC Davis Law Review, Forthcoming, University of Florida Levin College of Law Research Paper, Available at SSRN: https://ssrn.com/abstract=4277872 (criticizing view that corporations must pursue the goal of increasing the wealth of shareholders by increasing the value of their shares and that they may not forgoing sacrifice that goal to benefit the environment, charities, or the corporation's other stakeholders). Their central example arises when activities are not perfectly separable, such as a new product that generates environmental externalities.

[28] One problem with the Hart and Zingales approach is that a large number of shares are held by the ultimate beneficial owners through institutions and the preferences of institutional investors may diverge from those of the beneficial owners. See Jonathon Zytnick, Do Mutual Funds Represent Individual Investors? (October 16, 2022). NYU Law and Economics Research Paper No. 21-04, Available at SSRN: https://ssrn.com/abstract=3803690 or http://dx.doi.org/10.2139/ssrn.3803690. For different ways to address this problem, see https://mailchi.mp/ecgi/summit-2022-4?e=476ee7935e.

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negative externalities, Hart and Zingales see shareholders' non-financial interests as playing a similar function.

As with portfolio welfarism, shareholder welfarism departs significantly from shareholderism and traditional corporate governance by including in the company's objective function shareholder preferences that are extraneous to their shareholdings. In doing so, it shifts from maximizing shareholder *value* (often a plausible proxy for firm value) to maximizing overall shareholder *welfare* (rarely if ever a plausible proxy for firm value). Shareholder welfarism departs from managerialism both in taking into account extraneous interests and in failing to empower managers to balance shareholder and stakeholder interests.

C. Direct Social Welfarism

Direct social welfarism goes beyond portfolio welfarism and shareholder welfarism in that it is not even purportedly tied to shareholder interests, whether in firm value maximization, portfolio value maximization, or shareholder welfare maximization. The goal of direct social welfarism is to align the corporate objective directly with social welfare independent of shareholder preferences. Unlike the other strands of welfarism, direct social welfarism therefore represents a departure from shareholder primacy and an embrace of stakeholderism.

The British Academy's 2019 Principles for Purposeful Business is a useful illustration of "direct social welfarist" thinking about corporate governance.[29] For the Academy, the goal of aligning "corporate objectives" with social welfare will be achieved in a variety of ways.[30] Corporations are to adopt a "corporate purpose" that explicitly aligns business goals with increasing social welfare and not simply making a profit. "Profit" is to be redefined from the typical accounting measure to a broader notion that both recognizes investments in human capital and requires that the costs of remediating negative externalities be charged to the corporation whether or not the corporation has any legal liability related to those externalities.[31] And owners are to be re-educated to support "corporate purposes as well as . . . [deriving] financial benefit." Shareholders, under this view, will be expected to engage with firms to make sure those firms are contributing to social welfare. These goals will be implemented through a variety of tools: legal enforcement by shareholders or stakeholders,[32] political persuasion, and normative discourse designed to change the ideology of the boardroom and asset management.

Direct social welfarism departs from shareholderism in prioritizing general social welfare over shareholders' interests. It departs from managerialism both in not according deference to management and in broadening the firm objective to include "the avoidance of harm in not

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[29] https://www.thebritishacademy.ac.uk/publications/future-of-the-corporation-principles-for-purposeful-business/ .

[30] The two central pillars are: "the positive benefit of producing profitable solutions to the problems of people and planet, and the avoidance of harm in not profiting from producing problems for people or planet."

[31] Id. at 26; Colin Mayer, What is wrong with corporate law.

[32] Id. As with benefit corporations, where only shareholders can enforce the commitments to non-shareholder interests, Delaware General Corporation Law § 367, so too here the expectation is that shareholders with "non-representative" interests will enforce the commitments.

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profiting from producing problems for people or planet," thereby effectively extending the concept of stakeholders to everyone alive and yet to be born.[33] In the latter regard, direct social welfarism thus goes beyond traditional stakeholderism, which focused on the interests of constituents such as employees or customers who had direct dealings with the corporation.[34]

D. A Note on ESG

Over the last years, much has been written about ESG. ESG—the acronym for environmental, social and governance—is an imprecisely defined and poorly understood term.[35] Not only it is unclear what is and what is not included under the broad umbrella of "environmental, social and governance," but an ESG orientation can take multiple and inconsistent forms. ESG may refer to a consumer preference for products that have been produced in an ESG-friendly matter; it may refer to companies conducting their operations in an ESG-friendly way; it may refer to asset managers pushing companies in an ESG-friendly direction; it may refer to investors only investing in companies that score high on ESG metrics; or it may refer to governmental officials pursuing ESG policy goals.

Depending of what is included in ESG and what type of ESG is being discussed, ESG may be consistent with portfolio welfarism (as in asset managers trying to push companies not to engage in activities with negative intra-portfolio externalities), shareholder welfarism (as in investors wanting their companies not to discriminate), or direct social welfarism (as an expression of a social objective that companies should, independent of shareholder preferences, be concerned about the environmental and social impact of their actions).

But ESG can also be consistent with shareholderism and managerialism. Thus, companies may cater to ESG constituents because they believe doing so will increase sales or make it easier

[33] Colin Mayer, The Role of Corporate Law Reconsidered: A Brief Response to Paul Davies' Blog, The EGCI Blog, July 19, 2022, available at https://ecgi.global/blog/role-corporate-law-reconsidered-brief-response-paul-davies%E2%80%99-blog ("The conventional view would have it that the boundaries of the firm are defined by the property owned by the firm and its contractual claims and liabilities resulting from public and private law in the form of, for example, regulation and contracts. However, the effects of the firm are felt well beyond those boundaries and are determined by the changes that it brings about and the effects that it has on the wellbeing and flourishing of individuals, communities, and the natural world."); Robert P. Bartlett, III & Ryan Bubb, Corporate Social Responsibility Through Shareholder Governance ("The global scope of the climate change problem, in terms of both its causes and effects, means that essentially the entire global community is affected by every firm's operations and hence can be considered a stakeholder of every firm.")

[34] Adolf A. Berle, For Whom Corporate Managers Are Trustees: A Note, 45 Harv. L. Rev. 1365, 1372 (1932) (viewing "claims by labor, by customers and patrons, by the community and the like" as competing with claims by shareholders); Eric W. Orts, Beyond Shareholders: Interpreting Corporate Constituency Statutes, 61 GEO. WASH. L. REV. 14, 23–24 (1992) (arguing that constituency statutes, a 1980s reflection of stakeholderism, were meant to protect employees and local communities).

[35] See generally Elizabeth Pollman, The Making and Meaning of ESG (October 31, 2022). U of Penn, Inst for Law & Econ Research Paper No. 22-23, European Corporate Governance Institute - Law Working Paper No. 659/2022, Available at SSRN: https://ssrn.com/abstract=4219857

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to hire dedicated employees, and thereby increase firm value.[36] Asset managers or shareholders may believe that companies are not sufficiently attuned to ESG concerns and push companies to place greater weight on these concerns expecting that doing so will increase firm value.[37] Shareholders solely concerned with maximizing returns may believe that companies that do better on the ESG front are better prepared to, say, deal with upcoming regulations or meet future consumer demands and will hence see their stock price rise. And managers may believe that building the great company of the future requires addressing environmental, social and governance concerns for the sake of all constituents.

Thus, the ESG umbrella does not offer a good tool to distinguish managerialism, shareholderism and welfarism or to differentiate between strands of welfarism. In Section II.B., we will argue that one particular aspects of ESG—the rise of assets invested in vehicles purporting to consider ESG factors—is likely a reflection of the increased importance of non-financial concerns of shareholders and thus consistent with shareholder welfarism. Subject to that exception, however, we do not regard ESG as helpful in illuminating the issues we discuss in this Article.

II. **Early Signs of a Shift from Shareholderism to Welfarism**

The ideas underlying portfolio welfarism, shareholder welfarism, and direct social welfarism are not new. Thus, for example, the notion that ownership structure has become dominated by large, highly diversified institutional investors who should care about portfolio effects and hence "develop and pursue policies of virtuous efficiency, minimizing negative externalities and encouraging positive outcomes by the firms in their portfolios" was already developed in James Hawley and Andrew Williams' 2000 book THE RISE OF FIDUCIARY CAPITALISM.[38] And the theoretical case that, in firms with diversified shareholders, maximization of shareholder portfolio value will differ from maximization of firm value goes back at least to an 1984 working paper by Julio Rotemberg.[39]

The notion that corporations should have a social responsibility voluntarily to pursue social ends that conflict with profit maximization is even older. In the classic 1932 debate between Adolf Berle and Merrick Dodd, both sides endorsed this vision, though they parted way

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[36] Alan R. Palmiter, Awakening Capitalism: A Paradigm Shift (November 25, 2021). Available at SSRN: https://ssrn.com/abstract=3971661 or http://dx.doi.org/10.2139/ssrn.3971661.

[37] See Lund & Pollman, supra note 4 ("Today many companies pursue ESG goals, and many investors favor ESG funds, not for moral reasons or a prosocial willingness to sacrifice profits, but because ESG is thought to provide sustainable long-term value or higher risk-adjusted returns for shareholders.")

[38] James P. Hawley & Andrew Williams, The Rise of Fiduciary Capitalism: How Institutional Investors Can Make Corporate America More Democratic (Univ. of Pennsylvania Press, 2000),

[39] Julio J. Rotemberg, Financial transaction costs and industrial performance, WP# 1554-84, April, 1984, available at http://dspace.mit.edu/bitstream/handle/1721.1/47993/financialtransac00rote.pdf?sequence=1 .

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in other respects.[40] Four decades later, consumer-advocate Ralph Nader emerged as one the most prominent proponents of this view.[41] Dodd, for that matter, also embraced the view that enlightened business owners would run their companies not to maximize profits, but to serve the public, not due to a legal requirement but because they themselves wanted to do so.[42]

What has changed is that these ideas have moved from the ivory tower and are increasingly becoming part of the mainstream thinking by shareholders, asset managers, regulators, legislators, and corporate decisionmakers. In this Part, we will discuss the reasons why we believe that support for welfarism has grown, will continue to grow, and will change how individual firms balance maximizing firm value with broader social goals.

A. Ownership Structure

The last few decades have witnessed a major shift in the ownership structure of public corporations. At the time Berle and Means wrote their classic work THE MODERN CORPORATION AND PRIVATE PROPERTY,[43] the vast majority of the shares of publicly traded corporations were held by individuals. This remained true until around 1970, when private pension funds started to own an increasing share of corporate equities. By 1985, according to data compiled by the Federal Reserve Board, private pension funds owned 23% of equities, households and nonprofits owned 54%,[44] with the remainder owned by various other investor types. From 1985 onwards, the ownership by mutual funds started to grow rapidly, while the ownership by private pension funds shrank and the ownership by households continued its decline. By 2021, mutual funds and their close cousins, exchange traded funds, had increased their share of holdings from 5% in 1985 to 26% and the share held by households and nonprofits had dropped to 40%.[45] In sum, over this period, ownership of public corporations has shifted from individuals to financial institutions and, within the set of financial institutions, to mutual and exchange traded funds.

Institutional investors, in turn, have dramatically revised their approach to investing. Until 1975, institutions pursued so-called "active" investing strategies—selecting stocks of certain companies usually with the goal of earning superior returns. In 1975, John Bogle, the founder of the Vanguard Group, started the first index fund, the First Index Investment Trust, which invested

[40] See Berle, supra note **Error! Bookmark not defined.**; Dodd, supra note 4. See generally https://en.wikipedia.org/wiki/Berle-Dodd_debate#cite_note-2.

[41] Ralph Nader, Mark Green & Joel Seligman, TAMING THE GIANT CORPORATION (1976); see also C. Stone, WHERE THE LAW ENDS (1975); David L. Engel, An Approach to Corporate Social Responsibility, 32 Stan. L. Rev. 1 (1979).

[42] Dodd, supra note 4, at 1153.

[43] A. A. Berle & Gardiner C. Means, The Modern Corporation and Private Property (1932).

[44] Since, Federal Reserve data for households and nonprofits are residuals (in other words, they reflect totals for all sectors less known values for other sectors), the actual shares for households is likely somewhat lower. 1 Bd. Of Governors of the Fed. Reserve Sys., Guide to the Flow of Funds Accounts 170 (1993).

[45] Id. The only other major owner types tracked by the Federal Reserve Board that accounted for more than 5% of holdings are "rest of the world" (16%) and private pension plans (5%).

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its capital in the shares of all S&P 500 companies.[46] Although initially ridiculed as "un-American" and "a sure path to mediocrity,"[47] index investing eventually took off. By 2019, the First Index Investment Trust, now known as the Vanguard 500 Index Fund, had more than $400 billion in assets.[48] Overall, as of 2019, funds pursuing index strategies held nearly $7 trillion in assets, compared to $11 trillion in funds with active strategies.[49] In addition, many private and public pension funds pursue internal indexing strategies.[50]

The shift from picking individual stocks to a portfolio approach has had profound implications. The portfolios of institutional investors generally, and indexers in particular, contain shares in vast numbers of companies in approximately similar proportions (relative to the shares outstanding). As a result, the financial interests of institutional investors (and of their investors) are generally more closely aligned with the interests of the portfolio, which often resembles the market as a whole, than with the interests of any individual portfolio company. While the wedge between what may be best for an individual company (a single-firm focus) and what may be best from a portfolio perspective (a multi-firm focus) matters little when the action of an individual company has no effect on the value of the other securities, it can lead to conflicts when an action generates significant positive or negative externalities with respect to other portfolio companies. So much is undisputed.[51]

The notion that institutional investors can, should, or do induce individual portfolio companies to take their broader portfolio interests into account has recently gained significant traction and has become the driver for portfolio welfarism. The Shareholder Commons, the organization that sponsored the BlackRock shareholder proposal mentioned in the Introduction, argues that

> the greatest threat to the long-term returns of diversified investors does not come from the failure of individual companies to optimize their own returns, but rather from the trillions of dollars in social and environmental costs businesses externalize annually. Diversified shareholders do internalize these costs, and the company-first lens of current

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[46] CNBC, Jack Bogle changed investing forever with index funds, but wasn't always happy about it, Jan. 17, 2019, available at https://www.cnbc.com/2019/01/16/bogle-changed-investing-with-index-funds-but-wasnt-always-happy-about-it.html

[47] Insider, When Vanguard's founder first invented the index fund, it was ridiculed as 'un-American,' but 40 years later it's clear his critics were wrong, Jan. 18, 2019, available at https://www.businessinsider.com/vanguard-jack-bogle-first-index-fund-criticism-2019-1

[48] Id.

[49] CNBC, supra note 46.

[50] See, e.g., CalPERS Beliefs
Our Views Guiding Us into the Future, Agenda Item 7, available at https://www.calpers.ca.gov/docs/board-agendas/201702/pension/item7-01.pdf at 8 ("CalPERS will use index tracking strategies where we lack conviction or demonstrable evidence that we can add value through active management").

[51] Matthew Backus et al., *Common Ownership in America: 1980–2017*, 13 AM. ECON. J.: MICROECONOMICS 273 (2021).

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shareholder engagement cannot adequately address company behavior that undermines long-term, broad economic health.[52]

Striking in a similar vein, Madison Condon has argued that institutional investors could greatly increase the value of their portfolios by pushing oil companies to reduce their output.[53] On a more limited scale, Jeff Gordon has suggested that institutional investors should support management of systemically important financial firms "in a face-off with activist investors who want the firm to take greater risks to enhance shareholder return" in order to reduce the externalities from a possible financial crisis.[54]

The conceptual arguments in favor of multi-firm focus are strong. It is obviously correct that many shareholders are highly diversified and equally obviously correct that diversified shareholders care about the value of their portfolio rather than about the value of any particular firm. Moreover, the amount of benefits to be obtained from a multi-firm focus seems significant. One study estimates that the negative externalities created by public companies account for more than half of their profits.[55] Even if intra-portfolio externalities constitute only a fraction of the overall social costs—as many social costs will be borne by non-public firms or individuals—the potential for raising overall portfolio value by inducing firms, especially firms that generate an above-average share of externalities, to change how they conduct their business is substantial.[56]

As we and others have pointed out, however, significant, albeit not insurmountable,[57] barriers reduce the incentives, and constrain the ability, of institutional investors to pursue a

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[52] The Shareholder Commons, Systematic Stewardship, available at https://theshareholdercommons.com/system-stewardship/. See also Trucost, Universal Ownership: Why environmental externalities matter to institutional investors (2011), available at https://www.unepfi.org/fileadmin/documents/universal_ownership_full.pdf. BlackRock, like many institutional investors, tends to vote shares administered by all its funds on a centralized basis rather than leave voting decision to the managers of each fund. See Ryan Bubb & Emiliano Catan, The Party Structure of Mutual Funds, 35 Rev. Fin. Stud. 2839 (2022).

[53] Madison Condon, Externalities and the Common Owner, 95 Wash. L. Rev. 1 (2020) (estimating that a 1% reduction in the annual industrial emissions of Chevron and Exxon would increase BlackRock's portfolio value by $9.7 billion, compared to a $3.4 billion reduction in the value of its Chevron and Exxon stock). Similarly, a commentary in Barron's has urged BlackRock, State Street, and Vanguard to push Covid vaccine manufacturers to share their technology, know-how, and intellectual property, reasoning that vaccine inequity increases the risk of generating another Covid-19 variant that could cost the global economy trillions of dollars. Peter Singer, Investors Can Change The Course of This Pandemic, Barron's, Jan. 24, 2022, available at https://www.barrons.com/articles/investors-can-change-the-course-of-this-pandemic-51642800068.

[54] Jeffrey N. Gordon, Systematic Stewardship, 47 Colum. Bus. L. Rev. 627, 629 (2022).

[55] Schroders, Foresight, Apr. 2019, at 6, available at https://prod.schroders.com/en/sysglobalassets/digital/insights/2019/pdfs/sustainability/sustainex/sustainex-short.pdf.

[56] See id. at 20, 24 (estimating contribution to social welfare and relation between relation between social value and net profits for companies in different industries).

[57] For example, as we have recently argued elsewhere, directors and to a lesser degree shareholders face same fiduciary duty constraints if they induce companies to sacrifice firm value to advance their shareholders' portfolio value. But as we have pointed out, when directors themselves do not have a material conflict of interest, the

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multi-firm focus. Institutional investors are not the beneficial owners of the shares they manage, and thus have only diluted incentives to maximize portfolio values.[58] Institutional investors that run multiple funds, each with different investment portfolios, may run into conflicts of interests, as different actions would maximize portfolio values for different groups of investors.[59] Institutional investors do not themselves run companies and thus need to find effective mechanisms to induce directors and managers to pursue portfolio value maximization.[60] But fiduciary duties of directors and managers of portfolio companies may conflict with actions that increase the portfolio value of shareholders at the expense of firm value.[61] Depending on the mechanism used, and the issue, institutional investors may face backlash or legal liability if they try to push companies towards a multi-firm focus.[62]

The extent to which institutional investors have already succeeded in pushing portfolio companies away from firm value and towards portfolio value maximization is unclear.[63] Recent trends are difficult to pick up in empirical studies. Institutional investors may understandably be reluctant to admit that they adopt a multi-firm focus and induce companies to take actions that reduce their value in order to raise the value of their other portfolio holdings.[64] Rather, regardless of their true motivation, they may tend to couch their activities as intended to raise

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business judgment rule affords them substantial discretion – discretion that they can easily use to pursue a multi-firm focus under the guise of pursuing a single firm-focus. Kahan & Rock, supra note __.

[58] See Lewellen & Lewellen, supra note __; Kahan & Rock, supra note __.

[59] See, generally, Edward Rock and Daniel Rubinfeld, Antitrust for Institutional Investors, 82 Antitrust L. J. 221 (2018); John Morley, Too Big to Be Activist, 92 S. Cal. L. Rev. 1407 (2019); Max Schanzenbach & Robert Sitkoff, Reconciling Fiduciary Duty and Social Conscience, 72 Stan. L. Rev. 381, 399-425 (2020).

[60] C. Scott Hemphill & Marcel Kahan, The Strategies of Anticompetitive Common Ownership, 129 YALE L.J. 1392, 1395 (2020).

[61] Morley, supra note 59; Kahan & Rock, supra note 26; Brian Ponte, Activist to BlackRock: Prioritize Portfolios Over Holdings, Ignites, Apr. 26, 2022 "BlackRock claims that an activist investor's proposal that the money manager prioritize the value of a fund's portfolio over the returns of an individual portfolio company would cause the firm to violate its fiduciary obligations.")

[62] Kahan & Rock, supra note 25.

[63] The most significant studies in this area relate to the dark side of portfolio value maximization, that is to firms in the same industry engaging in anti-competitive conduct that decreases firm profits but increases industry profits. In the best known of these studies, Jose Azar, Martin C. Schmalz, and Isabel Tecu present empirical evidence suggesting that ownership by diversified institutional investors of U.S. airlines has resulted in higher ticket prices. Azar et al., supra note 23, at 1521-51. Their work generated multiple follow-up studies, mostly analyzing whether ownership by institutional investors of competing firms has had anti-competitive effects, with some studies finding supportive evidence and some not. See, e.g., Andrew Koch, Panayides Marios & Thomas Shawn, Common ownership and competition in product markets, 139 J. Fin. Econ. 109 (2020) (finding no evidence); Mohammad Torshizi & Jennifer Clapp, Price effects of common ownership in the seed sector, 66 Antitrust Bulletin 39–67 (2021) (finding evidence); José Azar et al., Ultimate Ownership and Bank Competition (May 4, 2019) (unpublished manuscript), https://perma.cc/C553-Q2YQ (finding evidence); Patrick Dennis et al., Common Ownership Does Not Have Anti-Competitive Effects in the Airline Industry (Fed. Rsrv. Bank of Atl., Working Paper 2019–15, 2019), https://perma.cc/NH2Y-LMEX (finding no evidence). A recent study by Azar and Vives attributes the initial results found by AST to common owners other than the so-called "Big Three," Namely, BlackRock, State Street, and Vanguard. José Azar & Xavier Vives, Revisiting the Anticompetitive Effects of Common Ownership (March 15, 2021). IESE Business School Working Paper, Available at SSRN: https://ssrn.com/abstract=3805047.

[64] Rock & Rubinfeld, supra note 59; Hemphill & Kahan; supra note 60.

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firm value.[65] Furthermore, while there are numerous conceivable mechanisms through which investors may induce a company to take their portfolio interests into account—from direct pressure to do so,[66] to a mere failure to pressure companies to take actions that raise firm value but reduce portfolio value,[67] to changes in the managerial compensation scheme[68]—these mechanism often leave no obvious tracks and affect corporate actions in different ways.

But whatever the current extent to which shareholders and public companies adopt a multi-firm focus, it is likely to rise in the future. For one, even if current trends were to continue even at an abated level, shareholdings would become both more diversified (at the portfolio level) and more concentrated (at the level of the institutional investor). As a result, both the *influence* of these investors on firm conduct and the *incentives* of institutional investors to use that influence to induce firms to take into account externalities imposed on other firms will rise. Second, if political gridlock continues to impedes the effective regulation of activities that generate externalities—for example, through imposition of a carbon tax—the potential payoff from a multi-firm focus would be likely to remain high or increase. Third, public calls for institutional investors to pursue a multi-firm focus and justifying such a focus as benefitting society at large may make investors both more aware of the potential benefits from doing so and increase its perceived legitimacy.[69]

B. **Shareholders' Non-Financial Interests**

There are significant indications that a large and growing segment of shareholders have material interests in the activities of companies in which they invest that go beyond the effect of these activities on their financial returns. Market observers regularly note the broadened scope of shareholder interests. For example, the S.E.C. noted in an 2022 release on ESG investment practices that "[i]nvestor interest in ESG strategies has rapidly increased."[70] Deloitte, one of the Big Four accounting firms, opined "[s]hareholders today are interested in a lot more than just the

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[65] Kahan & Rock, supra note 26.

[66] Azar et al. supra note 23, at 1554-56

[67] See Hemphill & Kahan, supra note 60, at 1427-1429 (discussing feasibility and plausibility of "selective omission").

[68] See, e.g., Miguel Antón, Florian Ederer, Mireia Giné & Martin Schmalz, Common Ownership, Competition, and Top Management Incentives (European Corp. Governance Inst., Finance Working Paper No. 511/2017, 2022), https://papers.ssrn.com/abstract=2802332 [https://perma.cc/9J7K-CLME]; (presenting an incentive compensation-based mechanism through which common ownership affects product market outcomes).

[69] Indeed, even if institutional investors do not themselves change their behavior, managers may follow this clarion call. See Matt Levine, The SEC Wants to Stop Activism, Bloomberg, Mar. 24, 2022, available at https://www.bloomberg.com/opinion/articles/2022-03-24/the-sec-wants-to-stop-activism ("'Keep shareholders happy' is a very generic goal. ... Increasingly, it means doing good environmental, social and governance things, as big shareholders become more diversified and more focused on ESG. ").

[70] Securities and Exchange Commission, Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, available at https://www.sec.gov/rules/proposed/2022/ia-6034.pdf

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balance sheet."[71] And Matt Levine, one of the most widely-read financial columnists, agreed that "keep[ing] shareholders happy … increasingly … means doing good environmental, social and governance things, as big shareholders become more diversified and more focused on ESG.[72]

These assertions are supported by several data points. Exhibit 1 is the steep rise in the capital and the number of vehicles devoted in some form to socially responsible investing. US SIF estimates that the amount of assets devoted to sustainable investing in the U.S. increased from $639 billion in 1995 to $17.1 trillion in 2020, an increase by more than 2500%.[73] According to Morningstar, sustainable funds have experienced record inflows in each of the past 5 years.[74] The Forum for Sustainable and Responsible Investment categorizes 1,741 funds as ESG funds as

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[71] Deloitte, Tectonic shifts: How ESG is changing business, moving markets, and driving regulation, Oct. 29, 2021, available at https://www2.deloitte.com/us/en/insights/topics/strategy/esg-disclosure-regulation.html/#endnote-12.

[72] See Matt Levine, The SEC Wants to Stop Activism, Bloomberg, Mar. 24, 2022, available at https://www.bloomberg.com/opinion/articles/2022-03-24/the-sec-wants-to-stop-activism; see also Lisa Fu, ESG Cannot Combat Climate Change: Ex-BlackRock Sustainable CIO, Fundfire (Mar. 18, 2021) https://www.fundfire.com/c/3105474/391684/cannot_combat_climate_change_blackrock_sustainable ("People were interested in ESG, not because they thought … it would help to generate alpha [but] because there was a growing societal anger around the lack of action on social issues." [statement by BlackRock's former chief investment officer for sustainable investing]); The increase in funds engaging, or purporting to engage, in socially responsible investing has even led to regulatory action. Earlier this year, the S.E.C. proposed a rule prohibiting funds that consider ESG factors, but do not do so to greater extent than other factors, from using ESG or similar terminology in their names. See Securities and Exchange Commission, Fact Sheet: Amendments to the Fund "Names Rule", available at https://www.sec.gov/files/ic-34593-fact-sheet.pdf ("Under the proposal, a fund that considers ESG factors alongside but not more centrally than other, non-ESG factors in its investment decisions would not be permitted to use ESG or similar terminology in its name. Doing so would be defined to be materially deceptive or misleading.") And in 2020, the Department of Labor proposed a rule essentially prohibiting ERISA fiduciaries from using ESG factors to guide investment decisions if doing so was based on social and public policy goal, as opposed to the goal of maximizing risk-adjusted returns. Joseph Lifsics , DOL Proposed Rule Urges Caution Regarding the Use of ESG Factors for ERISA Plans, Benefits and Compensation Blog, June 29, 2020, available at https://www.usbenefits.law/2020/06/dol-proposed-rule-urges-caution-regarding-esg/; Joseph Lifsics & Lennine Occhino, The Department of Labor's ESG-less Final ESG Rule, Harvard Law School Forum on Corporate Governance, Nov. 24, 2020, available at https://corpgov.law.harvard.edu/2020/11/24/the-department-of-labors-esg-less-final-esg-rule/. While the proposed rule permitted use of ESG factors as a tie breaker, it stated that ties "rarely, if ever, occur" and required fiduciaries "to document the basis for concluding that such investment options are indistinguishable." The Final Rule removed explicit references to ESG but retained the opposition to the use of non-pecuniary factors.

[73] US SIF, Report on US sustainable and impact investing trends 2020, available at: https://www.ussif.org/files/trends%20report%202020%20executive%20summary.pdf at 1. Broadridge Financial, presumably using a different definition of ESG assets, estimates that, as of November 2021, $8 trillion of assets were invested in dedicated environmental, social, and governance mutual funds, ETFs, institutional mandates, and private funds. Broadridge, ESG Investments Poised to Reach $30 Trillion by 2030, available at https://www.broadridge.com/intl/press-release/2021/esg-investments-poised-to-reach-30-trillion-dollar-by-2030.

[74] Sustainable Funds U.S. Landscape Report – More funds, more flows, and impressive returns in 2020, Morningstar Manager Research (Feb. 19, 2021), available at https://www.sec.gov/comments/climate-disclosure/cll12-8899329-241650.pdf.

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of 2020, compared to 55 funds in 1995.[75] An increasing number of these funds use names denoting a socially responsible investment strategy—almost 400 according to an S.E.C. estimate.[76] Economists, in turn, have taken to modelling the effect of social preferences on shareholding structure,[77] share prices,[78] expected shareholder returns,[79] and the scope of shareholder voting rights.[80]

Public statement and actions by leading investment managers seem to push in the same direction. For example, in his 2019 letter to CEOs, Larry Fink, the CEO of BlackRock, the world's largest asset managers, urged that "companies must demonstrate their commitment to the countries, regions, and communities where they operate, particularly on issues central to the world's future prosperity."[81] Similarly, in the year prior, he advised that "[t]o prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society."[82] State Street, another large investment advisor, similarly claims that "sustainability has been at the center of [its] asset stewardship program for a number of years."[83]

This change in shareholder attitudes seems to be backed up by shareholder actions. BlackRock announced that it will divest its actively managed portfolios from coal stocks.[84] New York's state pension fund, as well, announced that it was divesting from fossil fuels. Various other funds divested from, or declared an intent to divest from, firearms manufacturers, operators of private prisons, and companies from countries that do not meet specified labor standards, among

[75] US SIF, Report on U.S. Sustainable, Responsible and Impact Investing Trends, 2016, available at https://www.ussif.org/files/SIF_Trends_16_Executive_Summary(1).pdf and US SIF, Sustainable Investing Basics (2020), available at https://www.ussif.org/sribasics.

[76] Securities and Exchange Commission, Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, available at https://www.sec.gov/rules/proposed/2022/ia-6034.pdf at 185 (33 open end funds, 21 closed end funds and 35 UITs).

[77] Henry L. Friedman & Mirko S. Heinle, Taste, Information, and Asset Prices: Implications for the Valuation of CSR, 21 Rev. Accounting Stud. 740 (2016).

[78] Eugene F. Fama & Kenneth R. French, Disagreement, Tastes, and Asset Prices, 83 J. Fin. Econ. 66 (2007).

[79] Friedman & Heinle, supra note **Error! Bookmark not defined.**; Lubos Pastor, Robert F. Stambaugh & Lucian A. Taylor, Sustainable Investing in Equilibrium, 142 J. Fin. Econ. 550 (2021)

[80] Oliver Hart & Luigi Zingales. 2017. Companies should maximize shareholder welfare not market value. *Journal of Law, Finance, and Accounting* 2 (2): 247–275.

[81] BlackRock, Larry Fink's 2019 Letter To CEOs: Purpose & Profit, available at https://www.blackrock.com/corporate/investor-relations/2019-larry-fink-ceo-letter.

[82] BlackRock, Larry Fink's 2018 Letter To CEOs: A Sense of Purpose, available at https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter.

[83] State Street Global Advisors, Incorporating Sustainability Into Long-Term Strategy, Feb. 2019, available at https://www.ssga.com/investment-topics/environmental-social-governance/2019/02/incorporating-sustainability-into-long-term-strategy.pdf

[84] See Michal Barzuza, Quinn Curtis & David H. Webber, Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance, 93 S. Cal. L. Rev. 1243, 1274 (2020).

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others.[85] Last year's proxy season saw support for "an unprecedented number of ESG proposals, on issues ranging from climate change to human capital management to diversity, equity and inclusion."[86] According to an analysis by ISS, environmental and social issue proposals have earned in recent years "record levels of support".[87]

To be sure, socially responsible investing, and support for social issue shareholder proposals, do not necessarily indicate that shareholders are motivated by non-financial preferences. Arguably, individual shareholders are purely driven by financial returns and believe that socially responsible investing will generate such returns—believing, in effect, that socially responsible companies are undervalued.[88] If so, there would be no correlation between shareholders' views on issues like climate change or diversity and shareholders' investment decisions.

But this is unlikely. For one, empirical evidence indicates that mutual funds marketed as socially responsible are disproportionately held by more prosocial investors.[89] Second, data from Robinhood indicate that firms that publicly supported Black Lives Matter saw an increase in the number of retail investors holding their shares on its platform and to experimental studies indicating that many investors are willing to accept lower returns in exchange for firms acting in a more socially responsible fashion.[90] This, as Professors Barzuza, Curtis and Webber note, indicates that retail investors increasingly make investment decisions based on non-economic preferences.[91] Finally, if so many investors thought that that socially responsible companies are undervalued, the market price for the shares of these companies would already have

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[85] Paul G. Mahoney & Julia D. Mahoney, The New Separation of Ownership and Control: Institutional Investors and ESG, 2021 Colum. Bus. L. Rev. 840, at TAN 91 (2021).

[86] Wachtell, Lipton Rosen & Katz, Board Oversight of ESG: Preparing for the 2022 Proxy Season and Beyond Mar. 25, 2022. See also Jody Grewal, George Serafeim & Aaron Yoon, Shareholder activism on sustainability issues (2017), Working paper, available at: https://ssrn.com/abstract=2805512 (reporting that the number of shareholder proposals on sustainability doubled from 1999 to 2013).

[87] See Kosmas Papadopoulos, The Long View: US Proxy Voting Trends on E&S Issues from 2000 to 2018, Harv. L. Sch. F. on Corp. Governance, https://corpgov.law.harvard.edu/2019/01/31/the-long-viewus-proxy-voting-trends-on-es-issues-from-2000-to-2018/ (reporting that the percentage of proposals gaining more than 30% support grew from 0% in 2000 to 36% in 2018 and that a record percentage of proposals are withdrawn as companies reach pre-vote settlements with the proponents).

[88] This belief is highly disputed. See Cornell, Brad & Damodaran, Aswath, Valuing ESG: Doing Good or Sounding Good?, 1 The Journal of Impact and ESG Investing, 76 (2020); Terrence R. Keely, ESG Does Neither Much Good nor Very Well, Wall St. J., Sep. 13, 2022 ("Over the past five years, global ESG funds have underperformed the broader market by more than 250 basis points per year, an average 6.3% return compared with a 8.9% return."). Moreover, what type of stocks are overvalued or overvalued can change with time and even if companies that are socially responsible were undervalued 10 years ago, this would not imply that they remain undervalued today or will continue to be undervalued in 10 years.

[89] Arno Riedl & Paul Smeets, Why Do Investors Hold Socially Responsible Mutual Funds?, 72 J. FIN. 2505 (2017).

[90] See Barzuza et al., supra note 84.

[91] Id. (concluding that socially responsible investing, a "once relatively marginal" phenomenon, has "taken center stage in the corporate world.").

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adjusted[92]—unless, that is, a similarly large number of investors believed that these companies are *over*valued. But unlike in other areas where shareholders who believe that certain types of companies are misvalued have a choice of different investment vehicles—like growth funds and value funds, small stock funds and large stock funds, or sector funds devoted to different industries—we find only funds who specialize in socially responsible investing, but no funds that specialize in companies that score low on ESG metrics.[93] And while some are skeptical about how much investors in ESG funds are willing to sacrifice returns to pursue their non-financial interests,[94] investors at a minimum seem willing to incur the higher fees charged by ESG funds.[95]

Even if ultimate investors in socially responsible investment vehicles are motivated by non-financial concerns, it could be that asset managers, such as BlackRock and State Street that incorporate ESG in their engagement are purely returns driven.[96] This is more plausible. In particular, asset managers may push for social responsibility in their portfolio companies as part

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[92] There is indeed some evidence that sustainable stocks have become overvalued. See Nickolay Gantchev, Mariassunta Giannetti & Rachel Li, Sustainability or Performance? Ratings and Fund Managers' Incentives, ECGI Working Paper No. 747/2021 (2021),

[93] Strive Asset Management, which uses shareholder engagement and proxy voting to impress a non-ESG policy on companies (see https://www.investmentnews.com/anti-esg-movement-spawns-new-fund-in-battle-against-blackrock-vanguard-and-state-street-225185), is no counterexample. Strive's strategy is not based on the notion that firms that follow ESG are overvalued (given that strategy they follow), but that they would have a higher value if they changed their strategy. Similarly, if ESG investing were purely returns driven, a proposed 2020 Department of Labor rule to prohibit ERISA fiduciaries from taking ESG factors into account unless they are meant to increase returns would not have been heavily criticized by ESG proponents. Amanda Rose, A Response To Calls For S.E.C. Mandated ESG Disclosure, 98 Wash. U. L. Rev. 1821 (2021).

[94] Jennifer Arlen & Lewis A. Kornhauser, Battle for Our Souls: A Psychological Justification for Corporate and Individual Liability for Organizational Misconduct (July 3, 2022). Available at SSRN: https://ssrn.com/abstract=4152960 or http://dx.doi.org/10.2139/ssrn.4152960 (finding support for proposition that people want to be moral but are primarily driven by self-interest and will pursue self-interest if they can without feeling immoral).

[95] For example, the Vanguard ESG U.S. Stock ETF and the Vanguard FTSE Social Index Fund Admiral Shares charge annual fees of 0.09% and 0.14%, respectively, compared to 0.04% for both the Vanguard Large Cap ETF and the Vanguard 500 Index Fund Admiral. See Vanguard, Discover Vanguard Mutual funds & ETF, available at https://investor.vanguard.com/investment-products/list/all?managementstyle=index&assetclass=equity-region-us,equity-market_cap-large-cap,equity. Managers of ESG funds, as well, do not seem to believe that these funds offer superior returns. Thus, a study found that managers with more "skin in the game" exhibit significantly lower ESG performance in funds they manage than their peers and that managers, contrary to what one would expect if managers really considered ESG strategies an enhanced form of portfolio management. See Orlov, Vitaly and Ramelli, Stefano and Wagner, Alexander F., Revealed Beliefs about Responsible Investing: Evidence from Mutual Fund Managers (August 1, 2022). Swiss Finance Institute Research Paper No. 22-98, European Corporate Governance Institute – Finance Working Paper No. 883/2023, Available at SSRN: https://ssrn.com/abstract=4296497 or http://dx.doi.org/10.2139/ssrn.4296497.

[96] Asset managers generally claims that they are returns driven. See, e.g., BlackRock, Larry Fink's 2020 Letter to CEOs: A Fundamental Reshaping of Finance (2020) https://www.blackrock.com/corporate/investor-relations/2020-larry-fink-ceoletter (stating that BlackRock's "investment conviction is that sustainability- and climate-integrated portfolios can provide better risk-adjusted returns to investors"); see also Gordon, supra note 54 (arguing that index funds' approach to ESG matters can serve the interests of their investors by reducing systematic risk).

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of a multi-firm focus strategy[97] or to fend off regulation.[98] But while these motivations may well account in part for the decisions by asset managers, that fact that asset managers openly and vocally publicize their ESG orientation[99]—and, according to some, exaggerate their ESG activities[100]—suggests that they are trying to appeal to their investor clients. Indeed, BlackRock issued a report *Understanding Millennial Investors* that explains that to earn brand loyalty from millennial investors, it is crucial to do "things the 'right' way."[101] Put differently, asset managers act as if they believe that talking the ESG talk, and walking the ESG walk, will appeal to a substantial segment of their investors.

The amount devoted to ESG investments is likely to continue to grow. In 2020, a record $51.1 billion in additional funds was invested in ESG funds, approximately 10 times as much as during 2018. Even if fund inflows stabilize at that level, the percentage of the assets under management devoted to sustainable investing would be bound to rise. But many commentators foresee even greater growth. Bloomberg predicts that global ESG assets will exceed $53 trillion by 2025.[102] Broadridge Financial projects that ESG investments will grow to between $20 and $30 trillion by 2030.[103] Barzuza, Curtis and Webber have identified millennials as a demographic group that cares more, and more deeply, about non-financial considerations that prior

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[97] See supra note Section II.A. Asset managers may conceivably also pursue certain forms socially responsible investing as part of a multi-firm focus strategy, though it is not clear if a multi-firm focus translates into socially responsible investing (as opposed to engagement).

[98] But see Barzuza et al., supra note 84, at 1280 (noting that pursuit of ESG may increase regulatory pressure, as it did when the Department of Labor issued its proposed ERISA regulations on the use of ESG in investing).

[99] Larry Fink's letters to CEOs, for example, are prominently posted on the firm's website (see https://www.blackrock.com/us/individual?cid=ppc:BlackRock_USWA:google:BlackRockBrandNew&gclid=EAIaIQobChMIhYGwtMGM-AIVCuOzCh1PFwc1EAAYASAAEgKAGfD_BwE&gclsrc=aw.ds) and State Street accompanied its campaign for greater gender diversity on boards with a high profile placement of the "Fearless Girl" statue opposite the Charging Bull statue in Manhattan's Financial District. Barzuza et al., supra note 84, at 1243.

[100] See, e.g., Press Release, SEC Charges BNY Mellon Investment Adviser for Misstatements and Omissions Concerning ESG Considerations, May 23, 2022, available at https://www.sec.gov/news/press-release/2022-86 (reporting that the S.E.C charged BNY Mellon with overstating the degree to which ESG considerations affected investment decisions); Eshe Nelson, Sustainable investing risks becoming a victim of its own success, Dec. 13, 2018, available at https://qz.com/1490365/esg-investing-risks-becoming-a-victim-of-its-own-success/ (quoting Harvard Business School professor George Serafeim as stating that there are "now stronger incentives for asset managers to greenwash," and "ESG cannot be just a marketing tool to attract capital."); Sadok E. Ghoul, and Aymen Karoui, What's in a (Green) Name? The Consequences of Greening Fund Names on Fund Flows, Turnover, And Performance, 39 Finance Research Letters 101620 (2021) (not finding a statistically significant change in fund exposure to socially responsible investment following a fund name change suggesting socially responsible investment); Bertrand Candelon, Jean-Baptise Hasse & Qunetin Lajaunie, ESG-Washing in the Mutual Funds Industry? From Information Asymmetry to Regulation, Risks, 9, 199 (2021) (providing empirical evidence that some asset managers incorrectly portray themselves as socially responsible).

[101] Barzuza et al., supra note 84, at 1289-90.

[102] Bloomberg, ESG assets may hit $53 trillion by 2025, a third of global AUM, Feb. 23, 2021, available at https://www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/. These various sources do not specify what assets are regarded as invested in ESG and their estimates may differ because their definition of ESG assets differs.

[103] Broadridge, ESG Investment, supra note **Error! Bookmark not defined.**.

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generations.[104] And millennials are set for a huge increase in investable assets,[105] according to Larry Fink "the largest transfer of wealth in history."[106]

How investor preferences in general, and the growth in ESG investing in particular, affect company actions is a different issue. In principle, there are two mechanisms: "exit" and voice.[107] "Exit"—not investing in, and divesting from, companies whose actions do not accord with one's preferences—can influence corporate actions through two channels. First, if the pool of investors who refuse to fund certain objectionable investments is very large, there may not be enough capital left to fund these investments. Second, if certain investors refuse to fund certain objectionable investments, other investors (who care purely about financial returns) have to hold an unbalanced portfolio that entails some diversifiable risk—thereby raising the cost of capital for these investments.[108] However, a recent study estimates that the latter effect is unlikely to be significant,[109] casting some doubt at the effectiveness of the exit approach.

Voice may hold comparatively greater promise. Indeed, there is some evidence that investor voice has already started to affect corporate actions. Following the push for greater gender diversity, for example, gender diversity on boards has in fact increased.[110] And a large number of companies now make climate-related disclosures, a move that seems driven by investor demands.[111]

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[104] Barzuza et al., supra note 84, at 1284 – 85, 1291 – 1303.
[105] Id. at 1286.
[106] BlackRock, Larry Fink's 2019 Letter to CEOs, supra note 81 ("In the years to come, the sentiments of these generations will drive not only their decisions as employees but also as investors, with the world undergoing the largest transfer of wealth in history: $24 trillion from baby boomers to millennials.").
[107] See generally Albert O. Hirschman, Exit, Voice, And Loyalty: Responses To Decline In Firms, Organizations, And States (1970).
[108] Jonathan Berk & Jules H. Van Binsbergen, The Impact of Impact Investing (June 10, 2022), available at https://papers.ssrn.com/abstract_id=3909166.
[109] Id.
[110] Barzuza et al., supra note 84, at 1265 ("Calls for public companies to increase the gender diversity of their boards of directors are not new, but in recent years, calls for diversification have come not just from social activists, but from investors as well, and companies have responded."); see also Lowry, Michelle B. and Wang, Pingle and Wei, Kelsey D., Are All ESG Funds Created Equal? Only Some Funds Are Committed (March 15, 2022). European Corporate Governance Institute – Finance Working Paper No. 874/2023, Available at SSRN: https://ssrn.com/abstract=4104700 or http://dx.doi.org/10.2139/ssrn.4104700 (finding that ESG funds with higher incentives to engage demonstrate more discretionary voting on portfolio firms' ESG proposals and contribute to real ESG-improvements).
[111] See Securities and Exchange Commission, The Enhancement and Standardization of Climate-Related Disclosures for Investors, available at https://www.sec.gov/rules/proposed/2022/33-11042.pdf, note 76 ("over 3,000 companies have provided climate-related disclosures through the CDP's platform by responding to the CDP's questionnaires that are aligned with the TCFD's disclosure recommendations"); Grewal at al., supra note 86 (reporting that filing shareholder proposals are related to subsequent improvements in the performance of the company on the focal environmental or social issue, even though such proposals nearly never received majority support); but see Why ESG is fatally flawed, available at http://www.chrisleithner.com/why-esg-is-fatally-flawed/, (quoting former senior BlackRock executive as stating "Despite tens of trillions of ESG investments, investors haven't done very well nor generated much good. ESG advocates need to do better or stop claiming they can.").

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Whether company actions have, on the whole, come at the expense of corporate value is less clear.[112] Empirical studies in this area face a number of challenges. To the extent that companies have increased their ESG activities, it is often unclear whether they did so to make themselves or their products more appealing to customers and employees (which would be consistent with firm value maximization), to fend off a harsher regulatory climate (which would also be consistent with firm value maximization), or to accommodate shareholder non-economic preferences (which would detract from firm value maximization). Finally, ESG activities may be endogenous: firms that are profitable may be more likely to engage in them than firms at the brink of insolvency. Perhaps unsurprisingly, a recent comprehensive review of the literature concludes that "empirical studies examining the relation between corporate social responsibility and firm value find mixed results."[113]

But the issue is not the average relationship between acting in a socially responsible way and profitability. Even the most devoted shareholderist hardly believes that the best way for a company to make money is to mistreat its employees, customers and suppliers or to pollute the environment.[114] Up to some point, being a responsible corporate citizen is surely likely to enhance a company's financial performance. The issue rather is whether investor concern about non-financial metrics has driven companies to go beyond that point—an issue that is even more difficult to investigate empirically.

Even more relevant is whether, going forward, companies will be driven to sacrifice financial returns for other values. The shareholder push towards social responsibility is still relatively new. In our assessment, it is likely to get stronger as the percentage of assets under management devoted to values-based investment grows, as values-based investors get more expertise in dealing with portfolio companies, and as corporate resistance to investor demands breaks down. Furthermore, the anticipation of further growth and influence in the values-based investment sector may induce companies to change their behavior to preempt any pressure they may face in the future. Aiding these trends and enhancing the ability of shareholders to pressure

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[112] Hans Bonde Christensen, Luzi Hail & Christian Leuz, Mandatory CSR and Sustainability Reporting: Economic Analysis and Literature Review (May 17, 2021). European Corporate Governance Institute - Finance Working Paper No. 623/2019, Available at SSRN: https://ssrn.com/abstract=3427748; see also Ananth Madhavan, Aleksander Sobczyk & Andrew Ang, Toward ESG Alpha: Analyzing ESG Exposures through a Factor Lens, 77 Fin. Anal. J. 69–88 (2021) (surveying the literature which finds mixed performance); Gerhard Halbritter & Gregor Dorfleitner, The Wages of Social Responsibility—Where Are They? A Critical Review of ESG Investing, 26 Rev. Fin. Econ. 25, 35 (2015) (finding no link between ESG ratings and returns).

[113] Mandatory CSR, supra note 128; see also id. ("A different way to examine the potentially value-enhancing effects of CSR is to study its association with financial performance (e.g., return on assets), essentially testing whether companies "do well by doing good." There is a large number of studies broadly examining this relation and their results are again mixed."). Though many studies show a positive association between corporate social responsibility and firm performance, it could be that companies with better performance are more likely to be socially responsible. Id.

[114] Bartlett & Bubb Working Paper.

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companies, the S.E.C. limited companies' ability to exclude social issue shareholder proposals.[115] As shareholder pressure to pursue non-financial goals increases, the trade-off between the pursuit of firm value and the pursuit of non-financial goals will become starker.

C. Stakeholderism

On August 19, 2019, the Business Roundtable, an organization of chief executives of major U.S. corporations, released its new statement on the purpose of the corporation:

> [W]e share a fundamental commitment to all of our stakeholders. We commit to:
>
> - Delivering value to our customers. We will further the tradition of American companies leading the way in meeting or exceeding customer expectations.
> - Investing in our employees. This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect.
> - Dealing fairly and ethically with our suppliers. We are dedicated to serving as good partners to the other companies, large and small, that help us meet our missions.
> - Supporting the communities in which we work. We respect the people in our communities and protect the environment by embracing sustainable practices across our businesses.
> - Generating long-term value for shareholders, who provide the capital that allows companies to invest, grow and innovate. We are committed to transparency and effective engagement with shareholders.
>
> Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country.[116]

As the accompanying press release noted, the 2019 statement "moves away from shareholder primacy"—a principle that had been endorsed by every prior statement—to "include[] a commitment to all stakeholders."[117] The 2019 statement shows how far the Business

[115] Wachtell, Lipton, Rosen & Katz, SEC Staff Limits Exclusion of "Social Policy" Shareholder Proposals, Nov. 4, 2021, available at https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.27894.21.pdf.

[116] Statement on the Purpose of a Corporation, available at https://opportunity.businessroundtable.org/ourcommitment/

[117] Business Roundtable, Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans', Aug. 19, 2019, available at https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans. Stakeholders are not entirely new to the debate. In the late-1980, many states adopted constituency statutes that permitted the board to consider the interests of groups other than shareholders, such as employees and customers, in particular in deciding how to respond to a hostile takeover. See generally American Bar Association Committee on Corporate Laws, Other Constituencies Statutes: Potential for Confusion, 45 BUS. LAW. 2253 (1990). But these laws were about enabling managers to obstruct a bid that managers opposed but shareholders favored. See Marcel Kahan, Delaware's Peril, 80 U. Maryland L. Rev. 59, 70 ("The notion that constituency statutes would induce a board—technically elected by shareholders but in practice often deferential to top management—to take an action opposed

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Roundtable has moved since 1997, when it had declared that "[the paramount duty of management and of boards of directors is to the corporation's stockholders. … The interests of other stakeholders are relevant as a derivative of the duty to stockholders."[118]

Many applauded or opposed the statement.[119] Others regarded it as a meaningless "public relations move" that was "mostly for show"[120] and "largely rhetorical."[121]

We agree that the 2019 statement should not be read as a whole-hearted embrace of stakeholderism by corporate America. But we think the skepticism misses an important point. Even if the signatories of the 2019 statement did not truly mean what they said, the fact that they nevertheless issued the statement reflects an erosion of the norm of shareholder primacy, a norm that is foundational to shareholderism. [122]

There is plenty of evidence of erosion. According to a Fortune poll conducted in 2019, 41% of Fortune 500 CEOs agreed that "solving social problems should be 'part of [their] core business strategy.'"[123] Only seven percent thought that their main focus should be on making

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by managers and shareholders because it benefitted other constituents, such as employees, or not to take an action favored by managers and shareholders because it would hurt employees, seems farfetched.")

[118] Fortune, America's CEOs Seek a New Purpose for the Corporation, Aug. 19, 2019, available at https://fortune.com/longform/business-roundtable-ceos-corporations-purpose/

[119] Id. (noting support from CEO of Vanguard, President and CEO of Progressive Corporation, and President of the Ford Foundation); https://corpgov.law.harvard.edu/2019/08/22/so-long-to-shareholder-primacy/ (noting that seven CEOs declined to sign the statement and that the Council of Institutional Investors expressed concern that it gave "CEOs cover to dodge shareholder oversight."); Carmen Lu, Martin Lipton & William Savitt, Further on the Purpose of the Corporation, Harvard Law School Forum on Corporate Governance, available at https://corpgov.law.harvard.edu/2021/07/20/further-on-the-purpose-of-the-corporation/ (praising statement as embracing the "imperative of a society-facing purpose beyond a singular pursuit of profit"); Editorial, The 'Stakeholder' CEOs, Wall St. J. (Aug. 19, 2019, 5:09 PM), https://www.wsj.com/articles/the-stakeholderceos-11566248641 ("[a]n illdefined stakeholder model can quickly become a license for CEOs to waste capital on projects that might make them local or political heroes but ill-serve those same stakeholders if the business falters"); Karl Smith Corporations Can Shun Shareholders, But Not Profits, Bloomberg Opinion (August 27, 2019) ("it's a blueprint for ineffective and counterproductive public policy on the one hand, and blame-shifting and lack of accountability on the other").

[120] Lucian A. Bebchuk & Roberto Tallarita, The Illusory Promise of Stakeholder Governance, 106 Cornell L. Rev. 91, 98 (2020); see also Jay Coen-Gilbert, Andrew Kassoy & Bart Houlihan, Don't Believe the Business Roundtable Until It's CEO's Actions Match Their Words, Fast Company (August 22, 2019).

[121] Michael Hiltzik, Big Business buries the shareholder value myth, L.A. Times, available at https://enewspaper.latimes.com/infinity/article_share.aspx?guid=49054bfa-305d-484e-92a9-e70c6faf5ab7; see also Andrew Winston, Is the Business Roundtable Statement Just Empty Rhetoric? Harvard Business Review (August 30, 2019).

[122] By norm, we mean a nonlegally enforceable rule or standard. Edward B. Rock & Michael L. Wachter, Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation 149 U. Pa. L. Rev. 1619 (2001). Though directors generally owe fiduciary duties to the corporation and its shareholders, the business judgment rule confers significant discretion on directors who have no personal conflict of interest. As such, in most context, shareholder primacy is not legally enforceable.

[123] Cydney Posner, So Long to Shareholder Primacy, Aug. 22, 2019, Harvard Law School Forum on Corporate Governance, available at https://corpgov.law.harvard.edu/2019/08/22/so-long-to-shareholder-primacy/

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profits. New terms like "inclusive capitalism"[124] and "compassionate capitalism"[125] abound. Larry Fink's favorite term is stakeholder capitalism: "capitalism, driven by mutually beneficial relationships between you and the employees, customers, suppliers, and communities your company relies on to prosper."[126] Companies, in their letters to shareholders, increasingly claim to pursue social and environmental goals.[127] Wachtell, Lipton, Rosen and Katz, a leading advisor to management, likewise pays homage to the normative appeal of stakeholderism.[128] During the 2020 election season, two leading contenders for the Democratic nomination proposed

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[124] See, e.g., Council for Inclusive Capitalism website, https://www.inclusivecapitalism.com/ (website of Council for Inclusive Capitalism, a movement of CEO leaders doing business in ways that lead to a more inclusive and sustainable economy); The Rockefeller Foundation, A Framework for Inclusive Capitalism, https://www.rockefellerfoundation.org/rfbreakthrough/a-framework-for-inclusive-capitalism/; University of Oxford, The State and Direction of Inclusive Capitalism, https://www.sbs.ox.ac.uk/sites/default/files/2020-01/in-pursuit-of-inclusive-capitalism-V2.pdf. In a Westlaw search of the News file on November 21, 2022, the term was found in 1068 documents dated from 2017 to 2022.

[125] What is Compassionate Capitalism and Why We Need it in These Times of Planetary Crisis? https://www.managementstudyguide.com/compassionate-capitalism.htm; Carrie Sheffield, Compassionate Capitalism Is The Best Solution To Global Poverty, Forbes, Oct. 5, 2015, available at https://www.forbes.com/sites/carriesheffield/2015/10/05/compassionate-capitalism-is-the-best-solution-to-global-poverty/?sh=2e424706658d; Compassionate Capitalism: Journey To The Soul of Business (Book Title). In a Westlaw search of the News file on November 21, 2022, the term was found in 293 documents dated from 2017 to 2022.

[126] BlackRock, Larry Fink's 2022 Letter to CEOs, supra note **Error! Bookmark not defined.**; see also Frederick Alexander, Holly Ensign-Barstow, Lenore Palladino, & Andrew Kassoy, From Shareholder Primacy to Stakeholder Capitalism: A Policy Agenda for Systems Change (arguing that fiduciary duties should incorporate external costs of individual companies that harm portfolios); Tom Gosling, Can Shareholders Save Capitalism?, available at https://mailchi.mp/ecgi/summit-2022-4?e=476ee7935e ("The idea that untrammelled Friedmanite pursuit of shareholder value has led to environmental destruction, climate change, inequality, and all manner of other ills is widely held. The emergence of the idea of stakeholder capitalism has at its core the idea that shareholder interests need to be prioritized in favour of other goals.")

[127] Raghuram G. Rajan, Pietro Ramella & Luigi Zingales, What Purpose Do Corporations Purport? Evidence from Letters to Shareholders (March 27, 2023). University of Chicago, Becker Friedman Institute for Economics Working Paper No. 2023-44, Available at SSRN: https://ssrn.com/abstract=4405063

[128] Wachtell, Lipton, Rosen & Katz, On the Purpose of the Corporation, May 26, 2020 , available at https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.26961.20.pdf. (Corporations should be "to conduct a lawful, ethical, profitable and sustainable business in order to create value over the long-term, which requires consideration of the stakeholders that are critical to its success (shareholders, employees, customers, suppliers, creditors and communities)." Shareholders are merely "essential partners in supporting the corporation's pursuit of this mission.")

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corporate governance reforms that would confer substantial power to non-shareholder constituents.[129] And President Biden called for an end to the "era of shareholder capitalism."[130]

Some commentators argue that stakeholderism is consistent with, or even required for, firm value maximization. Thus, a Deloitte report claims that

> companies that hold themselves accountable to their stakeholders by increasing transparency will be more viable—and valuable—in the long term. ... Today, people from around the globe, including employees, suppliers, business partners, members of the community, activists, and society at large, are equal participants—stakeholders—in a direct dialogue with your company about what they expect from your business. ... As consumers, people increasingly want to purchase products they view as sustainable across the entire value chain, including matters of equity and equality. ... As employees, people are increasingly concerned with the ESG activities of their employers across all geographies.[131]

Similarly, Wachtell, Lipton bemoans what it claims to be "the confusion sewn by critics of stakeholder governance who pit shareholders against other stakeholders through the misleading allure of an existential conflict that requires directors to choose between value for one versus the other."[132]

It is surely correct that catering to one's customers, employees and supplies, and embracing wider concerns of equity and equality, can, *up to some point*, make a company more profitable. But it is equally correct that, *beyond that point*, the interests of shareholders and the interests of other stakeholders will conflict. Picking the optimal point, from the perspective of firm value maximization (or, for that matter, portfolio value maximization or shareholder welfare maximization), is not easy. Our guess is that companies will err or both sides, with some not going far enough and some going too far in taking into account stakeholder interests. But statements like those by Deloitte imply that most companies should show more concern about their non-shareholder stakeholders. Despite the rhetoric that doing so is merely meant to increase the long-term value of the company, these statements therefore suggest that stakeholder interests should be taken into account even if they conflict with shareholder interests.

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[129] Under Senator Bernie Sanders's proposal, employees at publicly traded companies would be entitled to elect 45% of the board members. Corporate Accountability and Democracy, Berniesanders.Com, https://berniesanders.com/issues/corporate-accountability-and-democracy/ Under Senator Elizabeth Warren's, they would have the right to elect 40% of the board. S. 3348, Accountable Capitalism Act, 115th Cong. (2018). Both proposals contained further provisions designed to make boards less responsive to shareholder interests. See Kahan, Delaware's Peril, supra note 117, at 70-71.

[130] CNBC, Biden says investors 'don't need me,' calls for end of 'era of shareholder capitalism,' (July 9, 2020), available at https://www.cnbc.com/2020/07/09/biden-says-investors-dont-need-me-calls-for-end-of-era-of-shareholder-capitalism.html.

[131] Deloitte, Tectonic Shifts, supra note 70.

[132] See Wachtell Lipton, supra note 8.

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Whether the erosion of the shareholder primacy norm reflects a resurgence of managerialism or the rise of direct social welfarism, it clearly indicates the waning of shareholderism. But ideology matters, especially in the absence of high-powered financial incentives. One important group that lacks such incentives are outside directors. Most outside directors own trivial stakes in the corporations on the boards of which they sit and do not receive much incentive-based compensation.[133] While they presumably want to retain their positions, involuntary departures—by failing to get re-nominated or failing to get re-elected if re-nominated—tend to be rare. In other words, outside directors have no strong financial reasons not to advance the interest of stakeholders at the expense of the interests of shareholders, at least if they are moderate about doing so and can plausibly claim that, viewed properly and over the long term, these interests do not really conflict.[134] If they repeatedly read in the press and hear from their peers, legal advisors, and investors that a corporation needs to pursue mutually beneficial relationships with employees, customers, suppliers, and communities, that companies must demonstrate their commitment to the communities where they operate, and that they should consider all the stakeholders with no special regard to shareholders, they will start acting accordingly.[135]

A second important group are members of the judiciary. And, indeed, there are indications that Delaware's case law may be moving in a welfarist direction. Consider the court's treatment of claims that directors or officers violated their fiduciary oversight duties—so-called *Caremark*[136] duties. Until recently, *Caremark* claims rarely survived a motion to dismiss. But in 2019, the Delaware Supreme Court in *Marchand v. Barnhill*[137] reversed a dismissal of a *Caremark* claim arising out of a listeria outbreak at an ice cream company that killed multiple people and sickened others.[138] The following year, the Delaware Chancery Court denied a motion to dismiss a *Caremark* claim that the board of AmerisourceBergen Company breached its duties to ensure that its subsidiaries complied with laws governing the sale of cancer drugs.[139] In 2021, that court denied a motion to dismiss a *Caremark* claim involving the crash of two Boeing 737 MAX planes.[140] And in 2022, the court denied a motion to dismiss yet another *Caremark* claim that a McDonald's officer, who himself was involved in sexual harassment, failed to comply with his duty of oversee the company's human resources function. Professor Jennifer Arlen, in a recent paper, has referred to this new body of case law as Caremark 2.0 and argued that it reflects an

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[133] Matthew Friestedt, Marc Treviño, and Melissa Sawyer, Trends in U.S. Director Compensation, Harv. L. School Forum on Corp. Gov., Aug. 16, 2020, available at https://corpgov.law.harvard.edu/2020/08/16/trends-in-u-s-director-compensation/ (average compensation of S&P 500 outside directors in 2019 was about $300,000 of which 57% was in form of stock awards and 3% in form of option grants).

[134] See Kahan & Rock, supra note __.

[135] Edward Rock, For Whom is the Corporation Managed in 2020, 76 Bus. Law. 363, 386-87 (2021).

[136] In re Caremark International, 698 A.2d 959 (Del. Ch. 1996).

[137] 212 A.3d 805 (Del. 2019)

[138] Caremark Exposure—And What to Do About It, Wachtell, Lipton, Rosen & Katz, Jan. 23, 2023 (noting that *Marchand* applied the *Caremark* framework "in a way that appeared to liberalize it").

[139] Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou, No. 2019-0816-SG (Del. Ch. Aug. 24, 2020).

[140] In re the Boeing Co. Derivative Litig., No. 2019-0907 (Del. Ch. Sept 7, 2021).

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extension in the focus of *Caremark* duties from lack of oversight that harms shareholders and towards a lack of oversight that is harmful to social interests.[141] Judges in other jurisdictions are, if anything, more inclined to be responsive to a shift in norms towards stakeholderism, though the case law is too sparse to determine whether such a shift is taking place.

Unlike outside directors and judges, managers have high-powered financial incentives.[142] At present, a substantial portion of their compensation is tied to shareholder returns. Moreover, managers rather than outside directors and judges make most day-to-day managerial decisions and, on most matters, outside directors tend to defer to management recommendations. As long as their financial incentives do not change, is it perhaps warranted to write off their endorsement of stakeholderism as cheap talk and not to pay much attention to the rise of stakeholderist norms?

Even the answer to that question is not clear cut. For one, norms may affect the attitudes of stakeholders such as employees or customers. Thus, in an experimental study, Hajin Kim showed that Amazon Mechanical Turk workers taught an exclusive profit maximization norm were less likely to sign a real petition against Amazon than those taught that firms can and should care about society.[143] Changed attitudes by stakeholders would in turn affect the actions of corporations, even if corporate managers do not themselves subscribe to the norms. For example, in 2019, Amazon improved its climate commitments in response to a walk-out by a few hundred of its employees[144]—presumably in order to maintain amicable employee relations.

More fundamentally, however, managerial incentives themselves are not written in stone, but are themselves endogenous. The present structure of high-powered incentives provided via stock-based compensation reflects the rise of shareholderism[145] and supplanted a compensation structure that relied much more on fixed salaries and accounting-based bonuses

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[141] Jennifer Arlen, Evolution of Director Oversight Duties and Liability under Caremark: Using Enhanced Information-Acquisition Duties in the Public Interest (August 28, 2022). NYU Law and Economics Research Paper No. 23-05, European Corporate Governance Institute - Law Working Paper No. 680/2023, Available at SSRN: https://ssrn.com/abstract=4202830 or http://dx.doi.org/10.2139/ssrn.4202830; see also Bird, Robert C. and Magid, Julie Manning, Operational Risk and the New Caremark Liability for Boards of Directors (March 2, 2023). Boston University Law Review, Forthcoming, Available at SSRN: https://ssrn.com/abstract=4376029.

[142] See Marcel Kahan, The Limited Significance of Norms for Corporate Governance, 149 U. Pa. L. Rev. 1869, 1896-97 (2001)

[143] Hajin Kim, Expecting Corporate Prosociality.

[144] James F. Peltz, Jeff Bezos Expanded Amazon's Climate Change Pledge. His Workers Wanted More , L.A. Times (Sept. 20, 2019), https://www.latimes.com/business/story/2019-09-19/amazon-climate-change.

[145] It is important to recognize in this regard that the shareholder primacy norm is itself of recent vintage. Up to the late 1970s, major U.S. corporations often retained earnings and reinvested them, providing workers with higher incomes and greater job security. William Lazonick, Profits Without Prosperity, Harv. Bus. Rev., Sep. 2014, available at https://hbr.org/2014/09/profits-without-prosperity Shareholder primacy as a norm came to the fore as a result of the works of Milton Friedman and of Michael Jensen and William Meckling, who coined the phrase agency costs to denote the fact than managers (the agents) should but fail to act in the interest of shareholders (the principals). See So Long Shareholder Primacy, supra note 139. The increased acceptance of that norm is presumably one of the reasons why traditional agency costs have declined.

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that prevailed under managerialism.[146] Ultimately, it is the board that structures managerial compensation. While managers must of course agree to these packages, there is no inherent reason to believe that managers would resist a change in structure, as long as the overall expected compensation levels do not decline and the riskiness of the compensation does not increase. Managers, indeed, did not seem to object to the rise of stock-based compensation in the 1980s and 1990s. Thus, in principle, nothing stands in the way of reorienting managerial incentives away from maximizing shareholder value and towards a broader set of objectives.

Managerial compensation based on the realization of goals beyond shareholder profits is already increasing. A recent article by Professors Lucian Bebchuk and Roberto Tallarita found that over half of S&P 100 companies in the U.S. included stakeholder-interest based metrics in their 2020 compensation package for their respective CEOs.[147] Bebchuk and Tallarita are skeptical that these current arrangements actually benefit stakeholders, as opposed to serving the interests of executives—and perhaps they are right. But these packages are consistent with the rhetorical move away from shareholder primacy and, as Bebchuk and Tallarita acknowledge, even in their present form, make executive pay less sensitive to firm performance and therefore less resistant to stakeholderism. More to the point, the present structure may evolve to provide meaningful incentives to managers to promote wider stakeholder interests.

D. **Welfarist Regulation of Public Corporations**

Publicly-traded corporations have long been subject to special rules and regulations that are designed to protect their investors. The most common form of these regulations are requirements to disclose information that is financially material to investors to eliminate information asymmetries and enable them to value the stock of these firms accurately.[148]

But increasingly, regulatory initiatives are more plausibly driven by corporate governance welfarist goals rather than investor protection. What makes these initiatives distinct, and different from boundary constraints that are fully compatible with shareholderism (and, to a lesser extent, managerialism), is that these initiatives apply *only* to public corporations.[149]

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[146] Marcel Kahan & Edward B. Rock, How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law, 69 U. Chi. L. Rev. 871, 884 (2002); Gordon, supra note 4, at 1530 – 31.

[147] Lucian A. Bebchuk & Roberto Tallarita, The Perils and Questionable Promise of ESG-Based Compensation, 48 J. Corp. L. 37 (2022); see also Rajan et al., supra note 127 (noting rise in bonus payments contingent on meeting social and environmental objectives).

[148] Joel Seligman, The Changing Nature of Federal Regulation, 6 Wash. U. J.L. & Pol'y 205 (2001).

[149] In this section, we primarily focus on U.S. regulation. European regulators are much farther down the road to welfarist regulation of public corporations. For large U.S. based publicly traded multi-national corporations, European regulations increasing set the standards. Luca Enriques and Matteo Gatti, The Extraterritorial Impact of the Proposed EU Directive on Corporate Sustainability Due Diligence, available at https://www.law.ox.ac.uk/business-law-blog/blog/2022/04/extraterritorial-impact-proposed-eu-directive-corporate. The EU has also provided criteria for determining whether an economic activity qualifies as environmentally sustainable. See Regulation (EU) 2020/852 Of The European Parliament And Of The Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088. For a list of applicable EU regulations, see European Commission, Corporate sustainability reporting, at https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-

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Welfarist public company regulations, as we use the term, thus do not include regular environmental, employment, and consumer protection laws that apply broadly and openly pursue goals other than investor protection.

One well-known instance of welfarist public company regulation is the mandate, imposed by the Dodd-Frank Act of 2010, that the S.E.C. require companies to disclose their use of conflict minerals.[150] Congress was clear that it was motivated by concerns beyond investor protection.[151] One purpose for these types of disclosure requirements is to create public pressure on corporations to reshape their supply chains.[152] Empirical evidence indicates that such pressure can be effective in changing corporate behavior.[153]

Another attempt to impose welfarist public company regulation was initiated the Human Capital Management Coalition (HCMC).[154] In 2017, the HCMC asked the S.E.C. to require each

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reporting/corporate-sustainability-reporting_en. For the CSDD text, see European Commission Proposal for a Directive on Corporate Sustainability Due Diligence 2022/0051 (COD)(23.2.3033) at https://eur-lex.europa.eu/resource.html?uri=cellar:bc4dcea4-9584-11ec-b4e4-01aa75ed71a1.0001.02/DOC_1&format=PDF

[150] Dodd-Frank Act, § 1502. The disclosure rules were struck down as violating the First Amendment in Nat'l Ass'n of Mfrs. v. Sec. & Exch. Comm'n, 800 F.3d 518, 530 (D.C. Cir. 2015).

[151] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111- 203, § 1502, 124 Stat. 1376, 2213 (2010) ("the exploitation and trade of conflict minerals . . . is helping to finance conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation therein"). The Dodd-Frank Act also required the S.E.C. to mandate disclosures by public companies on mine safety. Dodd-Frank Act, § 1503(a). While mine safety is presumably also a significant concern of investors, these rules are generally viewed as also reflecting social goals beyond investor protection. See Donald C. Langevoort & Robert B. Thompson, "Publicness" in Contemporary Securities Regulation after the JOBS Act, 2013 Geo. L.J. 337-386 (2013).

[152] Mahoney & Mahoney, supra note 85 (Conflict mineral disclosure rules were "designed to shame companies into reshaping their supply chains to avoid possibly introducing conflict minerals into their operations. Given the difficulty of tracing minerals back to their original sources, the statute had the predictable, if unintended, consequence of inducing companies to avoid sourcing any products from Congolese manufacturers, with 'devastating' consequences for its intended beneficiaries."); Christensen et al., supra note 128 ("The underlying idea is that reporting and the resulting transparency are change agents, incentivizing desirable behaviors and discouraging undesirables ones."); Christopher M . Bruner, Corporate Governance Reform and the Sustainability Imperative, 131 Yale L. J. 1217, 1254 (2022) ("In the corporate-sustainability context, many reform initiatives have aimed to require companies to make sustainability-relevant disclosures, assuming that various stakeholders armed with such information—investors, customers, employees, and so on—will do the rest.").

[153] Christian Leuz & Peter D. Wysocki, The economics of disclosure and financial reporting regulation: Evidence and suggestions for future research, 54 J. Accounting Research 525 (2016); Sugata Roychowdhury, Nemit Shroff & Rodrigo S. Verdi, The effects of financial reporting and disclosure on corporate investment: A review. 68 J. Accounting & Econ. 101246 (2019); Chandra Kanodia & Haresh Sapra, A real effects perspective to accounting measurement and disclosure: Implications and insights for future research, 54 J. Accounting Research 623 (2016) (finding that disclosure rules have a significant impact on the real decisions that firms make); Hans B. Christensen, Eric Floyd, Lisa Y. Liu & Mark Maffett, The real effects of mandated information on social responsibility in financial reports: Evidence from mine-safety records. 64 J. Accounting & Econ 284 (2017); Pietro Bonetti, Christian Leuz & Giovanna Michelon, Internalizing Externalities: Disclosure Regulation for Hydraulic Fracturing, Drilling Activity and Water Quality, available at https://www.ecgi.global/working-paper/internalizing-externalities-disclosure-regulation-hydraulic-fracturing-drilling?mc_cid=8346959a00&mc_eid=ce8925787e (finding the disclosure rules for hydraulic fracturing wells created public pressure that led to significant improvements in water quality).

[154] Rose, supra note 108.

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company to disclose, among other things, detailed data on the number of full-time and part-time workers, use of subcontracting and outsourcing, workforce turnover rates, workforce diversity, and pay equity policies.[155] In response, the S.E.C. amended its disclosure rules to require "[a] description of the registrant's human capital resources, including in such description any human capital measures or objectives that management focuses on in managing the business" if such information is material.[156] While the adopted S.E.C. rule can be justified as being principally designed for investor protection, the much broader disclosure requirements favored by the HCMC were more plausibly designed to promote social goals such as inducing companies to hire more full-time workers, limit outsourcing, and increase pay equity.[157]

Congress and the S.E.C. are not the only entities imposing welfarist public company regulations. The State of California enacted legislation requiring public companies headquartered in California to have a minimum number of directors who come from underrepresented communities[158] and who are female.[159] In 2021, NASDAQ imposed a rule which requires that boards of most NASDAQ-listed companies disclose board diversity data and either meet diversity objectives or explain why have not.[160] NASDAQ justified its rule on the ground that diverse boards are associated with better performance.[161] But it also noted that it consulted with a "broad spectrum of market participants and other stakeholders," including civil rights leaders, to obtain their views on how the proposed rule would "promote the public

[155] Letter from Hum. Cap. Mgmt. Coal., to William Hinman, Dir., Div. of Corp. Fin., S.E.C (July 6, 2017), https://www.sec.gov/rules/petitions/2017/petn4-711.pdf, at 26–27.

[156] Id.; Rose, supra note 92.

[157] See Bruner, supra note 152, at 1255 (bemoaning the adopted rules as weak from perspective of sustainability imperative)

[158] Assembly Bill 979. Directors from underrepresented communities include directors who identify as "Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identifies as gay, lesbian, bisexual or transgender."

[159] Senate Bill 826, available at https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180SB826&search_keywords=corporations+code. Both laws were held unconstitutional under California's equal protection clause by a California trail court, with an appeal pending. See Arnold & Porter, Double Trouble: California Set to Challenge Two Decisions Rejecting Diversification of Corporate Boards, Aug. 5 2022 (reporting on California superior court decisions Crest v. Padilla I and II that held the board diversity requirements were unconstitutional), available at https://www.arnoldporter.com/en/perspectives/advisories/2022/08/california-set-to-challenge-two-decisions.

[160] Sandra Feldman, Nasdaq's new board diversity rule, Aug. 30, 2021, available at https://www.wolterskluwer.com/en/expert-insights/nasdaqs-new-board-diversity-rule. This rule was currently under direct review in the 5th Circuit. See WilmerHale, Fifth Circuit Hears Argument on Nasdaq Board Diversity Rule, Sep. 7, 2022, available at https://www.wilmerhale.com/en/insights/blogs/ESG-Epicenter/20220907-fifth-circuit-hears-argument-on-nasdaq-board-diversity-rule. A similar law has been proposed in Hawaii. https://www.capitol.hawaii.gov/sessions/session2023/bills/HB1191_.PDF

[161] Securities and Exchange Commission, Release No. 34-90574; File No. SR-NASDAQ-2020-081, Dec. 4, 2020, https://www.sec.gov/rules/sro/nasdaq/2020/34-90574.pdf ("There is a significant body of research suggesting a positive association between diversity and shareholder value.")

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interest" and their assessment of the "inherent value of board diversity."[162] Again, it appears that NASDAQ's goals extended beyond enhancing firm value.[163]

The latest example of disclosure rules with a likely welfarist purpose are the recently proposed S.E.C. rules on greenhouse gas emissions. Under the proposed rules, all companies would have to disclose their direct GHG emissions that occur from sources owned or controlled by the company and their emissions primarily from the generation of electricity purchased and consumed by the company. In addition, companies would have to disclose "all indirect GHG emissions not otherwise included in a registrant's Scope 2 emissions, which occur in the upstream and downstream activities of a registrant's value chain" (Scope 3 emissions) if material or if the company has set a target that includes Scope 3 emissions.[164] As in the case of the conflict minerals rules, many commentators have predicted that disclosure will serve to pressure companies to change their behavior.[165]

A lot of ink has been spilled on the basis for the GHG emissions proposal. Some argue that GHG data are material in a strictly financial sense as they help market participants assess the value of securities.[166] Others argue that they are designed to give shareholders information that

[162] Id.

[163] See also Mahoney & Mahoney, supra note 85, at fn. 24.

[164] Wachtell Lipton Rosen & Katz, SEC Proposes New Climate-Related Disclosures, Mar. 22, 2022.

[165] See, e.g., Mahoney & Mahoney, supra note 85 ("political activists ... want to use the information to prod companies to change policies in socially-motivated directions); Langevoort & Thompson, supra note **Error! Bookmark not defined.** ("environmental disclosure can be designed to produce societal benefits, and we strongly suspect that the motivation for action in this area cannot be explained by investor needs alone"); see generally Barzuza at al., supra note 84, at 1311 (2020) (describing pressures applied by social activists).

[166] Rose, supra note **Error! Bookmark not defined.** (proponents on increased disclosure "include financially motivated investors and traditional asset managers who believe companies' approach to (at least certain) ESG topics will bear on the companies' long-term performance, or the long-term performance of the investors' or asset managers' broader investment portfolios."); Barzuza et al., supra note 84 ("Some investors doubtless believe that reducing greenhouse gas emissions and increasing workforce diversity are simply the best way to run a profitable company. ...[But] even investors indifferent to these as first order issues of business success understand that being labelled a bad corporate citizen when it comes to climate or diversity can have effects on firm value if it becomes difficult to recruit young investors or employees."); Jill E. Fisch & Cynthia A. Williams, Petition to the U.S. Securities and Exchange Commission for a rulemaking on environmental, social and governance (ESG) Disclosure (Oct. 1, 2018) at 6.

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shareholders want, whether they want it for financial or non-economic reasons.[167] Yet others do not see them as related to shareholder interests at all.[168]

While some of the disclosures required under the proposal may well be financially material, we believe that it is likely that other disclosures are not. Unlike the human capital regulation, the disclosures required under the GHG proposal are detailed and "prescriptive" (a specific list of required disclosure items) rather than "principles-based" (a general requirement to disclose material information on a topic).[169] Even the proposed Scope 3 disclosure requirements, which is generally subject to a materiality threshold, would require disclosure regardless of materiality for companies that have set an emissions target. Importantly, proponents of increased disclosure do not base their argument solely on the financial materiality of the information.[170] And a House Bill on climate disclosure that preceded the S.E.C. proposal

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[167] Rose, supra note 93**Error! Bookmark not defined.** (proponents on increased disclosure ""also include values-based investors who care about whether, and how, corporations address (at least certain) ESG topics due to religious or sociopolitical commitments."); Matt Levine, Securities and Environment Commission, Bloomberg Opinion: Money Stuff, Mar. 22, 2022, ("If it's material to an institutional investor that its portfolio be carbon-neutral, then it needs to know the carbon emissions of each portfolio company, even if those emissions are not actually material to that company."); Barzuza et al., supra note 84 ("While it is true that some ESG investors argue that ESG maximizes returns, we believe a significant cohort of investors care about their social goals at least as much, if not more than, returns."); Fisch & Williams, supra note 166, at 8.

[168] Rose, supra note **Error! Bookmark not defined.** (""The ESG umbrella also shelters various non-investor corporate stakeholders and third parties who care about whether, and how, corporations address (at least certain) ESG topics because they are personally affected (e.g., employees vis-à-vis labor practices) or due to religious or sociopolitical commitments (e.g., environmentalists vis-à-vis environmental impact).") Statement by Commissioner Hester M. Peirce, We are Not the Securities and Environment Commission - At Least Not Yet, Mar. 21, 2022, available at https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321; Jay Clayton & Patrick McHenry, The SEC's Climate-Change Overreach, Wall St. J., Mar. 20, 2022; Mahoney & Mahoney, supra note 85 ("Supporters of mandatory ESG disclosures deny that their purpose is to pursue policy goals outside the S.E.C.'s ambit. Institutional investors who have joined environmental and social activists in supporting mandatory ESG disclosures argue that the disclosures will help them generate superior returns—that ESG investing is about "value, not values." The S.E.C should recognize, however, that institutional asset managers could not make a social value argument even if they wished to, for they are fiduciaries for their shareholders or beneficiaries."); Barzuza et al., supra note 84 (quoting comment letter by Heritage Foundation as arguing that ""[R]hetorical obfuscation notwithstanding, the goal of proponents of ESG, CSR, SRI, sustainability requirements, diversity requirements or stakeholder theory is not to increase corporate profits but to instead alter corporate behavior by legislative, regulatory or other means in furtherance of some (or many) social or political objectives … [N]owhere in the mission of the Commission is found a reference to furthering any social, environmental or other factor.")

[169] Christensen et al., supra note 112. For the distinction between these rules, see Jay Knight, Recent SEC Comment Letter Reveals the Difference Between Prescriptive-Based and Principles-Based Rules, Nov. 5, 2020, available at https://www.bassberrysecuritieslawexchange.com/prescriptive-based-principles-based-rules-securites-exchange-commission-sec-comment-letter/.

[170] See, e.g., Fisch & Williams, supra note 166; John Armour, Luca Enriques, & Thom Wetzer, Mandatory Corporate Climate Disclosures: Now, but How? (November 1, 2021). European Corporate Governance Institute - Law Working Paper No. 614/2021, Columbia Business Law Review, Forthcoming, Available at SSRN: https://ssrn.com/abstract=3958819 (favoring disclosure regulation as second-best to mitigate climate change since direct regulation is politically in feasible); see also Ann M. Lipton, Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure, 37 Yale J. on Regul. 499 (2020).

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was "clear about its willingness to have the S.E.C. adopt an ESG disclosure framework that extends beyond traditional notions of financial materiality."[171]

For information that is not financially material, the line between information that shareholders want for non-economic reasons and information that serves goals beyond investor protection[172] is blurry. Any social goals to be advanced by a regulation will overlap with information that some shareholders may want for non-economic reasons—for the simple reason that some shareholders will share the social goal. More importantly, requiring disclosures that shareholders want for non-economic reason is also welfarist.

On top of these rules are numerous requests for disclosure rulemaking that the S.E.C. has not heeded, at least not yet. In the 29 months between January 1, 2020 and May 30, 2022, requests on six topics with, in our assessment, a material social regulation component were submitted: business dealings with China (2022); business dealings with Russia and Belarus (2022); COVID mandated terminations (2021); Black Lives Matter pledge fulfillment (2021); equal opportunity practices (2021); and exposure of physical assets to climate change (2020). For comparison, in the five years from 2011 to 2015, there were only two such requests, both on the use of corporate resources for political purposes (2014) and (2011).[173] The steep rise in requests for social regulation is a further indication that more such regulation may be forthcoming.

Welfarist public company regulation can succeed in changing public company behavior even if managers still try to run the company to maximize firm value because such regulation can affect what actions are firm-value maximizing. For example, the proposed regulations imposing

[171] Rose, supra note 93.

[172] There are several indications that the S.E.C. shared, rather than merely took account of, the non-economic preferences of shareholders favoring GHG disclosures. The House Bill preceding the proposal expressly encouraged the S.E.C. to incorporate multi-stakeholder environmental, social, and governance disclosure standards into its ESG metrics. See ESG Disclosure Simplification Act of 2019, H.R. 4329, 116th Cong. § 2(b)(3)–(4) (2019). European climate disclosure regulations (which also apply to non-public companies) are expressly based on sustainability goals, rather than mere investor protection goals. European Commission, Corporate Sustainability Reporting, supra note 160 ("EU rules require large companies to publish regular reports *on the social and environmental impacts of their activities*.") (emphasis added). S.E.C. Commissioner Lee indicated that the S.E.C. may start imposing employee, environmental, social and governance disclosures on large private companies—companies for which the investor protection rationale is far less plausible. Paul Kiernan, SEC Pushes for More Transparency From Private Companies, Wall St. J., Jan. 10, 2022. (quoting S.E.C. Commissioner Allison Lee as saying "When they're big firms, they can have a huge impact on thousands of people's lives with absolutely no visibility for investors, employees and their unions, regulators, or the public."); David A. Katz & Laura A. McIntosh, The SEC Takes Aim at the Public-Private Distinction, Harv. L. School Forum on Corp. Gov., Jan. 28, 2022, available at https://corpgov.law.harvard.edu/2022/01/28/the-sec-takes-aim-at-the-public-private-disclosure-gap/. Finally, many commentators regard the fact that the proposed rules are prescriptive, rather than principles-based, as an indication that they are not just meant to inform shareholders but to make it easier to pressure companies to change their behavior. Christensen et al., supra note 1128 (a descriptive approach divorced from financial materiality "is likely to attract external pressures from various (and potentially unforeseen) parties and also requires that standard setters apply political and moral judgments about the underlying CSR activities"); Mahoney & Mahoney, supra note 85; Lipton, supra note 184, at 513–17. (discussing conditions for "shaming campaigns").

[173] Securities and Exchange Commission, Petitions for Rulemaking Submitted to the SEC, available at https://www.sec.gov/rules/petitions.htm.

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GHG disclosure requirements could expose companies to pressure from consumers who buy fewer company products or from employees who are less willing to work for it. Still, such regulations could constitute welfarist public company regulations in that are imposed by the S.E.C., an agency charged with the protection of investors, and the mandate of which does not include supplying product information to consumer or work-related information to employees; they are imposed with the stated objective to enhancing investor protection or supplying information to investors that investors find significant for making investment decisions; and they are supported by at least a subgroup of investors that find the information at issue relevant to pursue a multi-firm focus or their non-economic interests.

III. The Inherent Limitations to Welfarism

Welfarism as a corporate objective is mostly addressed to companies with dispersed ownership. This is hardly coincidental. Because welfarism seeks to induce a company to pursue objectives that are extraneous to the corporation, the benefits to a shareholder from achieving the extraneous goal are not tied to the shareholder's stake in the corporation, while the costs (in terms of reduced firm value) are. Ceteris paribus, shareholders with a small stake are therefore more likely to favor sacrificing firm value to achieve extraneous goals.

This is most evident with respect to portfolio welfarism and shareholder welfarism. Consider, as a stylized example, a dispersed owner who holds a 1% stake in 1,000 companies. Each company can take an action that increases its profits but imposes an externality of 1 on each of the other 999 companies. The dispersed owner would suffer aggregate costs of 9.99 (1% of the 999 in total costs) from such action and would thus be willing to have a company sacrifice 999 in its profits by forgoing the action (since the owner's 1% share of the lost profits amount to 9.99). Compare this to a concentrated owner, with the same capital, who holds 10% stakes in 100 companies or 100% stakes in 10 companies. Such an owner would suffer similar aggregate costs—9.90 for the owner of 10% stakes in 100 companies and 9.00 for the owner for 100% stakes in 10 companies—to the owner of 1% stakes in 1000 companies, but bear a much greater share of the forgone profits. Finally, a sole, undiversified owner of each company would not be willing to sacrifice any of its profits, despite the effect on other firms. As a result, these owners will be willing to have a company sacrifice only 90, 9, or 0 respectively, of its profits to achieve the extraneous goal.

The story is similar for shareholder welfarism. Take a firm that can take an action that increases its profits but runs counter to the shareholders' non-economic preferences so that each shareholder would be willing to sacrifice 10 in wealth to have the corporation forego the action. If the firm has 1,000 shareholders, each holding 0.1% of the company's share, who all feel this way, they would favor the firm not taking the action as long as the firm's foregone profits are less than 10,000. If the firm had only a single shareholder, that shareholder would be willing to

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sacrifice only 10 in foregone profits. As these examples illustrate, even if the shareholders of any particular company have homogeneous preferences and identical portfolio holdings, portfolio and shareholder welfarism deliver much more bang—in terms of inducing companies to adapt their actions in a more pro-social welfare direction—for the buck for companies with dispersed ownership than for companies with concentrated ownership.

Importantly, welfarism's preference for corporations with dispersed ownership is another dimension along which welfarism differs from shareholderism. For scholars in the shareholderist mold, dispersed ownership is a source of governance problems: it creates agency costs, leads to undesirable deviations from the sole owner standard,[174] and causes collective action problems in shareholder voting. For welfarists, by contrast, dispersed ownership is a feature, not a bug. For any given investor with a certain amount to invest, the more dispersed the ownership, the better. This, notably, is not because dispersed ownership increases risk-adjusted returns (the standard benefit of diversification, which offsets governance problems) but because more widely dispersed owners internalize more intra-portfolio externalities, weigh the losses in firm value less in relation to their non-economic gains (which, for a shareholder welfarist, proxy for reduced externalities), or will put up less resistance to companies deviating from shareholder primacy to follow the prescriptions of direct social welfarism.

Because welfarism has limited traction for firms with a controlling shareholder and for closely-held companies, it cannot fully succeed in its grander mission of rectifying major social ills even if it succeeds in changing companies with dispersed ownership. As controlled and closely-held companies interact and compete in the marketplace with companies with dispersed ownership , profit opportunities not taken up by companies with dispersed ownership will be taken up by a controlled or closely-held one. Moreover, ownership structure is itself endogenous to the corporate objective and welfarism may induce a shift from dispersed to controlled or closely-held ownership.

Another limitation to welfarism derives from the very lack of consensus that creates dissatisfaction with shareholderism and fuels welfarism. Welfarism tries to escape this lack of consensus by moving from the political sphere to the sphere to the firm. But the same lack of consensus that prevents an effective political solution to social problems re-emerges under welfarism at the firm level. As we have noted before, from a shareholder welfarist perspective, the ideal shareholder base is the entire polity. But if we, as citizens and voters in political elections, cannot generate effective political solutions, why would we, as shareholders and voters in corporate elections, be more successful in inducing companies to create solutions at the firm level?

One possible answer is that the shareholder base differs from the voter base in the polity. Shareholders (especially larger shareholders) are presumably wealthier and better educated than non-shareholders and their preferences may align better with those of the proponents of

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[174] Lucian A. Bebchuk, The Sole Owner Standard for Takeover Policy, 17 J. LEGAL STUDIES 197 (1988).

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welfarism than those of voters. Likewise, asset managers who control the votes of large pools of capital may, as critics have alleged, have preference that align more closely with those of the proponents of welfarism than those of the beneficiaries of those assets. But if that is the argument, shareholder welfarism would be in danger of morphing into a property-based voting system where larger (and thus likely wealthier) shareholders or the "elites" who control institutional investors may vote to sacrifice firm value at the expense of smaller (and less wealthy) shareholders (and beneficiaries) with different preferences. This outcome of welfarism would lack political legitimacy. [175]

Similarly, direct social welfarism pre-supposes that one can arrive at a consensus on the social objectives beyond profit maximization that a corporation is supposed to serve. But if such a consensus exists, then why is it not already reflected in regulations governing and constraining corporate activities?

Portfolio welfarism, as well, assumes that decision-making on a company level is easier than political decision-making. If shareholders hold similar portfolios and capital markets functioned perfectly, this could indeed be true. But many prescriptions by portfolio welfarists—like Condon's suggestion that Exxon and Chevron greatly reduce their output—involve immediate quantifiable costs to identifiable companies (Exxon and Chevron) and longer-term less easily quantifiable benefits to less clearly identifiable recipients. Each of these factors makes it harder to adopt sensible rules at the political level. But each also makes it harder for capital markets to incorporate the benefits of an output cut into current stock prices.

Lack of consensus will also constrain welfarism in a different way: it generates political vulnerability. While supporters of welfarism may point to the government's inability to adopt regulations like a carbon tax as evidence of political dysfunction, opponents may view that failure as the outcome of a functioning democratic process and view some forms of welfarism as "woke capitalism."[176] The very lack of political consensus for substantive solutions will thus also reduce political support for welfarism. This is a particular problem for direct social welfarism and for welfarist public company regulations, which depend on some degree of political support. But even other forms of welfarism can be subject to political interference and backlash.[177] In sum,

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[175] Zohar Goshen, Assaf Hamdani and Alex Raskolinkov, Poor ESG, working paper 2023 (arguing that a feature of corporate based regulation of externalities (as compared to regulation) is that (a) its effects are less salient/public and (b) the losers (from, e.g., higher prices for gasoline) need not be compensated).

[176] Special Report ESG Investing, The Economist, Jul. 23, 2022, at 4.

[177] For example, a recent op-ed in the Wall Street Journal argued that Big Three investment advisors be broken up because they engaged in a coordinated pursuit of ESG objectives in violation of the antitrust laws. See Dan Morenoff, Break Up the ESG Investing Giants, Wall. St. J., Aug 31, 2022. Officials in Republican-led US states have launched investigations into BlackRock and State Street over their votes on shareholder proposals. Patrick Temple-West & Brooke Masters, Wall Street titans confront ESG backlash as new financial risk, Fin. Times. Mar. 1, 2023, available at https://www.ft.com/content/f5fe15f8-3703-4df9-b203-b5d1dd01e3bc Florida's State Board of Administration prohibited the state's pension fund from considering social, political, and ideological interests in making investment decisions. Press Release, AG Pax-ton Demands Black-Rock Account for its Under-per-form-ing, Potentially Illegal 'ESG' State Pension Fund Investments, Aug. 8, 2022, available at

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because welfarism necessarily operates in a political world, it can never fully escape the political dysfunction that gives rise to the need for welfarism in the first place.

Conclusion

Corporate governance is on the verge of entering a new stage. After the managerialism that dominated the view of the corporation into the 1970s and the shareholderism that supplanted it, we are witnessing the emergence of a new paradigm: corporate governance welfarism. Welfarism comes in three strands—portfolio welfarism, shareholder welfarism, and direct social welfarism—the first two of which are consistent with shareholder primacy. The important distinction between welfarism and shareholderism, rather, is that welfarism, by embracing goals that are much broader than shareholder value as a means to promote overall welfare, rejects the classical liberal economic theory that underpins shareholderism. By placing portfolio welfarism and shareholder welfarism on the other side of the dividing line from shareholderism, and on the same side as social welfare welfarism (which is not consistent with shareholder primacy), our analysis thus departs from the traditional view of corporate governance paradigms, which sees the principal fault line as running between shareholder primacy and stakeholderism.

Welfarism is on the rise ideologically. And while it is unclear how much welfarism has already affected operations at individual firms, the underlying drivers of welfarism—frustration with the political system, broadened scope of shareholder interests, growth of and increasing diversification within institutional shareholdings—are likely to remain or grow. There are therefore good reasons to believe that the push towards welfarism will take hold, grow, and, over time, generate a welfarist turn in corporate governance.

Welfarism, however, is subject to two inherent limitations. First, the recent push towards welfarism has its greatest traction for publicly traded companies with dispersed shareholders. By contrast, for companies with a single shareholder or controlling shareholder, the welfarist prescriptions will have only a limited impact. Second, the very lack of consensus that impedes political solutions reemerges under and constrains welfarism by generating disagreements among shareholders, impugning its legitimacy, and imposing political barriers to its implementation. As a result, welfarism, as a new paradigm of corporate governance and corporate purpose, cannot fully succeed in its grander mission of rectifying major social ills even if it succeeds in inducing change at individual companies.

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https://www.texasattorneygeneral.gov/news/releases/ag-paxton-demands-blackrock-account-its-underperforming-potentially-illegal-esg-state-pension-fund. And in the last year of the Trump administration, the Department of Labor proposed a rule to prohibit ERISA fiduciaries from taking ESG factors into account unless they are meant to increase returns.

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