The Underpinnings of Corporate Governance Approaches and the Shareholder Value Model

by Leslie N. Silverman and Julie L. Yip-Williams

This report summarizes the historical context in which the "shareholder value" model, which provides the analytical structure that supports most thinking about corporate governance today, arose and exists.

The "shareholder value" model has come to be accepted by most directors, shareholders, creditors, customers, academics, judges, legislators, and others over the last three decades as the optimal framework, or perhaps even the only cogent framework, underpinning corporate governance. This report examines the shareholder value model as well as alternative approaches, both as practiced in other countries and as proposed by academics and other governance experts.

What is the Corporation's Raison d'Être?

An assessment of the underlying assumptions and factors that drive governance approaches and structures necessarily begins with defining the corporate purpose. Is the corporation's overarching objective to make quality goods and services that enrich the lives of customers? Or is it to provide generous pay and job security to, and facilitate the professional development of, its employees? Does the corporation have social and moral obligations, for example, to minimize the polluting impact of its manufacturing activities or make charitable contributions to aid its local community? Or is the corporation's purpose to maximize profit for the benefit of the individuals and institutions that ultimately provide capital, without which there would be no corporation? Given that each of the constituencies identified in the above questions makes investments in the corporation, is it possible that a corporation's purpose includes all of the above? If so, can or should one objective be prioritized over others?

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The Conference Board Task Force on Investor Engagement

From accounting scandals to the global financial crisis, events of the past decade have damaged the reputation of business, contributing to a distrust of business in general. In February 2013, The Conference Board Governance Center formed a Task Force on Corporate/Investor Engagement to bring together directors of public companies and investors to find solutions to help create a stronger corporate governance system through effective engagement.

The task force will examine the facts, the issues, and the policy implications of the current state of U.S. corporate governance with the objective of addressing the following questions: What is the optimal balance in the relative roles of management, directors, and investors in the governance of public corporations? What are the gaps between the optimally balanced system and the current system? How should boards and investors engage with one another to lead to an optimally balanced system?

The task force will issue its report during the second half of 2013. For more information about the task force, its mission, and its members, visit its website (www.conference-board.org/taskforce) or contact it by email (**task.force@conference-board.org**).

These questions stood at the center of the long-standing debate between Professor Adolph Berle, coauthor of the groundbreaking 1932 classic *The Modern Corporation and Private Property*, and Professor Merrick Dodd. Berle, whose beliefs formed the foundation for the shareholder value model, maintained that the corporation exists solely to increase shareholder wealth, and, while the activities it engages in might have the effect of benefiting other constituencies, its activities should always be geared toward shareholder wealth maximization. Berle's argument was his answer to the inherent problem of dispersed share ownership, which is a fundamental characteristic of public corporations. Unlike proprietorships where a small group of equity owners can easily manage their own business, widely held corporations cannot, as a practical matter, be managed by their owners, so management must be entrusted to a board of directors chosen by the corporation's owners. This "separation of ownership from control" led Berle to conceive of directors as "agents" of the shareholders, with their powers to be exercised only for the benefit of the shareholders. Dodd, whose views laid the foundation for today's criticism of the shareholder value model, did not believe in the primacy of the shareholder. He argued that, as a legal entity created by the state for the public benefit, the corporation should be run by professional managers seeking to serve not only shareholders but also other stakeholders and the public interest. In addition, Dodd believed that the corporation's purpose had a social end as well as a profit-making function, including providing jobs for employees, serving customer needs, and contributing to society at large.

How the Modern Corporation and Its Prosperity Came to Be

To define a corporation's raison d'être, it may be helpful to briefly consider the history of the modern corporation and the factors that have led to its overwhelming prosperity and popularity.

The roots of the modern corporation can be found at least as far back as the empire-building joint stock trading companies of colonial times, which were chartered by monarchs for specific monopolistic purposes (e.g., spice trading to and from the East Indies). For centuries, corporate charters were hard to come by—both in the United States and elsewhere—because of a concern that corporations might abuse the express rights granted to them in their charters and do harm to the public welfare. The formation of a corporation usually required a legislative act, and investors had to be given a say in corporate governance. Corporations were required to comply with the purposes stated in their charters and could exist only for a finite time period. During the Industrial Revolution of the late 1800s, when the demand for capital to construct large public works projects grew and states began to recognize the potential benefit to their coffers of facilitating incorporation in their jurisdictions, special charter legislation and grants fell out of favor. Instead, corporations were formed with indefinite lives and the articles of incorporation registered with states were for general corporate purposes. Initially, and consistent with the traditional emphasis on serving the public interest, corporations were primarily formed to provide public services, including the construction of turnpikes, bridges, canals, railroads, and, in a later development, utilities and the operations of banks and insurance companies. Slowly, the corporation's popularity expanded into other sectors, making thousands upon thousands of individual Americans owners of limited numbers of shares in the stocks of an ever-growing number of corporations.[1]

The expansion of the modern corporation is attributable to the mutual benefits that both the corporate managers and shareholders perceived in using the corporate form to do business. The liberalizing of corporate charters to free the corporation to do what it (and its managers) wanted to do within legal limits no doubt played a significant role in the proliferation of the corporate form. As evidenced by its early use in the building of projects that required significant amounts of capital, the corporation's unique ability to aggregate money in a single vehicle to enable the execution of ambitious projects was also critical to its proliferation. Unlike other business forms, the corporation's existence and activities were not dependent on continued share ownership; a sale of shares by any number of shareholders did not interfere with the corporation's activities or require it to cease operations altogether and liquidate. This "lock-in" effect permitted management to devote capital to long-term investment and projects without fear that shareholders would request a return of their capital investment prematurely.

Finally, the separation of ownership from control gave the board and management the flexibility, although still bounded by fiduciary duties to shareholders, to run the corporation in the manner they deemed most beneficial. From the shareholders' perspective, the promise of limited liability capped each shareholder's economic risk to the cost of purchasing his shares, while preserving the potential of unlimited economic benefit if the value of a corporation's shares grew. The treatment of the corporation as a separate legal entity, distinct from its shareholders, also served to further insulate the shareholder from risk such that the shareholder was not liable for the corporation's conduct, liabilities or obligations. Share ownership also came with ease of transferability once the shareholder was ready to sell. The separation of ownership from control was also attractive to a vast majority of shareholders who lacked the interest and capacity to manage the corporation and who were interested only in monetary returns through passive investment.

Of course, all of the attributes described above remain true of today's corporation. But perhaps the most important factor in explaining the popularity of the corporate form then and now is the historic success achieved by corporations. Notwithstanding the occasional and sometimes spectacular failures (both of individual corporations and, in the case of recessions and financial crises, the corporate economy as a whole), the corporation model has been extraordinarily successful in bringing about sustained and durable wealth creation and accretion for multiple segments of society. The corporate form has proven itself an efficient and overall profitable means of operating complex businesses for the benefit of the many.

The Rise of the Shareholder Value Model

Even with the benefit of the lessons from history, defining the corporate purpose is not simple, and the prevailing sentiment has swung back and forth between Dodd's and Berle's views of the world. From the 1930s to the 1960s, Dodd's stakeholder-oriented view ruled the day with a "managerialist" approach that relied on professional managers called upon to serve as disinterested technocratic fiduciaries to guide the corporation in ways aimed to serve the interests of the general public. At a time when most shares were owned by individuals who cared little about being involved in corporate governance, managers enjoyed great discretionary authority to manage the corporation as they deemed appropriate. It is not surprising that such broad discretion coincided with the height of the conglomerate movement, which reflects a confidence in the manager's ability to manage business enterprises across a broad range of industries. However, that broad discretionary authority turned out to be the most troubling characteristic of the managerialist approach, and it eventually led to declining support for this approach and increasing doubt about the efficacy of the conglomerate movement. Critics of the managerialist model argued that when managers are given great discretion, they tended to disproportionately serve their own interests.

As Dodd's view of the world fell into disfavor, the pendulum swung to Berle's shareholder-oriented perspective. The concept reached its zenith at the turn of this century, with many arguing that Berle had definitively won the debate. Classrooms, boardrooms, and courtrooms spoke of the need for corporations to maximize shareholder value as though this was a universal, indelible truth. Indeed, it appeared as if the rest of the world was coming to recognize that their models, which had previously centered on prioritizing other stakeholders, were also converging on the absolute primacy of the shareholder.[2]

The resurgence of shareholder primacy echoed the themes once espoused by Berle: Shareholders are the "owners" of the corporation who, as a consequence of dispersed ownership and the separation of ownership from control, must appoint directors as their agents to manage the corporation for the shareholders' benefit alone. This time, however, Berle's shareholder-oriented perspective had the strong support of the free-market economists who argued that economic analysis supported the position that the corporate purpose should be solely to maximize shareholder wealth. They argued that, without a narrow focus on share value, shareholders are at risk of having their economic investments squandered by self-interested managers who, although bound by fiduciary duties, would have too much discretion if not held accountable by reference to share value. Shareholders who monitor and measure director and management performance, as indicated by share value, would successfully reduce the agency costs associated with the corporate form.

Under the new view, nothing could be a better measure of board and management's performance in carrying out their fiduciary obligations as agents to act in the best interest of shareholders than the corporation's share price. The simplicity of using share price as a metric has a certain appeal for the shareholder-oriented believer, as having shareholder value as the objective can help bring some clarity to a necessarily complex decision-making process. Indeed, under an alternative governance approach that says the corporation should be managed to benefit multiple stakeholders where claims by multiple stakeholders are seen as equally valid, there is no comparably all-encompassing and simple way to measure performance. Nevertheless, no statute in any jurisdiction requires boards to make decisions solely to maximize shareholder value.

Followers of the shareholder value model have no consideration for other stakeholders since other stakeholders (employees, creditors, customers and suppliers) and their rights are protected through contract and regulation, and therefore, need not be protected through the corporate governance process. No such protection exists for the shareholders, who as "residual claimants" do not have the benefit of any fixed compensation, but instead can only be compensated through corporate profit. Shareholder value advocates also argue the flip side of this point, to the effect that the interests of nonshareholder stakeholders are, in a sense, derivative. If the shareholders' interests are successfully advanced, the interests of the other stakeholders will, it is assumed, be adequately secured.

Problems with the Shareholder Value Model

With yet another swing of the pendulum, corporate scandals and market crises over the last decade have led many to question the legitimacy of shareholder value thinking.[3] Its critics say that the failures of Enron, WorldCom, and their brethren were the direct result of a fixation on maximizing share price. They further argue that this type of fixation contributes to behavior that may increase share price in the short term, but harms shareholders and other stakeholders in the long term. Directors and management are pressured to meet shareholder expectations for satisfactory returns, sometimes leading to earnings management or other improprieties. In any event, decisions intended to meet quarterly earnings targets are often made at the expense of longer-term growth. The focus on maximizing shareholder wealth also leads to a diversion of retained earnings away from long-term investments in the corporation that create jobs and lay the foundation for future innovation. They marshal data to show that capital generated from operations and from debt, which was once reinvested in the business, has instead been used in recent years to increase distributions to shareholders. At the same time, shareholders have been investing significantly less capital in public corporations than they have been withdrawing from corporations—particularly since the turn of the century.[4]

The pressures borne by directors and management are exacerbated today by the very nature of the shareholder base. Unlike the individual shareholder base of decades past, the shares of America's corporations today are owned in significant numbers by institutional investors who aggregate the capital of individual investors and whose managers are driven by the need to deliver—and whose investors judge them by—their short-term returns. Many of these institutional investors' strategies involve investing for short time horizons, which puts pressure on corporations to focus on short-term share price maximization.

It is important to note that the very existence and causes of short-termism and what critics charge is the resulting managerial myopia are themselves the subject of debate. In contrast to the views expressed above, the efficient market hypothesis posits that stock prices reflect the intrinsic value of any long-term decisions and that the markets recognize and reward decisions that will have long-term benefit to the corporation.

As a corollary, investors pursue long-term value but are confronted by managerial short-termism. Sophisticated investors monitor and discipline inherently opportunistic and self-interested managers to ensure that managers make decisions to maximize long-term value rather than meet short-term earnings goals.[5] Some academics have argued that while managers may feel pressured to make decisions that hurt long-term returns, research also shows that executives with a short-term orientation attract investors who are fixed on quarterly numbers.[66] The literature also suggests that, in addition to stock market and shareholder pressures, the causes for short-termism and managerial myopia may be subtle and rooted in subconscious motivations tied to natural human proclivities for the certainty of short-term rewards (as opposed to the risks associated with uncertain long-term activities), as well as a desire to adhere to group thinking and the status quo stemming from the corporation's organizational dynamics.[7]

Critics of shareholder value thinking also attack the underlying assumption on which it is based, arguing that there is in fact no principal-agent relationship between shareholders and corporations. The principal-agent relationship assumes that shareholders own corporations, which they do not. Legally, corporations are independent entities, legal persons with certain rights and obligations. Shareholders own shares of the stock of the corporation; they do not own the corporation itself. The stock certificate is not a deed of ownership to a piece of the corporation, but represents a contract with the corporation under which the shareholder has certain limited rights, including certain claims to the corporation's wealth.[8] As part of their contractual bargain, shareholders supply capital, just as workers supply physical labor, customers supply revenues, and governments supply the rule of law and a social context within which to function. Investors supply a critical input without which the corporation could not exist, just as all other stakeholders provide other critical inputs essential to the life of the corporation.

Those who believe that shareholder wealth maximization should not be the sole purpose of the corporation generally view the corporation as a collaborative effort among a number of participants, all of which are essential to the sustainability of the enterprise over the long term. They believe the corporation has many purposes: to provide equity investors with solid returns, but also to create great products and services, to provide decent livelihoods for employees, and to contribute to the community and the nation.[9] Shareholder value naysayers also find flaws in the contention that shareholders somehow bear more risk than other stakeholders, which are supposedly protected by contract and regulation. Shareholders are not the only participants in corporate life to fare well (or poorly) when the corporation fares well (or poorly). Lenders' returns are also dependent on the corporation's performance, and employees also may be viewed as having invested in their employer in terms of time, knowledge, and skill, with no guarantee of return beyond their salaries. Employees do not have the freedom to move between employers without significant cost. By contrast, shareholders are able to diversify and liquidate their holdings typically with relatively small transaction costs.

Finally, critics of the shareholder value model raise concerns that corporations take on too much risk when their focus is primarily on maximizing shareholder returns. Shareholder interests in stock price maximization and taste for risk create powerful managerial incentives to engage in riskier behavior to meet investor expectations for better-than-average returns. Those risk tolerances are frequently imparted to management, whose compensation is designed to align their interests with the shareholders. Those who assign partial blame for the recent financial crisis to the shareholder value model point out that shareholder wealth maximization is not a strategy but a result, while focusing on delighting customers can be a winning strategy that results in increasing shareholder value.[10]

Stakeholder-Oriented Alternatives to the Shareholder Value Model

Critics of the shareholder value model have called for the adoption of a different mindset and point to other countries as examples of alternatives. In truth, many developed countries with relatively vibrant and successful corporations do not adhere to shareholder primacy and instead follow some version of a stakeholder-oriented model, in which one group of stakeholders is generally given primacy. This section considers the labor-oriented model as practiced in Germany and the state-oriented model as practiced in Japan. It also considers variations of other stakeholder-based models that have been proposed by certain academics and governance experts.

Germany's labor-oriented model Germany, while recognizing the importance of corporate shareholders' interests, places relatively large weight on the interests of employees through its labor-oriented model. This model is characterized by a two-tier corporate board structure that consists of a supervisory board and a management board. The supervisory board is an executive body that oversees the lower-tier management board, which is a controlling body composed of senior executives. Through this two-tier structure, the German model seeks to directly involve employees in corporate governance by including employee representation on both the management board and the supervisory board. Employees' role in corporate governance varies depending on the size of the company, but most large companies are subject to some level of codetermination. For example, companies with more than 500 employees are subject to a codetermination regime under which employees can elect a certain number of members to the supervisory board. For companies with more than 2,000 employees, one-third of the supervisory board must be appointed by employees and one member of the management board must be designated as a labor director.[11] The justification for mandatory formal employee involvement in corporate governance is the notion that contract law, the usual method for governing relationships between employees and employers, is simply inadequate, especially as it relates to large companies where long-term employer-employee relationships are difficult to manage.[12] The labor-oriented model seeks to ensure that senior managers are concerned with more than just the market performance of the company and that concerns such as employee training and education and employment security are taken into account by the boards. This governance approach is designed to promote a sense of employee commitment to the long term prosperity of the corporation, which is generally viewed as a positive for a corporation and guarantees a return on the investment that employees have put into the corporation. It may, consequently, provide an emphasis on long-term perspectives for corporations generally that tips the balance away from the kind of short-termism that critics of the current U. S. corporate environment regularly decry.

Japan's state-oriented model Japan's state-oriented model, at least in its traditional form, is characterized by the direct role of government in the affairs of large corporations. Under the state-oriented model, the underlying reason for government involvement is the belief that companies should be run for the benefit of various stakeholders and the public interest, and not solely for the end of maximizing shareholder value.

The state-oriented model views government as the arbiter of stakeholder interests, which it accomplishes by exercising its influence through board representation, frequently enforcing its judgments through state-administered criminal sanctions and arranging "back door" deals between government officials and representatives of the corporation or significant shareholders. The main benefit of the state-oriented model lies in the fact that, absent extensive shareholder pressure to achieve maximum shareholder value, the board is free to cooperate with and institute the preference of government officials, such as policies that result in maximization of benefit to the public.[13] At its best, perhaps this model also tips the balance of influence toward longer-term perspectives than might otherwise prevail.

Other stakeholder-oriented models The literature on corporate governance offers various versions of stakeholder-oriented models as an alternative to shareholder value. Stakeholder model advocates argue that stakeholders will be subject to opportunistic exploitation by the corporation and its shareholders if managers are accountable only to the firm's shareholders; corporate law must therefore ensure that managers are responsive to stakeholder interests as well.[14]

Some proposals prioritize one stakeholder group over another. For example, supporters of a customer-first model claim that customer prioritization translates into an opportunity to build a brand for the long term rather than to exploit short-term transactional opportunities, which, in turn, will be good for shareholders and all other constituencies.[15] Other proponents of a stakeholder model place the emphasis on society at large. They argue that corporate purpose must be redefined as creating "shared value," which involves creating economic value in a way that also creates value for society, and that this will offer business its best chance of restoring legitimacy and trust. They contend that not all profit is equal and profit involving a social purpose represents a higher form of capitalism—one that will enable society to advance more rapidly while allowing companies to grow even more than they otherwise could, resulting in a positive cycle of company and community prosperity that leads to profits that will endure.[16]

Other proposals do not call for a prioritization of any one stakeholder group. Rather, they impose on the board the responsibility of weighing the interests of shareholders and other stakeholders. One theory offered to support this approach starts with the premise that different constituencies come together through investment of money, time, knowledge, and other resources in the corporation to produce a shared output. The theory posits that a contract alone is inadequate to distribute the output of that joint effort and that control over the distribution must be allocated to an independent third party (i.e., the board) that can take into account all stakeholders' interests and typically allocate rewards among stakeholders most prudently.[17]

The other versions of these proposed stakeholder models contemplate one or more stakeholder groups appointing representatives to the board, which then decides on policies that maximize the joint welfare of all stakeholders, subject to the bargaining leverage that each group brings to the boardroom. The board functions ideally then as a kind of collective fiduciary even though its individual members remain partisan representatives. The board thus becomes a coalition of stakeholder groups and functions as an arena for cooperation with respect to the function of monitoring management as well as an arena of resolving conflicts with respect to the specific interests of different stakeholder groups.[18]

Assessment of Potential Approaches

Labor and state oriented models While the labor-oriented and state-oriented models are the norms in Germany and Japan, respectively, they are a product of those countries' unique histories and cultural traditions. History, culture, tradition, and law in the United States, by contrast, with its laissez-faire capitalist orientation, make it highly unlikely those particular models would succeed in this country. Long-standing tensions between labor and corporate managers make it difficult for labor to enter the boardroom on a systemic basis in the United States. Those constituencies have long and heavily relied on the bargaining process to negotiate their rights vis-à-vis one another.

Additionally, it would seem that through funded pensions and, in some cases, participation in stock ownership programs, organized labor and employees already have a say in the corporate governance process, although in their capacity as shareholders, rather than as labor. As for Japan's state-oriented model, the potential for management malfeasance and resulting harm to shareholders, customers, and other constituencies through uncomfortably close ties to possible insufficiently accountable bureaucrats run counter to the strong preference for no state involvement in business enterprises in this country.

Other stakeholder models Providing employees, creditors (outside of the bankruptcy context), customers, suppliers, or any social group access to the board would require radical changes to existing norms, not to mention current laws. The mandatory inclusion of any stakeholder representative on the board could greatly hinder managerial efficiency and flexibility through the creation of potential board factions and, at the very least, lead to an increased number of disagreements that are inevitable when more participants with opposing views (who are themselves charged with representing the diverse perspectives of one or more stakeholder groups) are brought into the corporate decision-making process. Further, directors owe a fiduciary duty to all shareholders, not just to the faction that nominated them.

A Possible Compromise: A Modified Shareholder Value Model

A model that continues to focus on shareholder value, but also provides boards with direction or authority to consider other stakeholders in making any given decision, has perhaps the strongest likelihood of acceptance and success in the United States. This is due in large part to the fact that the legal framework for such an approach is already in place. The business judgment rule already provides boards with protection when making their decisions, specifically providing that a court will not second-guess an informed business decision made by a disinterested board of directors and will, therefore, refuse to hold directors liable for any such decision that satisfies the generally lenient rule. This is true even where that decision harms shareholder value.[19] Delaware courts have specifically stated that in all but one very specific, limited (albeit critical) circumstance—after directors have determined to put a company up for sale—directors can take into consideration the interests of multiple constituencies and that shareholder interests are not necessarily superior to those of other constituencies.[20] Other jurisdictions already permit boards to consider the interests of other stakeholders, and, as noted above, no statute in any jurisdiction requires boards to make decisions to maximize shareholder value. Further, while most charters or articles of incorporation include statements of corporate purpose, such documents rarely, if ever, specifically state that the corporate purpose is to maximize shareholder value. Rather, charters typically allow the corporation to engage in any "lawful" business.[21] Additionally, corporate managers are likely already weighing the interests of multiple constituencies in their strategic planning and decision-making processes as part of their legal obligation to act in the best interests of the corporation (as well as shareholders) in the belief that what is good for stakeholders as a whole will likely be good for shareholders. Shareholder value maximization is not necessarily at odds with doing what's best for all stakeholders, particularly when the focus is on long-term shareholder value maximization.[22]

Dominic Barton, global managing director of McKinsey & Company, has summarized how this more nuanced modified shareholder value approach might work. Barton writes:

> [T]here are three essential elements of the shift. First, business and finance must jettison their short term orientation and revamp incentives and structures in order to focus their organizations on the long term. Second, executives must infuse their organizations with the perspective that serving the interests of all major stakeholders—employees, suppliers, customers, creditors, communities, the environment—is not at odds with the goal of maximizing corporate value; on the contrary, it's essential to achieving that goal. Third, public companies must cure the ills stemming from dispersed and disengaged ownership by bolstering boards' ability to govern like owners.[23]

Indeed, these proposals by Barton offer important insights and ideas for addressing the many criticisms that have been lodged against a governance model that is solely and narrowly focused on maximizing shareholder value to the exclusion of all other considerations.

Endnotes

1 For more on the history of the corporation, see 1 James D. Cox and Thomas Lee Hazen, *Cox & Hazen on Corporations: Including Unincorporated Forms of Doing Business*, §§ 2:3–2:13, 2nd ed. (New York: Aspen Publishers, 2003).

2 Henry Hansmann and Reinier Kraakman, "The End of History for Corporate Law," *Georgetown Law Journal*, 89, 2001, pp. 439–468.

3 For a thorough criticism of the shareholder value model, see Lynn Stout, *The Shareholder Value Myth* (San Francisco: Berrett-Koehler Publishers, 2012).

4 Lawrence E. Mitchell, "Whose Capital; What Gains?" Issues in Governance Studies, The Brookings Institution, July 2012. Dean Mitchell's data demonstrate that the history of twentieth-century finance has been the disappearance of equity funding and its replacement with debt, a development that aligns with the rise of the concept of shareholder wealth maximization as the primary purpose of public corporations.

5 See David Marginson and Laurie Mcaulay, "Exploring the Debate on Short-Termism: A Theoretical and Empirical Analysis," *Strategic Management Journal* 29, no. 3, 2007, pp. 273–292.

6 Francois Brochet, George Serafeim, and Maria Loumioti, "Short-Termism: Don't Blame Investors," *Harvard Business Review*, June 2012, p. 28.

7 See, for example, Kevin J. Laverty, "Economic Short-Termism: The Debate, the Unresolved Issues, and the Implications for Management Practice and Research," *Academy of Management Review*, 21, no. 3, July 1996, pp. 825–860.

8 Traditionally, shareholders only have veto power over some board decisions (i.e., fundamental ones like sale of the corporation) and the affirmative power to amend and adopt certain bylaws. In CA, Inc. v. AFSCME Employees Pension Plan, 953 A.2d 227 (2008), the Delaware Supreme Court explained that a bylaw amendment could only be initiated by shareholders where the proposed bylaw is process-oriented, and not where it seeks to substantively govern decisions made by the board of directors. The court established a distinction between a bylaw that "establishes or regulates a process for substantive director decision-making" and "one that mandates the decision itself," making clear that the only proper subjects for shareholder bylaw proposals are those that establish procedural rules. The court noted, specifically, that the "proper function of bylaws is not to mandate how the board should decide specific substantive business decisions, but rather to define the process and procedures by which those decisions are made." This distinction limits the ability of shareholders to influence the business and affairs of the corporation by preventing shareholders from initiating the adoption or amendment of bylaws that substantively affect "the board's management prerogatives" under state corporate law. Professor Lucian Bebchuk disagrees with such limitations on shareholder rights, arguing that state law should be revised to permit shareholders to initiate what he calls "rules-of-the-game" and "game ending" decisions. See Lucian Bebchuk, "The Case for Increasing Shareholder Power," *Harvard Law Review*, December 2004, p. 833.

9 Stout, *The Shareholder Value Myth*, p. 3.

10 Jack Welch, considered by many to be a leading practitioner of the idea of shareholder value, recognized in 2009 that shareholder value is a result, not a strategy. Stephen Denning, "From Maximizing Shareholder Value to Delighting the Customer," *Strategy & Leadership*, 40, no. 3, 2012, pp. 12–16, citing Francesco Guerrera, "Welch Condemns Share Price Focus," *Financial Times*, March 12, 2009.

11 Lars Friske, Bernhard Maluch, and Andreas Rasner, "Germany" in Ira Millstein and Holly Gregory (eds.) *Corporate Governance 2012* (London: Law Business Research Ltd, 2012), p. 52.

12 Hansmann and Kraakman, "The End of History for Corporate Law."

13 Hansmann and Kraakman, "The End of History for Corporate Law."

14 Hansmann and Kraakman, "The End of History for Corporate Law."

15 Denning, "From Maximizing Shareholder Value to Delighting the Customer."

16 Brian Leavy, "Getting Back to What Matters—Creating Long-term Economic and Social Value," *Strategy & Leadership*, 40, no. 4, 2012, pp. 12–20.

17 Margaret M. Blair and Lynn A. Stout, "A Team Production Theory of Corporate Law," *Virginia Law Review*, 85, no. 2, March 1999, p. 248.

18 Hansmann and Kraakman, "The End of History for Corporate Law."

19 See, for example, Air Prod.'s & Chem., Inc. v. Airgas, Inc., 8 A.3d 1182 (2010). In that case, Airgas directors declined a takeover offer by Air Products at $70 per share, a $20–$30 premium over the price at which Airgas shares were trading at the time. Nevertheless, the court held that the Airgas board was "not under any per se duty to maximize shareholder value in the short term."

20 Stout, *The Shareholder Value Myth*, p. 29.

21 Stout, *The Shareholder Value Myth*, p. 28.

22 For example, Michael Porter and Mark Kramer argue that it is possible to create economic value for a business in a way that also creates value for society and stakeholders. Under what they called the "shared value" model, companies should implement "policies and operating practices that enhance the competitiveness of [the] company while simultaneously advancing the economic and social conditions in the communities in which it operates." Porter and Kramer distinguish what is commonly known as corporate social responsibility from "shared value" in that corporate social responsibility is often built around compliance with environmental and social regulations, charitable giving, etc., which are unconnected to profit-making. Rather, Porter and Kramer argue for an approach that will simultaneously create value for stakeholders and shareholders. For a thorough discussion of the shared value model, see Michael Porter and Mark Kramer, "Creating Shared Value," *Harvard Business Review*, January/February 2011.

23 Dominic Barton, "Capitalism for the Long-Term," *Harvard Business Review*, March 2011. Barton's third point should not be read as advocating for a return to the managerialist approach. Rather, where Barton says that boards should govern like owners, he argues that boards need to be made more effective by imbuing their members with deeper knowledge, skill, and expertise and creating better committee structures, and that compensation reforms are needed to create appropriate incentives. The issue that Barton touches on is not a board power versus shareholder power issue, but rather, an issue of the ability of corporate boards to manage the affairs of the corporation effectively and meaningfully-like real owners.

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About Director Notes

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