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Stakeholder Governance

The Crucial Role of Corporate Governance in Safeguarding Stakeholders' Interests

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This article explores the shift in corporate governance from shareholder primacy to stakeholder-centric approaches, focusing on whether companies can authentically embrace stakeholder governance without significant changes to their governance frameworks. It discusses voluntary initiatives like the 2019 Business Roundtable declaration and legal efforts in Europe to integrate stakeholder interests into corporate decision-making. Key questions include the likelihood of companies adopting stakeholder-centric approaches voluntarily and the future direction of corporate governance. By exploring these themes, the article seeks to examine the challenges and opportunities inherent in promoting responsible business practices that prioritize the interests of all stakeholders, not just shareholders, and emphasizes the essential role that corporate governance plays in driving this shift.

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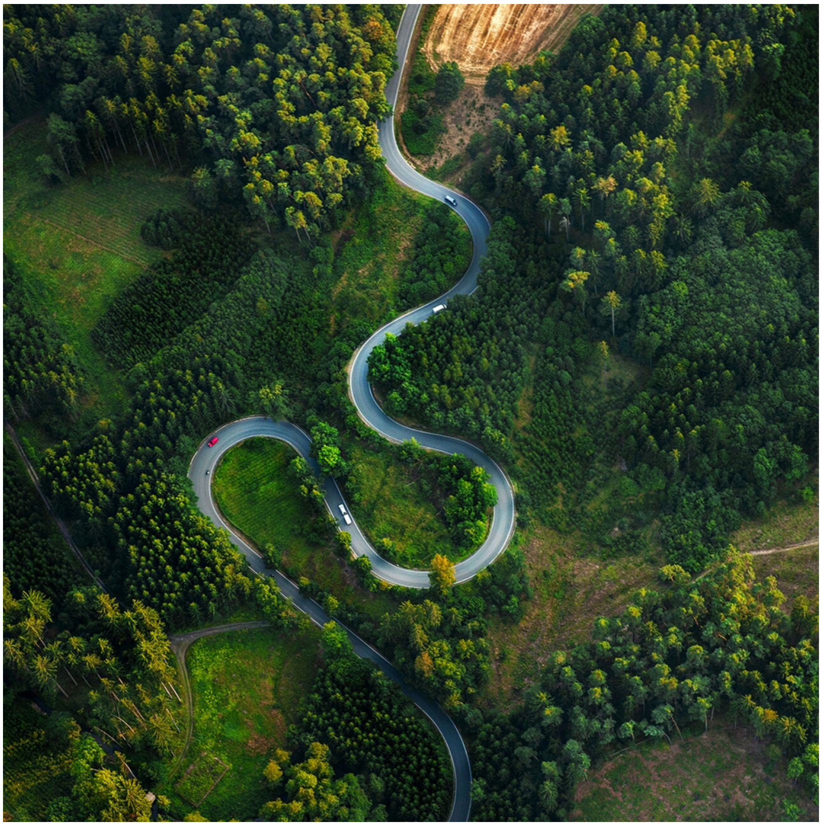

In 1919, the Michigan State Supreme Court issued a ruling in the case of Dodge v Ford Motor Company. The lawsuit was initiated by the Dodge brothers, minority shareholders in Ford, who contested Ford's decision to not distribute dividends. Ford's rationale behind doing this was to instead reinvest retained earnings into the company, with the aim to hire more workers, raise wages, and lower consumer prices. **The Dodge brothers argued that Henry Ford's focus on benefiting employees and consumers came at the expense of shareholders.**

The court sided with the shareholders, asserting that there should be no confusion that the purpose of a corporation is "primarily for the profit of the stockholders and that the powers of the directors are to be employed for that end"[1]. **This case set the landmark for the shareholder primacy concept, which grew in popularity during the 1930s, becoming widely accepted by the 1990s, and has so far been considered the norm.**

Fast forward 100 years, the Business Roundtable ("the BRT") published an alternative view in 2019, with a focus on long-term benefits for various stakeholders. 181 CEOs of the United States' largest corporations overturned a 22-year-old policy statement that previously defined that a corporation's main objective is to maximize shareholder return. The BRT adopted a new statement on the purpose of a corporation declaring that **companies should act for the benefit of all stakeholders – customers, employees, suppliers, communities, and shareholders.** Similarly, in 2020, the World Economic Forum issued a new Davos Manifesto establishing that a company serves not only its shareholders but all its stakeholders[2].

Did the CEOs who signed the manifesto live up to their promises?

Harvard Law School researchers Bebchuk and Tallarita conducted a **research study** in 2021 of the 128 US public **companies that joined the BRT statement**[3] and concluded that the statement was "mostly for show" and did not represent a meaningful commitment. Over a two-year period, **the findings revealed a consistent pattern: despite some companies updating governance rules, the majority retained a focus on shareholder primacy.** Most companies maintained a shareholder-centric approach in their governance rules, explicitly stating in responses to shareholder proposals that joining the BRT statement did not require changes. Corporate bylaws and proxy statements also reflected a continued emphasis on shareholder value. All companies continued to pay directors compensation that strongly aligned their interests with shareholder value and avoided any use or support of stakeholder-oriented metrics. The study findings suggested that the implication in the BRT statement may have been largely symbolic, raising questions about the substantive impact of their endorsement.

1. Dodge v. Ford Motor Company, 170 N.W. 668 (Mich. 1919).

2. Schwab, K. (2019, December 2). *Davos manifesto 2020: The universal purpose of a company in the Fourth Industrial Revolution.* World Economic Forum. https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/

3. Bebchuk, L. A., & Tallarita, R. (2021, August 5). *Will corporations deliver value to all stakeholders?* Vanderbilt Law Review, Volume 75, 2022, pp. 1031-1091 Harvard Law School John M. Olin Center Discussion Paper No. 1078 Harvard Law School Program on Corporate Governance Working Paper 2021-11. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3899421

Can companies effectively shift from shareholder primacy to a stakeholder-centric approach without reshaping their corporate governance rules?

A company's corporate governance system plays a pivotal role in shaping the mechanism directing board decisions and corporate actions. The notion that a company's mission is primarily to maximize shareholder value forms a fundamental part of its identity. **If a company aspires to adopt a stakeholder-centric approach, reforming its corporate governance system is a fundamental step in that journey.** Although there is a tendency to overlook the "G" in ESG (Environmental, Social and Governance), it stands as a critical factor for a company's success in effectively serving all stakeholders. **A robust corporate governance system that reflects the company's mission will determine and guide the company's success in E&S matters.**

What are the current legal frameworks in Europe? Can companies serve all stakeholders under European corporate laws?

In recent years, the concept of **Enlightened Shareholder Value** has gained traction. According to this perspective, **corporate leaders should acknowledge that prioritizing the well-being of stakeholders can contribute to the maximization of shareholder value in the long term.** This principle is embodied in section 172 of the UK Companies Act, mandating directors to consider a variety of interests when fulfilling their duty that would be most likely to promote the success of the company[4]. Some argue that this version of stakeholderism is conceptually not different from shareholder primacy given that the interests of stakeholders are taken into account instrumentally to drive shareholder value up.[5] The problem arising from this situation is that it restricts directors from advancing the interests of stakeholders at the cost of shareholders.

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4. Agostini, F. & Corgatelli, M. (2022) *Article 25 of the Proposal for a Directive on Corporate Sustainability Due Diligence: enlightened shareholder value or pluralist approach?* European Company Law, 19(4), pp. 92-99. Available at: https://eprints.gla.ac.uk/276788/1/276788.pdf

5. Bebchuk, L. A., & Tallarita, R. (2020, February 27). *The illusory promise of stakeholder governance.* Cornell Law Review, Volume 106, 2020, pp. 91-178 Harvard Law School John M. Olin Center Discussion Paper No.1052 Harvard Law School Program on Corporate Governance Working Paper 2020-1. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3544978

Additionally, it fails to offer protection to companies that prioritize purpose beyond the pursuit of shareholder value. **Corporate law experts have argued that if stakeholder governance is the goal, radical revisions of corporate law are needed, and proposals are already in place to reform article 172 in the UK[6,7]**.

In December 2023, the Council and the European Parliament reached a provisional deal on the Corporate Sustainability Due Diligence Directive (**CSDDD**)[8]. The aim of this Directive is to foster sustainable and responsible corporate behavior and to anchor human rights and environmental considerations in companies' operations and corporate governance[9]. The initial drafts of the directive included an **article covering directors' duty of care** that required directors to take into account the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change, and environmental consequences. The article was very controversial given that it referred to the "interest of the company" - a concept that does not exist in every legislation, and "duty of care" which is interpreted differently among Member States[10]. The ambiguity in the article could lead to confusion. On March 15th, 2024, the final version of the CSDDD was approved, which included the removal of the article on the duty of care of directors. The legislation is now awaiting a final vote in the European Parliament in April before it becomes law.

Throughout Europe, various **legal frameworks provide avenues for companies that want to embody their commitment to a broader purpose.** For instance, *Entreprise à mission* in France establishes a legal structure wherein businesses actively pursue specific social and environmental objectives with clearly defined sustainability goals. Similarly, Italy and Spain have legal frameworks like *Società Benefit and Sociedad de Beneficio e Interés Común*, respectively, enabling companies to reflect their intentions to contribute to a larger societal purpose.

Another way in which companies showcase their commitment to all stakeholders is by getting certified by **B Lab** as "B Corps". To get certified, companies must meet certain standards of social and environmental performance, accountability, and transparency.

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6. The Better Business Act (2021) *The Better Business Act Campaign Overview*. Retrieved from https://betterbusinessact.org/wp-content/uploads/2022/04/Better-Business-Act-Campaign-Overview.pdf

7. The British Academy. (2019) *Principles for Purposeful Business*. Retrieved from https://www.thebritishacademy.ac.uk/publications/future-of-the-corporation-principles-for-purposeful-business/

8. (2023, December 14). *Corporate Sustainability Due Diligence: Council and Parliament Strike Deal to Protect Environment and Human Rights*. Retrieved from https://www.consilium.europa.eu/en/press/press-releases/2023/12/14/corporate-sustainability-due-diligence-council-and-parliament-strike-deal-to-protect-environment-and-human-rights/

9. *Corporate sustainability due diligence*. European Commission. (n.d.). https://commission.europa.eu/business-economy-euro/doing-business-eu/corporate-sustainability-due-diligence_en

10. The European Company Law Experts Group. (2022, November 28). *The proposed due diligence directive should not cover the general duty of care of directors*. ECGI. https://www.ecgi.global/blog/proposed-due-diligence-directive-should-not-cover-general-duty-care-directors

How likely is it that companies will shift to a stakeholder governance approach on a voluntary basis? Can directors be held accountable for not considering the interests of all stakeholders with current legal frameworks?

As discussed earlier, Europe already has various legal frameworks and certifications designed for companies that wish to serve other stakeholders alongside shareholders. Notably, in 2020, **Danone** became **the first French-listed company to adopt the mission-driven status.** This move received strong support from shareholders, with 99.4% voting in favor of amending the articles of association related to the adoption of the *Entreprise à mission* status. Danone's ambitious goal is to obtain full B Corp certification on a global scale by 2025.

Nonetheless, some experts believe that legal changes must take place if stakeholder protection is the aim. In the "Illusory Promise of Stakeholder Governance" paper, **Harvard researchers claim that *stakeholderism* is unlikely to be achieved on a voluntary basis[11].** They argue that corporate leaders lack strong incentives to protect stakeholders beyond what would serve shareholder value. Thus, they advocate for external interventions, such as new legislations and regulations, to force or incentivize corporations to improve stakeholder treatment and extend benefits to all stakeholders.

For Palombo[12], the legal framework should regulate the conduct of corporations having two goals in mind: **Purpose**, which adopts a **pluralistic approach considering stakeholders alongside shareholders and the board**, and **Do Not Harm**, wherein **businesses are held accountable for the harm they inflict on stakeholders** affected by their activities. Palombo proposes two different approaches for the latter objective. One approach involves internalizing stakeholders' interests by granting them the ability to file lawsuits against directors or by appointing stakeholder representatives to the board. Alternatively, the second approach externalizes stakeholders' interests, allowing them to file complaints against multinational enterprises.

11. Bebchuk, L. A., & Tallarita, R. (2020, February 27). *The illusory promise of stakeholder governance*. SSRN. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3544978

12. Palombo, D. (2022, August 26). *The future of the corporation: The Avenues for Legal Change*. Journal of the British Academy, 10(s5), 43–86. https://www.thebritishacademy.ac.uk/documents/4259/JBA-10s5-03-Palombo.pdf

The Future of Corporate Governance

The evolution of corporate governance from a shareholder primacy model to a stakeholder-centric approach has been a topic of significant debate and scrutiny, with a variety of opinions on the most appropriate path forward. In Europe, legal frameworks and proposed directives have aimed to integrate stakeholder interests into corporate decision-making, although they face various challenges. Despite legal frameworks promoting stakeholder governance, there is still pessimism among academics when it comes to the likelihood of companies voluntarily adopting such approaches. Examining the current landscape of **corporate governance** practices reveals a growing trend among companies to adhere to the **highest standards, surpassing mere legal obligations to align with local recommendations and meet investor expectations.**

Two key stakeholder groups, consumers and employees, are evolving significantly and will be key in the way boards make decisions in the upcoming decade. Generation Z is set to become a major force in the workforce, with sustainability being a priority for them. A Deloitte[13] study found that, for a large majority of Gen Z and Millennials, sustainability is a key factor in both purchasing decisions and career choices. Climate concerns and human rights are driving talent retention and consumer satisfaction, with many already switching jobs or planning to do so based on a company's environmental policies.

Whether stakeholder protection comes from voluntary efforts from companies or legal requirements, it is clear that corporate governance will be essential for the shift. Once more, **the "G" in ESG is the piece that will hold the E&S strategies together,** setting the framework that companies need to advance their sustainable policies and to cascade the message across the organization.

13. Deloitte. (2023) 2023 *Gen Z and Millennial Survey*. Retrieved from https://www.deloitte.com/global/en/issues/work/content/genzmillennialsurvey.html

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