# SHAREHOLDERS VS. STOCKHOLDERS: CEO CAPITULATION OR EMPTY DOUBLESPEAK?

The Corporate End Game

#### Setting the table

- The premise of shareholder primacy: For decades, at least in theory, the end game for companies has been built around the primacy of shareholders.
- A shift in focus? Last week. the Business Roundtable, composed of the CEOs of some of America's largest companies, put out a press release that seemed to be saying that corporations should be run to protect all corporate stakeholders, defined to include customers, society and employees.
- It's personal: Since I teach and write about corporate finance, a discipline historically built around shareholder wealth maximization, and valuation, which is about measuring it.

#### The Business Roundtable sent a message...

- While each of our individual companies serves its own corporate purpose, we 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

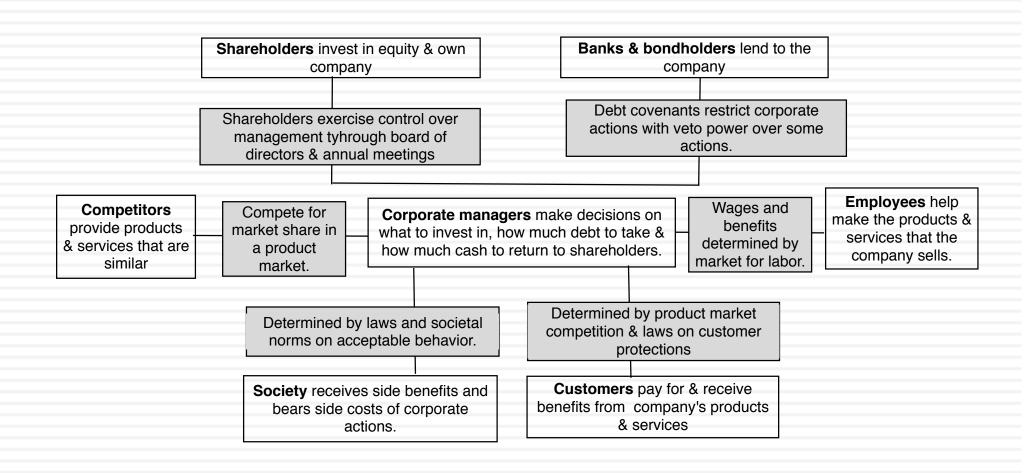
#### And chose a messenger...

- A very good banker: Jamie Dimon, the CEO of JP Morgan Chase, who was the messenger is a very good banker and he has excellent political skills, a plus at a money center bank.
- Not a shareholder advocate: Over the last decade, Jamie Dimon has repeatedly clashed with his own stockholders, first over his decision to chair the board of directors that is supposed to oversee him and multiple times about his compensation.
- Not credible on this topic: Jamie Dimon talking about shareholder wealth is about as believable as Madonna singing "like a virgin" or Kim Kardashian speaking about the importance of privacy.

### The importance of having an objective

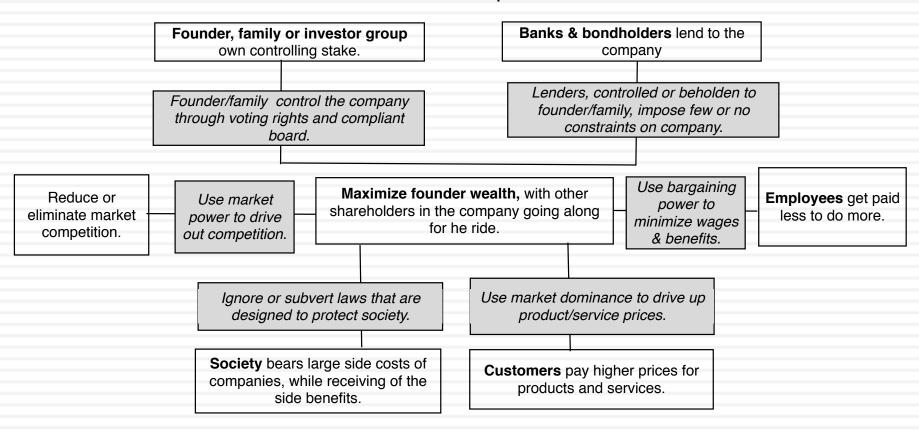
- A central choice: To most laymen, the debate about whether to focus on shareholders or stakeholders may seem like an obscure one that has few consequences for their lives, but it is of huge import.
- Guides corporate decisions: The choice of an objective or an end game drives how decisions get made in companies on:
  - What new investments to take and what old ones to end or divest.
  - How to finance these investments, i.e., debt or equity and what types of debt and equity instruments
  - How much and when to return cash to shareholders
- And is the basis for performance evaluation and compensation: The choice of objective also drives how managers get evaluated and compensated.

### The stakeholders in a public company



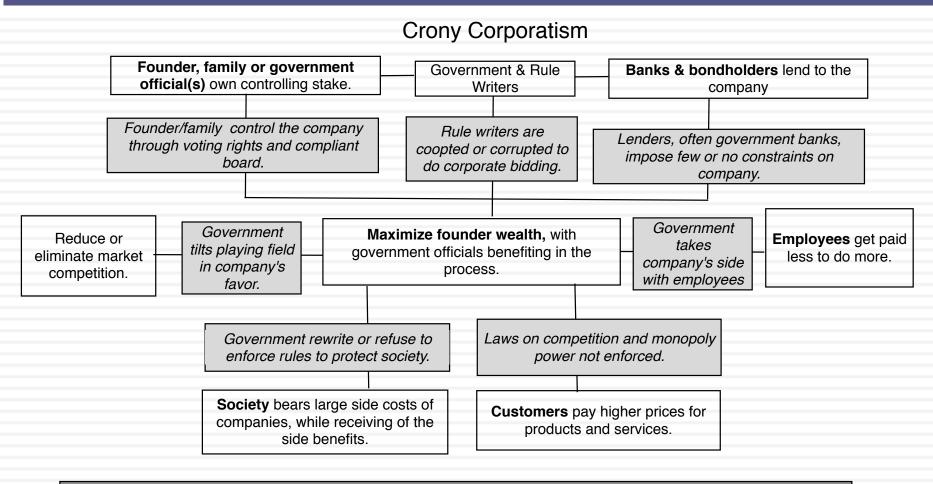
#### 1. Cutthroat Corporatism

#### **Cutthroat Corporatism**



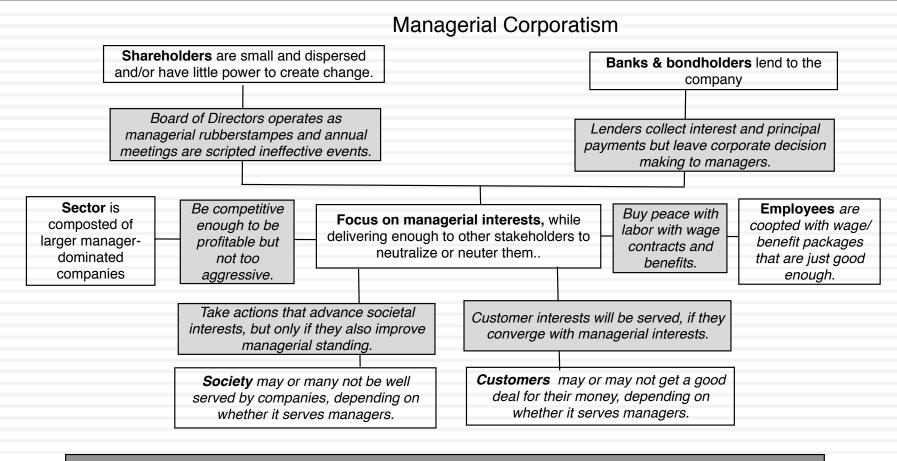
The Darwinian End Game: Winning companies dominate or monopolize their markets, exploiting customers, employees & society, while enriching their founders (and shareholders).

#### 2. Crony Corporatism



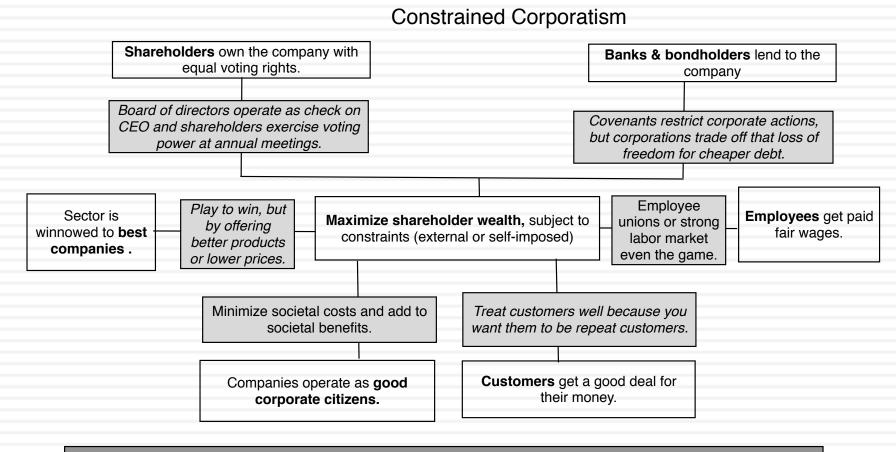
The Connections End Game: The most-politically connected ompanies dominate or monopolize their markets, exploiting customers, employees & society.

#### 3. Managerial Corporatism



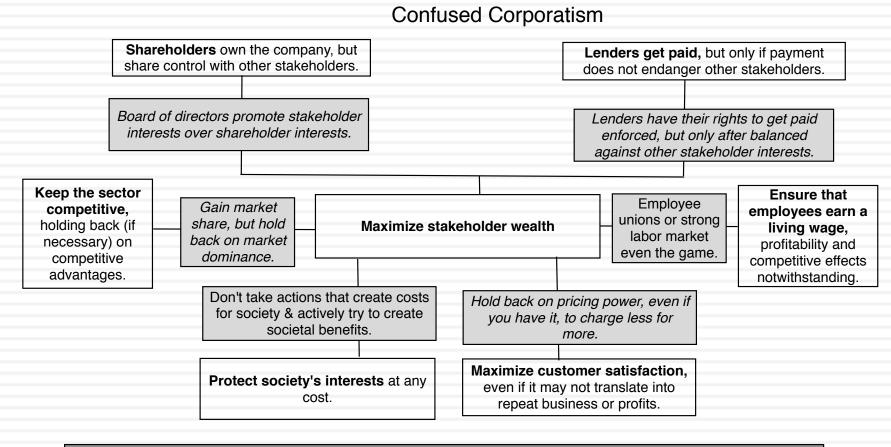
The Managerial End Game: The surviving companies are the ones that find a way to keep managers happy (either economically or with side benefits) with other stakeholders' interests being served well or badly depending on whether they converge with managerial interests.

#### 4. Constrained Corporatism



The Constrained End Game: The winner companies are the ones that find a way to maximize shareholder wealth, while being good corporate citizens, protecting employee interests and delivering good value to customers.

#### 5. Confused Corporatism



The Confused End Game: No stakeholder's interests will be served but there will be no accountability for managers, leading to companeis that are less competitive and efficient, when faced with competition.

## If confused corporatism sounds like a good deal, some cautionary notes..

- Government-owned companies: The managers of these companies were given a laundry list of objectives, resembling in large part the listing of stakeholder objectives, and told to deliver on them all. The end results were some of the most inefficient companies on the face of the earth, with every stakeholder group feeling ill-served in the process.
- US research universities: These entities lack a central focus, where whose interests dominate and why shifts, depending on who you talk to and when. The end result is not just economically inefficient operations, capable of running a deficit no matter how much tuition is collection, but one where every stakeholder group feels aggrieved; students feel that they pay too much in tuition and have too little say in their education, faculty believe that their rights are being chipped away by no-nothing administrators and the communities feel disrespected and cheated

#### Interpreting the Shift

- A <u>Public Relations Move</u>: Populists on both sides of the political divide have found that the public buys into their framing as corporations as self-interested entities that don't care about employees, customers or society, with their focus on shareholders being the reason. CEOs have noticed, and the Business Roundtable's statement may be just a restatement of constrained corporatism.
- A Return to the Past: The cynic in you may lead you to conclude that what the CEOs in the roundtable would like to see is a return to the good old days of managerial corporatism, where they could rule their companies with little push back, and that this push for stakeholder interests is a diversionary tactic.
- The Conspiratorial Twist: The CEOs who are in the Roundtable represent the status quo, large and established companies, many of which find their business models being disrupted by young, start-ups. One way to preempt disruption is to increase the costs of doing business and having to take care of all stakeholders does that, but it is a cost that established companies may be able to bear better right now than their disruptive competitors.

#### Conclusion

- The wrong choice: This is a trying time to be a corporate CEO, with people demanding that you cure society's ills and the economy's problems, but you cannot win this battle by giving up on the focus on shareholder wealth and replacing it with an ill-thought through and potentially destructive objective of stakeholder wealth maximization.
- A better one? A healthier discussion would be centered
  - On creating more transparency about how corporations treat different stakeholder groups and
  - Linking that information with how companies get valued in the market.
  - I think we are making strides on the first, with better information disclosure from companies and CSR measures, and I hope to help on the second front by connecting these disclosures to intrinsic value.
- The end game: If we want companies to behave better in their interactions with society, customers and employees, we have to make it in their financial best interests to do so, buying products and services from companies that treat stakeholders better and paying higher prices for their shares.