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Corporate Social Responsibility through Shareholder Governance

Law Working Paper N° 682/2023
February 2023

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ECGI Working Paper Series in Law

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For helpful comments and discussions, we are grateful to Emiliano Catan, Stavros Gadinis, Marcel Kahan, Lewis Kornhauser, Zach Liscow, Michael Ohlrogge, Frank Partnoy, Ed Rock, and seminar participants at Cornell Law School, Fordham Law School, Hebrew University, NYU School of Law, Stanford Law School, and the UC Berkeley / Duke Organizations and Social Impact Conference. Ginger Hervey provided outstanding research assistance.

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Abstract

New approaches to corporate purpose have emerged in recent years that hold out the promise of addressing concerns about corporate social responsibility (CSR) through shareholder governance, rather than in spite of it, by reconceptualizing shareholder interests in more holistic ways. We provide the first comprehensive analysis of such attempts to reconcile shareholder primacy with CSR. The seminal approach—enlightened shareholder value (ESV)—is based on the idea that treating other stakeholders well can ultimately redound to long-term shareholder value. Two newer approaches depart from the traditional corporate objective of long-term shareholder value by positing that it is shareholders' welfare, not their wealth per se, that managers should pursue. The shareholder social preferences (SSP) view incorporates into the corporate objective the degree to which the firm's operations aligns with the social views of shareholders. The portfolio value maximization (PVM) view, in contrast, argues that corporate fiduciaries should maximize the value of diversified shareholders' portfolios by considering the externalities of the firm's operations on those portfolios. While the long-term shareholder value objective of ESV does align to some extent with key stakeholder concerns, it falls short of resolving all social conflicts about corporate conduct, and moreover management will sometimes, perhaps often, fall short of the degree of social responsibility that is consistent with the shareholder value objective. But incorporating shareholders' social preferences into the corporate objective offers little hope for improvement. For one, shareholder welfare puts far greater relative weight on long-term shareholder value than would a proper conception of social welfare. As well, shareholders' insulation from the social and moral pressures that generate pro-social behavior at the individual level mutes their social preferences with respect to corporate conduct. Conflicts among shareholders about social issues further dampen the role of social preferences in shareholder welfare. Additionally, the shareholders actually willing to hold the shares of the companies that pose the greatest social concerns will be those least concerned about the social issues implicated. And even among these shareholders, management faces significant information problems in gleaning their social preferences. Finally, we show that the optimal incentive scheme under SSP in fact focuses management squarely on shareholder value. The story is much the same for PVM. Diversified shareholders' portfolio value captures only a small portion of the externalities like pollution that its proponents hope to address. The type of externalities it does capture effectively are competitive effects on other firms, the result of which is to motivate socially destructive anticompetitive conduct. Shareholder governance nonetheless does hold significant promise for improving corporate conduct, but this promise does not stem from any innovation in our basic understanding of shareholders' interests along the lines of shareholder welfarism. Rather, the future of CSR, as with its past, is with ESV. The existing law-and-economics literature on ESV, however, has been stunted by key misconceptions. The first is to frame ESV as an alternative to shareholder value as a corporate objective. This is a category mistake; ESV is best understood as a reform agenda targeting a particular class of agency costs and information problems that harm not only shareholders but also other corporate stakeholders. A second misconception is that the behavior of all the key actors in the corporate system is determined by their incentives and so ESV ideas cannot influence it. But we show that this "determinacy paradox" is a challenge for all normative arguments in corporate law scholarship and that there are good reasons to think it can be surmounted in the case of ESV. As a positive matter, the increasing use by various actors in the corporate system of normative arguments that sound in ESV terms is by our lights a phenomenon worth studying rather than simply dismissing. The renewed interest in CSR in recent years may lead to new pathways for achieving social progress through pursuit of enlightened shareholder value.
Keywords: Corporate Objective, Corporate Social Responsibility, Enlightened Shareholder Value

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CORPORATE SOCIAL RESPONSIBILITY THROUGH SHAREHOLDER GOVERNANCE

Robert P. Bartlett, III,[*] *and Ryan Bubb*[†]

February 16, 2023

New approaches to corporate purpose have emerged in recent years that hold out the promise of addressing concerns about corporate social responsibility (CSR) through *shareholder governance, rather than in spite of it, by reconceptualizing shareholder interests in more holistic ways. We provide the first comprehensive analysis of such attempts to reconcile shareholder primacy with CSR. The seminal approach—enlightened shareholder value (ESV)—is based on the idea that treating other stakeholders well can ultimately redound to long-term shareholder value. Two newer approaches depart from the traditional corporate objective of long-term shareholder value by positing that it is shareholders' welfare, not their wealth per se, that managers should pursue. The shareholder social preferences (SSP) view incorporates into the corporate objective the degree to which the firm's operations aligns with the social views of shareholders. The portfolio value maximization (PVM) view, in contrast, argues that corporate fiduciaries should maximize the value of diversified shareholders' portfolios by considering the externalities of the firm's operations on those portfolios.*

While the long-term shareholder value objective of ESV does align to some extent with key stakeholder concerns, it falls short of resolving all social conflicts about corporate conduct, and moreover management will sometimes, perhaps often, fall short of the degree of social responsibility that is consistent with the shareholder value objective. But incorporating shareholders' social preferences into the corporate objective offers little hope for improvement. For one, shareholder welfare puts far greater relative weight on long-term shareholder value than would a proper conception of social welfare. As well, shareholders' insulation from the social and moral pressures that generate pro-social behavior at the individual level mutes their social preferences with respect to corporate conduct. Conflicts among shareholders about social issues further dampen the role of social preferences in shareholder welfare. Additionally, the shareholders actually willing to hold the shares of the companies that pose the greatest social concerns will be those least concerned about the social issues implicated. And even among these shareholders, management faces significant information problems in gleaning their social preferences. Finally, we show that the optimal incentive scheme under SSP in fact focuses management squarely on shareholder value.

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The story is much the same for PVM. Diversified shareholders' portfolio value captures only a small portion of the externalities like pollution that its proponents hope to address. The type of externalities it does capture effectively are competitive effects on other firms, the result of which is to motivate socially destructive anticompetitive conduct.

Shareholder governance nonetheless does hold significant promise for improving corporate conduct, but this promise does not stem from any innovation in our basic understanding of shareholders' interests along the lines of shareholder welfarism. Rather, the future of CSR, as with its past, is with ESV. The existing law-and-economics literature on ESV, however, has been stunted by key misconceptions. The first is to frame ESV as an alternative to shareholder value as a corporate objective. This is a category mistake; ESV is best understood as a reform agenda targeting a particular class of agency costs and information problems that harm not only shareholders but also other corporate stakeholders. A second misconception is that the behavior of all the key actors in the corporate system is determined by their incentives and so ESV ideas cannot influence it. But we show that this "determinacy paradox" is a challenge for all normative arguments in corporate law scholarship and that there are good reasons to think it can be surmounted in the case of ESV. As a positive matter, the increasing use by various actors in the corporate system of normative arguments that sound in ESV terms is by our lights a phenomenon worth studying rather than simply dismissing. The renewed interest in CSR in recent years may lead to new pathways for achieving social progress through pursuit of enlightened shareholder value.

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INTRODUCTION

Corporate managers play crucial roles in our society, sitting as they do atop organizations in control of vast agglomerations of resources. A long-standing debate in American law concerns how corporate fiduciaries should conceive of their jobs—what objective should they pursue? The traditional understanding is that the fiduciaries of a business corporation should pursue shareholder wealth, and much of our corporate governance system is designed to that end. Pursuit of shareholder wealth, of course, can conflict with other interests in society. The classic alternative to the shareholder wealth maximization paradigm is some form of stakeholderism, in which shareholder wealth is but one of the ends to be sought by management, alongside the interests of its workers, other suppliers, customers, and the broader community.

But stakeholderism has foundered due to two key problems. First, state corporation statutes give shareholders the right to elect the board of directors, which in turn holds legal power to manage the corporation.[1] Directors are naturally oriented toward serving the interests of their equity investor electorate, so that absent deeper reforms that would give other stakeholders board representation, shareholders' interests are likely to continue be treated as primary.[2] Second, stakeholder theorists have not congealed around any methodology to determine how corporate management should strike the inevitable tradeoffs among the competing interests of different stakeholders, simply leaving it up to management to sort out as they see fit.[3] Lacking any metric against which management performance can be judged, stakeholderism in practice risks reducing the accountability of management.[4] While it is hoped that managers will use their discretion to advance stakeholder interests, the interests they are most likely to advance might be their own.

The debate about corporate purpose is old, dating back at least as far as the foundational exchange between Professors Dodd and Berle in the pages of the *Harvard Law Review* in the early 1930s.[5] Yet as early as that era there were those who questioned the extent to which shareholder interests are

[1] *See, e.g.*, Del. Code Ann. tit. 8, § 141(a) (2001).

[2] Leo E. Strine Jr, *Corporate Power is Corporate Purpose I: Evidence from my Hometown*, 33 OXFORD REV. ECON. POL'Y 176 (2017); Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91 (2020); Edward B. Rock, *For Whom is the Corporation Managed in 2020?: The Debate Over Corporate Purpose*, 76 BUS. LAW. 363 (2021).

[3] Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L. Q. 403 (2001).

[4] FRANK H EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 38 (1991); Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 14 J. APPL. CORP. FIN. 8, 14 (2001) ("By failing to provide a definition of better [and worse decision-making], stakeholder theory effectively leaves managers and directors unaccountable for their stewardship of the firm's resources.").

[5] E. Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932); A. A. Berle, *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932).

actually incompatible with stakeholder interests. Mistreating workers, customers, and other firm patrons is not in general a recipe for long-term business success.[6] As Professor Dodd himself put it, "No doubt it is to a large extent true that an attempt by business managers to take into consideration the welfare of employees and consumers … will in the long run increase the profits of stockholders."[7] While not embraced by Professor Dodd,[8] this so-called "enlightened" shareholder value view has historically represented the primary alternative to stakeholderism for those seeking to reorient corporate managers towards more socially responsible business practices.[9]

But recent years have given rise to new perspectives on how corporate managers should understand shareholders' interests that aim to weaken the grip of shareholder value on the hearts and minds of corporate managers and provide a new north star by which they could chart a more socially responsible course. The key to these innovations is the recognition that the shareholders of a business corporation in general care about more than just the return on the company's common stock. For one, shareholders care about other stakeholders' interests directly because of their own personal normative commitments (their "social preferences," in the reductive parlance of economists). And even from just a financial perspective, each shareholder's stake in the company is held as part of a broader portfolio. Some portion of the external harms that arise as byproducts of the company's pursuit of profits—to the environment, for example—will ultimately fall on other companies held in shareholders' portfolios. Under this view, for corporate fiduciaries to further shareholders' true interests, properly understood, they must eschew narrow shareholder wealth maximization and instead focus on shareholder *welfare* maximization, which incorporates these shareholder social preferences and portfolio effects.

In this Article we provide the first comprehensive analysis of these attempts, new and old, to pursue corporate social responsibility through shareholder governance. In Part I we provide a brief overview of the traditional debate about the objective of a business corporation. In Part II we dilate on the idea of enlightened shareholder value (ESV) as a way to pursue corporate social responsibility (CSR) within the traditional norm of shareholder primacy. In Part III we outline the more recent attempts to improve corporate conduct by incorporating more holistic understandings of

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[6] Jensen, *supra* note 4, at 16 ("[I]t is a basic principle of enlightened value maximization that we cannot maximize the long-term market value of an organization if we ignore or mistreat any important constituency.").

[7] Dodd, *supra* note 5, at 1156.

[8] Dodd, *supra* note 5 at 1156–57 ("[O]ne need not be unduly credulous to feel that there is more to this talk of social responsibility on the part of corporation managers than merely a more intelligent appreciation of what tends to the ultimate benefit of their stockholders.").

[9] *See* Dorothy S. Lund, *Enlightened Shareholder Value, Stakeholderism, and the Quest for Managerial Accountability* in RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD 91, 94-99 (Elizabeth Pollman & Robert B. Thompson eds., 2021) (documenting embrace of ESV among corporate managers and investors).

shareholder interests. We distinguish between two main versions of "shareholder welfarism," one that focuses on shareholders' social concerns and another that considers shareholders' financial interests from a diversified portfolio perspective, which we refer to as the shareholder social preferences (SSP) view and the portfolio value maximization (PVM) view, respectively.

In Part IV we turn to evaluating the extent to which these three competing approaches to pursuing CSR through shareholder governance—ESV, SSP, and PVM—are likely to induce corporations to behave responsibly from a social perspective. We begin by analyzing the degree to which the corporate objective posited by each captures CSR concerns, ignoring the challenges to inducing managers to pursue each objective. While the long-term shareholder value objective of ESV does align to some extent with key stakeholder concerns, it falls short of resolving all social conflicts about corporate conduct, even putting feasibility concerns to the side. But incorporating shareholders' social preferences into the corporate objective offers little hope for improvement. For one, shareholder welfare puts far greater relative weight on long-term shareholder value than would a proper conception of social welfare. As well, shareholders' insulation from the social and moral pressures that generate pro-social behavior at the individual level mutes their social preferences with respect to corporate conduct. Finally, conflicts among shareholders about social issues further dampen the role of social preferences in shareholder welfare.

Diversified shareholders' portfolio value is even less normatively attractive as a corporate objective. It captures only a small portion of the externalities like pollution that its proponents hope to address. The type of externalities it does capture effectively are competitive effects on other firms—like competitors' loss of business following a cut to the price of the firm's output—the result of which is to motivate socially destructive anticompetitive conduct.

We then consider the feasibility of implementing each approach. Much of the scholarly literature on corporate law is preoccupied with the extent to which corporate managers have appropriate incentives and information to pursue ESV's objective of long-term shareholder value.[10] On the one hand, the types of considerations raised by CSR under the ESV approach are squarely in management's wheelhouse. But while ESV is substantially feasible in terms of its information demands, management's incentives are more mixed. Standard agency cost theory teaches that whenever managers do not own 100% of the firm's residual claims, their incentives are not perfectly aligned with those of shareholders. Corporate short-termism is one species of agency costs that might result in management failing to engage in CSR that would benefit shareholders in the long-term. Overinvestment due

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[10] *See, e.g.*, Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 312 (1976); REINIER KRAAKMAN, ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 35–36 (2d ed. 2009).

to "empire-building" in high-negative-externality industries is another. In sum, in practice management will sometimes, perhaps often, fall short of the degree of social responsibility that is consistent with the shareholder value objective.

Adding shareholders' social preferences to the corporate objective, however, would provide little by way of incremental incentives to act responsibly. For one, given that shareholders' social preferences are in important part associative, the shareholders actually willing to hold the shares of the companies that pose the greatest social concerns will be those least concerned about the social issues implicated. As well, management faces significant information problems in gleaning the strength and content of the social preferences of their shareholder base. Indeed, diversified shareholders themselves, we submit, would struggle to formulate such preferences across the myriad social issues implicated by their portfolio. These information problems of the SSP approach in turn produce a fundamental incentive problem. With one far more important component of the objective for which managers have reasonably good information—shareholder value—and one far less important component for which they have little information—shareholders' social preferences—the optimal incentive scheme focuses management squarely on shareholder value.

The story is much the same for PVM. Corporate managers are likely to be far better informed about how its business produces cash flows for the company, and about competitive effects on other firms, than about other externalities of the company's business on other public companies. The optimal incentive scheme for firm managers under PVM would thus also focus on long-term shareholder value of the firm. To the extent it incorporated externalities, they would be largely of the competitive variety, leading to worse corporate behavior from a social perspective.

Shareholder governance does hold significant promise for improving corporate conduct, but this promise does not stem from any innovation in our basic understanding of shareholders' interests along the lines of shareholder welfarism. Rather, the future of CSR, as with its past, is with ESV. The existing law-and-economics literature on ESV, however, has been stunted by two key misconceptions, which we attempt to dispel in Part V. The first is to frame ESV as an alternative to shareholder value as a corporate objective. This is a category mistake; ESV is best understood as a reform agenda targeting a particular class of agency costs that harm not only shareholders but also other corporate stakeholders. A second misconception is that the behavior of all the key actors in the corporate system is fully determined by their incentives and so ESV ideas cannot improve it. But we show that this "determinacy paradox" is a challenge for all normative arguments in corporate law scholarship. The generality of this analytic challenge for normative arguments in the field has not previously been recognized. Yet we also provide good reasons to think that this challenge can be surmounted in the case of ESV.

As a positive matter, the increasing use by various actors in the

corporate system of normative arguments that sound in ESV terms is by our lights a phenomenon worth studying rather than simply dismissing. To illustrate this phenomenon, we tell in brief the story of a recent activist intervention at ExxonMobil that succeeded in electing three new directors on an ESV platform. This episode illustrates that the most promising way forward for the renewed interest in CSR in recent years is through pursuing enlightened shareholder value, and we conclude by outlining an ESV research agenda that can better illuminate the scope for CSR through shareholder governance.

I
THE TRADITIONAL DEBATE ABOUT CORPORATE OBJECTIVE

The traditional debate about the objective of a business corporation traces back to an influential exchange almost a century ago between Columbia Law School Professor Adolf A. Berle and Harvard Law School Professor E. Merrick Dodd that grappled with a fundamental question posed by the publicly-traded corporation: given the practical inability of dispersed shareholders to monitor managers, what maximand should managers pursue in exercising their resulting wide discretion over corporate affairs?[11]

A. Shareholder Wealth Maximization

Berle's solution was to turn to the law of trusts and argue that managers are trustees obligated to exercise their discretion solely for the benefit of the shareholders,[12] which he understood narrowly in terms of their interests in the corporation's profits.[13] It was this view of the corporation that was later reprised in Milton Friedman's famous assertion that corporate executives' "responsibility is to conduct the business in accordance with [shareholders'] desires, which generally will be to make as much money as possible while conforming to the basic rules of the society..."[14] For Berle, this was a matter of managerial accountability. The only alternative he saw to the shareholder wealth maximization norm was to simply hand over "the economic power now mobilized and massed under the corporate form … to the present administrators with a pious wish that something nice will come out of it all."[15]

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[11] *See* Dodd, *supra* note 5 at 1147 ("Directors and managers of modern large corporations … are free from any substantial supervision by stockholders by reason of the difficulty which the modern stockholder has in discovering what is going on and taking effective measures even if he has discovered it.").

[12] *See* A. A. Jr. Berle, *Corporate Powers As Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931).

[13] Berle, *supra* note 5 at 1367 ("Now I submit that you can not abandon emphasis on 'the view that business corporations exist for the sole purpose of making profits for their stockholders' until such time as you are prepared to offer a clear and reasonably enforceable scheme of responsibilities to someone else.")

[14] Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES (Sept. 13, 1970), at SM12.

[15] Berle, *supra* note 5, at 1368.

The shareholder wealth maximization norm has historically enjoyed broad support for several reasons. First, as a matter of economic theory, if markets are complete, firms are price takers, and there are no externalities not effectively addressed by government policy, corporate profit maximization results in a socially efficient outcome in the sense that there is no way to improve anyone's well-being without making someone else worse off.[16] Similarly, under these conditions, shareholders with conflicting preferences about the timing of consumption will nevertheless be unified in a corporate mandate to maximize shareholder wealth, since shareholders can satisfy their diverse preferences by borrowing and saving.[17] Second, these theoretical arguments are complemented by the agency-cost concerns articulated by Berle. Share value provides a simple metric by which to evaluate managers and to hold them accountable for the efficient deployment of corporate assets. Indeed, pioneering work on agency cost theory by Michael Jensen and William Meckling in the 1970s later formalized Berle's central premise.[18] Lastly, the basic structure of corporate law reflects the shareholder wealth maximization norm, particularly in the key state of Delaware. While legal authority to manage the corporation is lodged in its board of directors, it is the stockholders who are entitled to elect directors.[19] Likewise, courts have defined the fiduciary duties that directors owe to the corporation as ultimately oriented toward stockholder wealth.[20] A broad range of complementary institutions has developed that further entrench shareholder interests as the primary end of the corporate system.[21]

B. Stakeholderism

In contrast to Berle, Dodd identified a trend in public opinion toward viewing the publicly-held corporation as an "economic institution which has a social service as well as a profit-making function,"[22] and believing that "business has responsibilities to the community."[23] He viewed this trend in public opinion as desirable and likely to become the view of corporate

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

[17] IRVING FISHER, THE THEORY OF INTEREST AS DETERMINED BY IMPATIENCE TO SPEND INCOME AND OPPORTUNITY TO INVEST IT (1930).

[18] *See* Michael C. Jensen & William H. Meckling, *supra* note 10.

[19] *See, e.g*., Del. Code Ann. tit. 8, § 141(a) (2001); Model Bus. Corp. Act § 8.01(b) (1999) (establishing that business and affairs of corporations shall be managed by or under direction of board of directors); Del. Code Ann. tit. 8, § 211(b) (2001) ("[A]n annual meeting of stockholders shall be held for the election of directors on a date and at a time designated by or in the manner provided in the bylaws.").

[20] As summarized by Vice Chancellor Laster in *In Re: Trados*, "the standard of conduct for directors requires that they strive in good faith and on an informed basis to maximize the value of the corporation for the benefit of its residual claimants [i.e., common stockholders] . . . not for the benefit of its contractual claimants." In re Trados, Inc., 73 A.3d 17, 40–41 (Del. Ch. 2013).

[21] Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563 (2021).

[22] Dodd, *supra* note 5, at 1148.

[23] *Id.* at 1153.

managers, who would develop business ethics that would be "in some degree those of a profession rather than of a trade."[24] Normatively he argued against the position of Berle that corporate fiduciaries have a legal responsibility just to stockholders in order to preserve the freedom of action necessary for management to fulfill their inchoate social obligations.[25] The conceptualization of those to whom corporate managers owe these social responsibilities as "stakeholders" took off much later with an influential book aimed at corporate managers by Edward Freeman titled "Strategic Management: A Stakeholder Approach."[26] Freeman offered a capacious definition of "stakeholders" as "any group or individual who can affect or is affected by the achievement of the organization's objectives."[27] Owing in part to the influence of Freeman,[28] the school of thought originally launched by Professor Dodd has since become known as "stakeholder theory" or simply "stakeholderism."[29] Under this view, corporate fiduciaries should voluntarily advance not just the interests of shareholders but also the interests of workers, creditors, other suppliers, customers, and all others who are affected by the corporation's activities. The term "corporate social responsibility" is generally used to refer to this view of a firm's obligations to advance the interests of its stakeholders.

To organize the various types of social concerns that animate stakeholder theory, it is useful to distinguish between corporate stakeholders that transact with the firm—which we will refer to as "firm patrons"—and stakeholders that do not. One type of concern regarding the treatment of firm patrons stems from market failures that lead to inefficient outcomes. A primary source of such market failures is market power. A firm with market power in the labor market, for example, will depress workers' wages in order to maximize its profits.[30] Similarly, market power with respect to its customers can lead to inefficiently high prices for the firm's output. In both cases these deviations from competitive prices result in deadweight costs—inefficient reductions in transactions in the market. Market power also raises distributive concerns—a greater share of the social surplus generated in the relevant market goes to the firm rather than firm patrons. Distributive concerns can also arise even in the absence of market power, when the relevant market is competitive and efficient. Stakeholderists might view the low wages in a competitive labor market, for example, as socially

[24] *Id.* at 1161.

[25] *Id.*

[26] R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH (1984).

[27] *Id.* at 246.

[28] Joshua D. Margolis & James P. Walsh, *Misery Loves Companies: Rethinking Social Initiatives by Business*, 48 ADMIN. SCI. Q. 268, 279 (2003) ("Freeman's ideas provided a language and framework for examining how a firm relates to 'any group or individual who can affect or is affected by the achievement of the organization's objective' (Freeman, 1984:46).").

[29] Bebchuk and Tallarita, *supra* note 2.

[30] Efraim Benmelech, Nittai K. Bergman & Hyunseob Kim, *Strong Employers and Weak Employees How Does Employer Concentration Affect Wages?*, 57 J. HUM. RES. S200 (2022).

undesirable and advocate for the firm to pay its workers more.[31]

Concerns about non-firm patrons, in contrast, typically involve externalities. Consider, for example, climate change. Firms' operations inevitably entail some amount of greenhouse gas emissions, which contribute to the total stock of greenhouse gases in the atmosphere and in turn to the warming of the planet. 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. But many other externalities are much smaller in scale, resulting in a firm's local community typically having a greater interest in the firm's operations than those further afield.

Note that the basic normative claim at the heart of stakeholderism, that corporate fiduciaries should voluntarily advance the interests of all firm stakeholders and not just the interests of shareholders, presumes some sort of imperfection in current law and policy or in corporations' responses to it. Stakeholderists argue, in effect, that current public policy is not sufficient to protect stakeholder interests, and so corporate managers should go even further on their own.[32]

Notwithstanding the orientation of corporate law toward shareholder wealth maximization, certain core features of corporate law provide the managerial discretion that is necessary to implement stakeholderism. Director decision-making in the absence of financial conflicts of interest remains largely shielded from judicial scrutiny by the business judgment rule. As a result, corporate managers enjoy broad discretion to consider an array of stakeholder interests so long as their decisions can be justified as ostensibly in the interests of the corporation.[33] Moreover, many state legislatures have amended corporate statutes to increase the compatibility of corporate law with stakeholderism. For instance, so-called constituency statutes have been adopted in most states—but not Delaware—that make clear that corporate fiduciaries are not required to consider only shareholder interests to the exclusion of other stakeholders' interests.[34] The main

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[31] *See, e.g.*, Addie Stone, *Improving Labor Relations Through Corporate Social Responsibility: Lessons from Germany and France*, 46 CAL. W. INT'L L. J. 147, 150–151 (2016) ("Employees are key stakeholders, and their compensation is an important CSR issue… companies should focus their CSR efforts on providing a living wage to its employees.").

[32] *See* David L. Engel, *An Approach to Corporate Social Responsibility*, 32 STAN. L. REV. 1, 36 (1979) ("One cannot persuasively claim to have found an extra-profit goal that society wants corporations to pursue, unless one can offer at least a plausible explanation of why the legislature did not long ago enact liability rules, regulations, or other measures, to implement the goal in question quite independently of any management practice of social responsibility.").

[33] *See, e.g.,* Shlensky v. Wrigley, 237 N.E.2d 776, 778 (1968) (holding that, absent fraud, illegality or conflict of interest, the decision of the Chicago Cubs not to hold night games was properly in the hands of the board of directors and the courts would not intervene.) The court pointed out that the decision might in principle be justified based on the financial interests of the corporation, for example because of the possible negative effect on the property value of Wrigley Field that a deterioration in the surrounding neighborhood might cause. *Id.*

[34] MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY 219 (1995).

motivation of these reforms was to prevent corporate takeovers on the ground that takeovers and their associated restructurings could be harmful to workers and local communities.[35] Even in Delaware, the case law evolved to endorse the prerogative of corporate directors to take action to fend off a premium acquisition offer that the shareholders are eager to accept in order to pursue directors' long-term vision of what is in the corporation's best interest.[36] More recently, the adoption of public benefit corporation statutes has been similarly grounded in a desire to enable business corporations to pursue stakeholderist objectives.[37] These developments show that there is nothing inevitable about privileging the shareholders in operating a commercial enterprise. Indeed, a wide variety of enterprises—such as consumer cooperatives, producer cooperatives, and nonprofits—have chosen to privilege a different set of stakeholders.[38]

II
ENLIGHTENED SHAREHOLDER VALUE

Stakeholderism correctly identifies that shareholders' interests in corporate profits can conflict with other interests in society. From a static, short-run perspective especially, these conflicts can loom large. Squeezing suppliers and customers can increase corporate profits at their expense. Cutting back on greenhouse gas emissions will improve the environment but at a direct cost to the company's bottom line. And so on and so forth—the list of such conflicts is endless. But taking a longer-term perspective on the company and its business may lessen the degree of conflict between stockholders and other firm stakeholders. More generally, for a range of reasons, considered in some detail below, it can be in shareholders' interests for the company to incur costs to improve the well-being of the firm's stakeholders. Or put more colloquially, companies can "do well by doing good." This "enlightened shareholder value" perspective, while often dismissed by stakeholder theorists as insufficient[39] and by shareholder value theorists as uninteresting[40] or even counter-productive,[41] has gained

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[35] *See, e.g.* Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 23–24 (1992).

[36] Paramount Communications, Inc. v. Time Inc., 571 A.2d. 1140 (Del. 1989) (upholding defensive measures by the Time, Inc., board motivated in part by a desire to preserve the company's editorial integrity).

[37] *See* Jill E. Fisch & Steven Davidoff Solomon, *The value of a public benefit corporation*, RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD 68 (2021).

[38] *Cf.* HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE (1996).

[39] *See, e.g.,* Dodd, *supra* note 5 at 1156–57; COLIN P. MAYER, PROSPERITY : BETTER BUSINESS MAKES THE GREATER GOOD 6 (2018) ("'Doing well by doing good' is a dangerous concept because it suggests that philanthropy is only valuable where it is profitable, and it converts charity into profitgenerating entities…").

[40] *See, e.g.,* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 744 (2005); Bebchuk and Tallarita, *supra* note 2, at 110 ("Enlightened shareholder value is thus no different from shareholder value tout court.").

[41] Lucian A. Bebchuk, Kobi Kastiel & Roberto Tallarita, *Does Enlightened Shareholder Value Add Value?*, (2022), https://papers.ssrn.com/abstract=4065731.

increasing traction in recent years as a way to respond to the concerns of stakeholderism that is compatible with existing institutions that put shareholder interests first.[42]

Today the idea of ESV is more commonly referred to under the moniker "ESG," which stands for "Environmental, Social, and Governance." While ESG is a notoriously protean term, used for a range of different ideas,[43] its origins are as a term that captures ways that investors can improve their risk-adjusted returns by incorporating environmental, social, and governance considerations into their investment process.[44] A key aspect of the standard rationale for the use of ESG factors to improve investment returns is the idea that such factors affect profitability at the level of the portfolio company.[45] Indeed, the notion that paying attention to "ESG" matters for firm financial performance has become part of the zeitgeist of recent years, with public companies increasingly discussing their ESG initiatives on quarterly earnings calls,[46] hiring executives to oversee ESG reforms,[47] and tying executive compensation to ESG metrics.[48] Another aspect of this rationale for ESG investing is the claim that the stock market misprices ESG factors.[49] To be sure, the term ESG is also used for practices that sacrifice investor returns in order to achieve benefits for stakeholders.[50] But in the main, much of the standard rhetoric around ESG, and its intellectual origins, reflect what

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[42] *See, e.g.*, Lund, *supra* note 9, at 97-98 (arguing that concerns about corporate short-termism have led to a shift toward an enlightened shareholder value perspective); Jensen, *supra* note 4, at 9 ("Enlightened value maximization uses much of the structure of stakeholder theory but accepts maximization of the long run value of the firm as the criterion for making the requisite tradeoffs among its stakeholders…. In so doing, it solves the problems arising from the multiple objectives that accompany traditional stakeholder theory by giving managers a clear way to think about and make the tradeoffs among corporate stakeholders."); Michael E. Porter & Mark R. Kramer, *Creating Shared Value*, 89 HARV. BUS. REV. 62 (2011); ALEX EDMANS, GROW THE PIE : HOW GREAT COMPANIES DELIVER BOTH PURPOSE AND PROFIT (2020).

[43] For an illuminating discussion of the origins of and diverse meanings ascribed to ESG, *see* Elizabeth Pollman, *The Making and Meaning of ESG*, (2022), https://papers.ssrn.com/abstract=4219857.

[44] *Id.* at 11–13; THE GLOBAL COMPACT, WHO CARES WINS (2004), i-ii.

[45] Who Cares Wins, *supra* note 44, at 9; Robert G. Eccles, Ioannis Ioannou & George Serafeim, *The Impact of Corporate Sustainability on Organizational Processes and Performance*, 60 MGMT. SCI. 2835 (2014) (finding high sustainability companies outperform low sustainability companies both in terms of stock market and accounting performance).

[46] Goldman Sachs Equity Research, *The Corporate Commotion – a rising presence of ESG in earnings calls* (Oct. 13, 2020), https://www.goldmansachs.com/insights/pages/gs-sustain-corporate-commotion-f/report.pdf.

[47] Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401 (2020).

[48] The Conference Board, *Linking Executive Compensation to ESG Performance* (2022), https://www.conference-board.org/pdfdownload.cfm?masterProductID=41301 (reporting that 73 percent of S&P 500 companies tied executive compensation to some form of ESG performance as of 2021).

[49] *See* Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 437 (2020) ("For an investor to be able to profit by trading on ESG factors, the market must consistently misprice them.").

[50] Schanzenbach and Sitkoff, *supra* note 45, at 397–398 (referring to this form of ESG as "collateral-benefits ESG").

we refer to as ESV.[51] As of 2022, some $8.4 trillion in assets under management in the U.S. are invested using an ESG approach.[52]

ESV theorists typically describe the corporate objective as "*long-term* shareholder value." The modifier "long-term" serves two purposes. First, it signifies that much of the financial value of the firm's shares stems from cash flows it will produce far into the future. Second, it reflects the possibility that a company's stock price might not fully reflect immediately the future cash flows that an action to sacrifice corporate cash flows today will ultimately produce.[53] But the basic valuation framework underlying ESV is entirely conventional: the firm should be managed to maximize the net present value of the firm's equity, calculated by discounting the cash flows available to equity holders using the appropriate risk-adjusted discount rate (however long it might take for the markets to catch up and price the company's stock accordingly). In other words, ESV is not an alternative conception of corporate purpose—it retains the exact same corporate objective as standard shareholder value theory.[54] Instead, ESV theory identifies a set of mechanisms through which firm managers can increase long-term shareholder value by behaving in a more socially responsible way.[55]

With respect to the treatment of firm patrons, one mechanism posited entails a type of "efficiency wage": treating a class of firm patrons better can induce reciprocal improved treatment of the firm by those firm patrons. For example, when a firm pays its workers better than their outside option—the market wage for similar labor—workers have greater incentive to perform their jobs well, in order to reduce the risk of dismissal, and the resulting increase in productivity can more than compensate for the firm's increased wage bill.[56] Other accounts emphasize the importance of employee morale and perceptions of fairness: workers who are paid what they consider to be an unfair wage are likely to shirk or otherwise cut back on effort, and vice-versa.[57] Similarly, a corporation that invests in promoting a diverse and inclusive work culture might boost employee motivation and performance[58]

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[51] *See*, *e.g.,* United Nations Principles for Responsible Investing, A Blueprint for Responsible Investment (2006), https://www.unpri.org/download?ac=5330 ("That environmental, social and governance factors each contribute to creating long-term value is a case well-understood by many, but remains new to many others – so it is a case we must continue to make.").

[52] US SIF, 2022 Report on US Sustainable Investing Trends, 1 (2022).

[53] Jensen, *supra* note 4, at 17; Edmans, *supra* note 42, at 121.

[54] Analyses of ESV as a distinct normative standard for corporate decision-making thus largely miss the point of ESV. *See, e.g.,* Bebchuk et al, supra note 41. We discuss critiques of ESV in some detail in section V *infra*.

[55] For instance, a recent McKinsey Quarterly publication identifies five distinct channels through which more socially responsible corporate behavior can improve long-term profitability. Witold Henisz et al., *Five Ways that ESG Creates Value*, MCKINSEY Q. (Nov. 2019).

[56] Carl Shapiro & Joseph E. Stiglitz, *Equilibrium Unemployment as a Worker Discipline Device*, 74 AM. ECON. REV. 433 (1984).

[57] George A. Akerlof & Janet L. Yellen, *The Fair Wage-Effort Hypothesis and Unemployment*, 105 Q. J. OF ECON. 255 (1990).

[58] WAITER, IS THAT INCLUSION IN MY SOUP? A NEW RECIPE TO IMPROVE BUSINESS

and attract talented workers away from less enlightened competitors.[59] Consistent with this view—and with the stock market underpricing the benefits of favorable treatment of workers—the shares of companies identified as among the "100 Best Companies to Work For in America" earned significant excess returns from 1994 to 2009.[60]

A related mechanism stems from the value of inducing firm-specific investments from firm patrons. A firms' contracts with its patrons are often long-term and, in important respects, implicit.[61] Workers, for example, invest in human capital that is to some extent specific to the firm and less valuable elsewhere. In order to induce workers to make such costly investments, the firm promises in return to pay them a share of the surplus generated by their increased productivity. For such relational contracts to work, however, firm patrons must be able to trust the firm to perform its end of the bargain down the line. Breaching that implicit contract by cutting wages, say, can ultimately harm shareholders by destroying the firm's reputation for trustworthiness.[62]

The ESV perspective also posits a set of mechanisms through which incurring costs to treat non-patrons well can ultimately create net financial benefits to shareholders. Consider, for example, an energy company's decision of how much to invest in exploring for oil. The optimal level of investment if one takes a myopic view and assumes that the current market demand for oil will continue indefinitely might be much higher than if one instead adopts a more realistic forecast of the coming transition to a low-carbon economy due to future policy changes and technological developments. The idea is that putting one's head in the ground and investing based on a naïve assumption of continuing demand, even if it generates increased profits in the short- to medium-term, risks the eventual incurrence of large losses on "stranded assets."

The social preferences of one class of firm patrons can also produce

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PERFORMANCE, (2013), https://www2.deloitte.com/content/dam/Deloitte/au/Documents/human-capital/deloitte-au-hc-diversity-inclusion-soup-0513.pdf; Jie Chen, Woon Sau Leung & Kevin P. Evans, *Female board representation, corporate innovation and firm performance*, 48 J. OF EMPIRICAL FIN. 236 (2018).

[59] Gail Robinson & Kathleen Dechant, *Building a business case for diversity*, 11 ACAD. OF MGMT, EXEC. 21 (1997).

[60] Alex Edmans, *Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices*, 101 J. OF FIN. ECON. 621 (2011); Alex Edmans, *The Link Between Job Satisfaction and Firm Value, With Implications for Corporate Social Responsibility*, 26 ACAD. OF MGMT. PERSP. 1 (2012).

[61] OLIVER E WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM : FIRMS, MARKETS, RELATIONAL CONTRACTING (1985).

[62] Andrei Shelifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers*, *in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 33 (Alan J. Auerbach ed., 1988). Implicit contracts and the value of the firm's reputation can also provide reasons for the firm to act in a socially responsible manner with respect to its customers. Consider a car insurance company that can increase its profits in the short run by engaging in various practices that slow down or limit the payment on policyholders' claims. Such short-term financial benefits, however, might be swamped by the future costs of lost customers from the resulting harm to the firm's reputation as a reliable insurer that treats its policyholders fairly.

financial incentives to treat other classes of firm patrons and non-patrons well.[63] For instance, given consumer demand for environmentally sustainable products, investment in these products can result in increased profits as well as an improved environment.[64]

While the foregoing identifies conceptually coherent mechanisms through which incurring costs to further stakeholder interests can ultimately redound to the financial benefit of stockholders, we do not mean to suggest that all corporate decisions ostensibly justified on that basis are in fact in stockholder interests. Indeed, ESV arguments might be advanced strategically by stakeholderists for actions that in fact will reduce long-term shareholder value. Similarly, ESV might be used as cover by management for actions taken to further management's interests at the expense of stockholders.[65] We return to the information and incentive problems posed by ESV in Part IV below.

III
SHAREHOLDER WELFARISM

The ESV view posits considerable alignment between the financial interests of shareholders in the long term and the interests of other firm patrons and the broader society. It thus provides one avenue to pursue CSR through shareholder governance. We now consider an alternative approach to doing so that is newer to the scene, which we refer to as *shareholder welfarism*. It posits that corporate management should seek to maximize shareholder welfare, not just share value, by incorporating a more complete understanding of how the corporation affects the well-being of shareholders. There are two primary strands of shareholder welfarism in the literature—the shareholder social preferences view and the portfolio value maximization view—which we take up in turn.

A. Shareholder Social Preferences

The shareholder social preferences (SSP) version of shareholder welfarism begins with the commonsense observation that public company shareholders care about more than just their own wealth—they also have ethical and social concerns. Many shareholders care about the environment, inequality, and racial justice, to give just a few examples, based on their own personal normative commitments. There is of course a wide range of views

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[63] The social views of Millennial and Gen Z workers and customers might produce greater incentive for firms to engage in more socially responsible behavior than in the past, given their evident greater willingness to express those views in their decisions about where to work and shop. *See* Michal Barzuza, Quinn Curtis & David H. Webber, *The Millennial Corporation* (2021), https://papers.ssrn.com/abstract=3918443.

[64] Stephanie M. Tully & Russell S. Winer, *The Role of the Beneficiary in Willingness to Pay for Socially Responsible Products: A Meta-analysis*, 90 J. OF RETAILING 255 (2014).

[65] Jonathan Macey, *Why Is the ESG Focus on Private Companies, Not the Government?*, BLOOMBERG L. (Aug. 19, 2021) ("Managers like ESG investing because the concept is so complex and multi-faceted that almost any action short of theft or outright destruction of corporate property can be defended on some ESG ground or the other.").

on such social issues. But while public company shareholders might not be perfectly representative of the entire population, there is no reason to think that corporate shareholders, unlike others in society, are narrowly self-interested and lack any social preferences.

Many shareholders would thus presumably often prefer that company management sacrifice share value in order to further their social preferences, at least to some extent. Consumer markets provide a useful analogy. Consider "fair trade" coffee, which is sold in major grocery chains across the United States. Fair trade goods are marketed to consumers at a premium price on the basis that the greater markup is passed on to poor producers. This is intended to appeal to consumers with ethical concerns about the treatment of such producers. Such a consumer might be willing to pay more for goods that promise better outcomes for the producers, a hypothesis confirmed by experimental evidence.[66] Suppose those same consumers are also shareholders of a corporation that sources coffee beans. The SSP view posits that those same social preferences would also lead them to be willing to sacrifice investment returns as shareholders in order for the corporation to pay producers more.[67] Under the SSP view, corporate fiduciaries should manage the corporation not to maximize shareholder wealth but rather to maximize shareholder welfare, incorporating shareholders' social preferences.[68]

To be sure, in some cases, shareholder welfare so conceived is in fact maximized by simply maximizing shareholder wealth. Corporate charitable contributions provide an example. Tax complications aside, the goal of furthering shareholder social preferences provides no basis for such corporate philanthropy since the corporation could instead pay those funds out to shareholders, who in turn could donate directly to charity. Professors Hart and Zingales—prominent proponents of the SSP view—characterize this as a case in which the social concern is "separable" from the company's business. But Hart and Zingales argue convincingly that social concerns and money-making by the company are often inseparable.[69] They offer as an example shareholder concerns about mass shootings. Walmart might much more effectively advance those shareholder social preferences by no longer selling high-capacity magazines than by contributing the profits from doing so to charity.[70] Indeed, it seems plausible that for virtually every major CSR

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[66] The leading study found that replacing a generic product label with a Fair Trade label increases sales of coffee by almost 10%, with higher demand holding steady at up to an 8% price premium. Jens Hainmueller, Michael J. Hiscox & Sandra Sequeira, *Consumer Demand for Fair Trade: Evidence from a Multistore Field Experiment*, 97 REV. ECON. STAT. 242 (2015).

[67] There is some evidence, however, that individuals are less willing to pay to advance social concerns in investment decisions than in consumption decisions. *See* Scott Hirst, Kobi Kastiel & Tamar Kricheli-Katz, *How Much Do Investors Care About Social Responsibility?*, (2021), https://papers.ssrn.com/abstract=4115854.

[68] Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247 (2017).

[69] *Id.* at 247–275.

[70] *Id.*

concern there are important aspects of the problem that are not completely separable from the businesses of the corporations involved.

The extent to which shareholders are willing to sacrifice their wealth to address various social concerns of course varies from shareholder to shareholder. Hart and Zingales propose that such heterogeneity be handled through voting by shareholders. The board of directors of the corporation could be required to periodically poll shareholders about corporate policies that implicate social concerns so that the median shareholder's views on the issue (on a share-weighted basis) prevail.[71] Implicit in this voting-based approach is that the "shareholder welfare" objective weights each shareholder's preferences by the number of shares they own.[72]

A further wrinkle is that most corporate shares today are held by institutional investors.[73] Under the SSP view, it is the social preferences of the underlying investors in those institutions that corporate management should seek to advance. Institutional investors would thus have to channel their investors' views in voting the stock in their portfolio companies in order for corporate voting to accurately reflect shareholder welfare. Hart and Zingales envision asset managers segmenting the market based on the social views the asset manager will seek to advance in voting shares of its portfolio companies, so that individual investors can simply sort themselves to the appropriate asset manager.[74]

B. Portfolio Value Maximization

The portfolio value maximization (PVM) strand of shareholder welfarism, in contrast, retains the focus on shareholders' financial interests of the traditional shareholder value approach but considers their financial interests from a portfolio perspective. Most shareholders in public

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[71] *Id.* at 260–261.

[72] It is not entirely clear how companies with multiple classes of stock with different voting rights and cash flow rights should be handled under the SSP view. One natural approach would be to calculate shareholder welfare by weighting each shareholder's preferences by the cash flow rights they hold. This would align most closely with the approach taken to the corporate objective under the traditional shareholder value view of the corporate objective.

[73] Amil Dasgupta, Vyacheslav Fos & Zacharias Sautner, *Institutional Investors and Corporate Governance*, 4, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3682800.

[74] Hart and Zingales, *supra* note 68. at 265–266. One might wonder whether SSP and shareholder wealth maximization might yield similar results with regard to CSR given the valuation effects of shareholders' buying and selling stocks according to their social preferences. For instance, if shareholders divest from a "dirty" company based on their social preferences, the resulting decrease in the company's stock price might arguably induce wealth-minded managers to turn "clean" in the name of maximizing shareholder wealth. Professors Broccardo, Hart and Zingales argue against this result given that any fall in prices among dirty firms is likely to be muted by marginal investors who purchase the newly discounted shares on account of the lower weight these investors place on their social preferences. *See* Eleonora Broccardo, Oliver Hart and Luigi Zingales, Exit Versus Voice, 130 J. POL. ECON. 3101, 3117-3120 (2022). Empirical evidence also suggests that divestment from "dirty" companies produces only modest price declines. *See* Jonathan Berk and Jules H. van Binsbergen, *The Impact of Impact Investing*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3909166. We discuss sorting of shareholders into firms according to their social preferences in Section IV(B)(2)(a) *infra*.

companies are highly diversified, and increasingly so with the ongoing shift from active management to passive investment vehicles.[75] From this perspective, the actual interests of a firm's shareholders are in terms of their diversified portfolio value, not the value of the firm's shares. Accordingly, corporate fiduciaries should seek to maximize the value of the firm's shareholders' portfolios, not their own firm value.

The main implication of the PVM approach concerns between-firm externalities, meaning ways that the decisions of one firm affect the value of other firms. Such spillover effects come in a variety of forms. One form stems from market competition. When a firm gains market share by cutting prices, competing firms often lose customers. Economists refer to this type of external effect as a "pecuniary externality." A quite different form—referred to as a "technological externality"—occurs when a production or consumption activity imposes costs or benefits on other producers or consumers and does not operate through the price system.[76] For example, suppose a factory releases toxic chemicals that reduce agricultural productivity in the surrounding area. From the traditional shareholder value perspective, corporate managers should manage the corporation to maximize the value of its equity without regard to such spillover effects on the value of other firms or on consumers. But under the PVM view, the company's shareholders would want firm managers to incorporate such external effects to the extent that they reduce the value of other securities held in shareholders' portfolios.

The social desirability of such PVM behavior by firm managers depends critically on the nature of the externality at issue and the extent to which it is internalized in shareholders' portfolios. In the case of pecuniary externalities, having firm managers take them into account would interfere with market competition. For example, if each firm in an industry were operated to maximize the total value of the industry, that would entail pricing their output above the competitive level, with all of the standard inefficiencies from monopoly pricing that would result. In recent years a burgeoning empirical literature claims that the growth of diversified institutional investors has in fact led to such anticompetitive outcomes in certain industries.[77] The internalization of pecuniary externalities through the PVM approach is thus generally not socially desirable.

But for technological externalities, PVM offers hope that running the firm in the true interests of shareholders—maximizing the value of their diversified portfolios—would result in more socially responsible corporate behavior. For example, the portfolio value maximizing level of pollution emitted by a firm would take into account the portion of the costs of that

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[75] Vladyslav Sushko, *The Implications of Passive Investing for Securities Markets*, BIS Q. REV. 113, 115 (March 2018).

[76] J.-J. Laffont, *Externalities*, *in* ALLOCATION, INFORMATION AND MARKETS 112 (John Eatwell, Murray Milgate, & Peter Newman eds., 1989).

[77] José Azar, Martin C. Schmalz & Isabel Tecu, *Anticompetitive Effects of Common Ownership*, 73 J. OF FIN. 1513 (2018).

pollution that fall on other firms in the portfolio.

These basic implications of running a corporation to maximize the value of diversified shareholders' portfolios were worked out theoretically by economists decades ago.[78] They entered the legal literature when the growth of private and public pension funds, and their growing use of indexed investment strategies, led to calls for these so-called "universal owners" to exercise their shareholder rights in order to advance broader social interests with respect to corporate behavior.[79] More recently, Professor Condon has argued that attempts by asset managers to pressure their portfolio companies to combat climate change can be explained by their desire to maximize the value of the diversified portfolios they manage.[80]

The recent PVM literature has thus largely focused on normative arguments about how diversified institutional investors should exercise their ownership rights—that they should do so to change a portfolio company's policies in ways that increase the value of their diversified portfolios, even at the cost of the particular company's own value.[81] But as Professors Kahan and Rock argue, doing so without changing the legal norm defining the purpose of a business corporation would conflict with the fiduciary duties of corporate officers and directors, which are based on the traditional shareholder wealth maximization norm.[82] In what follows we thus focus our analysis on a more ambitious version of PVM that includes changing the legal definition of corporate purpose to encompass the internalization of externalities that fall on other firms held in their shareholders' portfolios.

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The main appeal of shareholder welfarism, in both its shareholder social preferences and portfolio value maximization guises, is that it holds the promise of addressing the two key problems with conventional stakeholderism. First, it retains the basic norm that shareholder interests are primary in the management of a corporation. As such, shareholder welfarism is thought to be compatible with the standard norms and incentives governing corporate affairs that put shareholders first, which the recent growth of institutional shareholders has further entrenched. Second, each

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[78] *See, e.g.,* Julio J. Rotemberg, *Financial Transaction Costs and Industrial Performance*, MIT Alfred P. Sloan School of Management Working Paper #1554-84 (1984); ROGER H. GORDON, *Do Publicly Traded Corporations Act in the Public Interest?* (1990), https://www.nber.org/papers/w3303; Robert G. Hansen & John R. Lott, *Externalities and Corporate Objectives in a World with Diversified Shareholder/Consumers*, 31 J. OF FIN. AND QUANTITATIVE ANALYSIS 43 (1996).

[79] ROBERT A. G. MONKS & NELL MINOW, WATCHING THE WATCHERS : CORPORATE GOVERNANCE FOR THE 21ST CENTURY (1996). *See also* HAWLEY AND WILLIAMS, *supra* note 10; Jeffrey N. Gordon, *Systematic Stewardship*, 47 J. CORP. L. 627 (2022).

[80] Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1 (2020).

[81] *Id.*; Gordon, *supra* note 79.

[82] Marcel Kahan & Edward B. Rock, *Systemic Stewardship with Tradeoffs*, (2021), https://papers.ssrn.com/abstract=3974697. *See also* Roberto Tallarita, *Portfolio Primacy and Climate Change* (2021) at 45–46, https://papers.ssrn.com/abstract=3912977.

form of shareholder welfarism provides a conceptual framework through which corporate management could determine, at least in principle, how to trade off among competing stakeholder interests. These two key aspects of the appeal of shareholder welfarism are shared by the ESV view. It too is compatible with existing norms that privilege shareholder interests and provides a clear objective to guide corporate management in trading off current profits in order to further stakeholder interests: long-term shareholder value.

IV
EVALUATING THE THREE APPROACHES TO CSR THROUGH SHAREHOLDER GOVERNANCE

We now turn to evaluating the three approaches to pursuing corporate social responsibility through shareholder governance—enlightened shareholder value (ESV), shareholder social preferences (SSP), and portfolio value maximization (PVM)—based on their potential to induce the management of public companies to incur costs on a voluntary basis in ways that further the interests of other stakeholders in the firm. We will refer to such actions as engaging in "corporate social responsibility" (CSR).[83] We divide our analysis into two parts. We first evaluate the normative attractiveness of the corporate objective posited by each approach, ignoring the practical challenges to inducing corporate managers to pursue each objective. We focus simply on the extent to which each proposed corporate objective captures various social concerns about corporate behavior. We then turn to the feasibility of each approach in terms of the extent to which managers would have the information and incentives needed to pursue the posited corporate objective.

A. Normative Attractiveness of Competing Models' Corporate Objectives

To what extent do the corporate objectives of ESV, SSP, and PVM capture CSR concerns? Our analysis in this Subpart can be thought of as adopting the assumption of no information costs and no agency costs: we imagine a world in which public companies fully maximize the corporate objective function posited under each approach. The corporate objective posited by the ESV view is "long-term shareholder value," meaning the net present value of the future cash flows paid on the company's equity, discounted based on the firm's opportunity cost of capital. Note that long-term shareholder value is also a major component of the corporate objectives

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[83] We put to the side here the general debate between stakeholderists and shareholder primacy theorists about whether such CSR is effective in achieving its ultimate goals. For example, critics of stakeholderism argue that, even if the management of one corporation acts responsibly, they won't make a difference in outcomes because some other firm will fill the void and act irresponsibly. For example, if one oil firm cuts back on oil production, some other firm will just pump that oil out of the ground. We ignore all that and just take the basic goals of stakeholderism and CSR as given.

posited by SSP and PVM. ESV and its long-term shareholder value objective thus form a key benchmark against which to judge SSP and PVM. We begin by characterizing qualitatively the extent to which the long-term shareholder value objective of ESV *fails* to capture CSR concerns so that even in a world in which management were perfectly successful at maximizing long-term shareholder value in an enlightened way, there would remain significant residual social concerns. We then turn to the SSP and PVM objective functions and consider the extent to which the further considerations they incorporate in addition to long-term shareholder value might capture CSR concerns beyond the ESV baseline.

1. Enlightened Shareholder Value

We begin by repeating an observation we made in our discussion of stakeholderism in Part I: corporate behavior is significantly shaped by the constraints and incentives produced by law and public policy, much of which is intended to address market failures and distributional concerns that arise from corporate conduct. This forms an important starting point for thinking about how, in a world in which managers perfectly maximize long-term shareholder value, there might remain social concerns about corporate conduct. Those concerns are, by definition, those not addressed by current law and public policy.

One category of social concerns about corporate conduct that would persist in such a world is with respect to the treatment of firm patrons. First, the outcomes for firm patrons—especially workers—might raise distributive concerns. Competitive labor markets, for example, operating under current tax and transfer policies induce a particular distribution of income and welfare in which low-skilled workers, in particular, earn income that many find unfairly low.[84] As we discussed above, maximizing long-term shareholder value generates some incentive for firms to pay their workers more than they otherwise would based on the value of incentivizing effort or firm-specific investment, but this is true only up to a point. Indeed, for workers for which such incentive contracting concerns do not loom large, the shareholder-value-maximizing wage might be little more than the competitive wage in the relevant labor market. Furthermore, it seems likely that such cases will often involve workers with relatively low levels of human capital, whose low incomes raise the greatest distributive concerns from a social perspective. Put simply, efficiency wages and the like are no panacea for the standard concerns about the income inequality produced by market economies.

Another limitation of this class of ESV mechanisms stems from "last period" concerns. Firms have incentives to perform on implicit contracts in order to preserve the going concern value of the firm, which relies on the trustworthiness of the firm as perceived by current and future patrons. Implicit contracting thus depends critically on the firm and its patrons having

[84] THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY (2014).

a long future ahead of them. But as the probability that the firm will cease to operate and be liquidated goes up—due to business setbacks, for example—the incentives produced by the value of the firm's reputation for trustworthiness are attenuated.

Market power of firms raises additional social concerns. While efficiency wage and implicit contracting considerations might moderate to some extent the incentive of shareholder-value-maximizing firms to exploit their market power, in the main the long-term shareholder value objective is better understood as the key cause of the social problems posed by market power rather than as their solution.

In a similar way, maximizing long-term shareholder value provides no universal cure for other sources of contracting failures between the firm and various classes of firm patrons.[85] A firm that possesses better information than its customers about the safety of its products, for example, might well succumb to the temptation to cut back on safety to save costs, correctly concluding that the reputational and other costs of doing so are outweighed by the short-run savings even when viewed through the lens of long-term shareholder value.

With respect to externalities on non-firm patrons, the limits of ESV are even easier to see. By definition, when production or consumption of a firm's output generates a negative technological externality, running the firm to maximize long-term shareholder value will result in socially excessive levels of the activity (and the reverse is true for positive externalities). The mechanisms discussed in Part II through which ESV can incentivize firms to improve their treatment of non-patrons do not change this powerful implication of economic theory. When externalities exist that are not effectively addressed through taxation or regulation, the private costs and benefits of the activity that drive the maximization of long-term shareholder value diverge from the social costs and benefits of the activity.

In summary, the corporate objective of long-term shareholder value only mitigates and does not resolve social conflicts with respect to corporate conduct. We turn now to SSP and PVM to consider the extent to which the objective function posited by each might go further than ESV in motivating CSR.

2. *Shareholder Social Preferences.*

The corporate objective under the SSP view is based on two key components of shareholders' well-being: (1) the long-term value of the shares; and (2) shareholders' social preferences with respect to corporate conduct. The weight each shareholder puts on these two components depends on their own preferences. As well, the specific content of shareholders' social preferences will vary from shareholder to shareholder.

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[85] Indeed, the basic thesis of Henry Hansmann's Ownership of Enterprise is that such contracting failures can result in the efficient assignment of ownership of the firm being to a class of firm patrons other than investors. HENRY HANSMANN, *supra* note 38.

To calculate aggregate shareholder welfare, individual shareholders' well-being levels are weighted by their share ownership and summed.

Because of heterogeneity across shareholders in the strength and content of their social preferences, aggregate shareholder welfare for a corporation will depend on who owns the shares of the company. In turn, the decisions of individuals to hold the shares may well depend on the conduct of the corporation and the social preferences of the individuals. For now we adopt the simplifying assumption that all shareholders are fully diversified, so that there is no variation in the share-weighted social preferences of shareholders of different public companies.

Under these assumptions, how would maximizing shareholder welfare, taking into account the social preferences of shareholders, change corporate conduct relative to maximizing long-term shareholder value? Consider first the weight that aggregate shareholder welfare would put on long-term shareholder value. This is an empirical question, based on the share-weighted preferences of corporate shareholders. But we make three points that together point to the conclusion that aggregate shareholder welfare would be largely, perhaps even overwhelmingly, based on long-term shareholder value rather than shareholders' social preferences.

To begin, it is useful to contrast shareholder welfare with overall *social* welfare. Social welfare does include as a component a firm's long-term shareholder value—the well-being of the claimants to that value count, of course, in any appropriate measure of social welfare. But social welfare also includes the well-being of those who are *not* shareholders of the firm. As a result, the relative weight a social planner would place on long-term shareholder value in maximizing social welfare is diluted, as compared to the relative weight it gets in shareholder welfare, by the need to consider the well-being of these non-shareholders. This dilution effect alone means that maximizing shareholder welfare will generally not provide an incentive for managers to sacrifice profits to the extent required for the firm to behave appropriately as a social matter. Consider, for example, a profitable factory that emits such a large amount of pollution that, from a social welfare perspective, it should be shut down. Because shareholder welfare puts much more weight on firm profits than social welfare does, it will often not be in shareholders' interests in such a situation to shut down the plant, even including consideration of their social preferences.

Second, the shareholders of a public corporation are insulated from the social and moral pressures that generate other-regarding behavior at the individual level.[86] This is due in part to the complex governance structures that stand between individual shareholders and corporate decision-making that make shareholders anonymous to those who might impose social sanctions for harm done by the corporation, as well as due to diversified shareholders' basic lack of information about corporate affairs (ignorance is

[86] Elhauge, *supra* note 40.

bliss).[87] Professor Elhauge argues that this insulation will result in shareholders putting much more weight on corporate profits relative to social concerns than would sole proprietors, who are far less insulated.[88] This is even more strongly the case with respect to shareholders who own interests in corporate shares through intermediaries like mutual funds and are therefore "double insulated."[89] In sum, from a revealed preference perspective, the welfare of diversified shareholders might be understood as stemming overwhelmingly from shareholder value rather than from social preferences.

Finally, what little weight shareholder welfare does put on social concerns as opposed to shareholder value is further muted by conflicts among shareholders about social issues. Professors Hart and Zingales introduce the idea of shareholder welfare in a simple model in which the social concern is about pollution that is a byproduct of firm operations and shareholders' preferences vary only in terms of the weight they put on environmental harm from the firm's pollution versus on their own wealth. In this framework, aggregate shareholder welfare will be based on the share-weighted average of the weights individuals put on environmental harm relative to personal wealth.

But corporate activities typically pose tradeoffs not just between profits and social concerns but as well among competing social concerns. For example, suppose that reducing the pollution of the firm would require scaling back production in ways that would eliminate jobs in a community with high unemployment and limited economic opportunities.[90] Shareholders will vary not just in the weight they put on social concerns versus share value but as well in the weights they put on environmental harms versus income inequality. The conflicting preferences about these two competing social concerns will cancel each other out, at least to some extent, further attenuating the ultimate weight on the social preferences component of aggregate shareholder welfare. In contrast, the long-term shareholder value component of shareholder welfare is common to all shareholders and not subject to such canceling out.

In light of these considerations, the only social issues for which incorporating shareholders' social preferences into the corporate objective might potentially make a meaningful difference, relative to the ESV baseline, in motivating CSR would be issues on which there is a broad and strong social consensus. But these are exactly the set of issues for which the residual social concerns left under the ESV approach after fully maximizing

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[87] *Id.* at 798.

[88] *Id.* There is experimental evidence for this hypothesis. *See* Hirst, Kastiel, and Kricheli-Katz, *supra* note 67.

[89] Elhauge, *supra* note 40, at 817.

[90] *See* Alperen A Gözlügöl, *The Clash of 'E' and 'S' of ESG: Just Transition on the Path to Net Zero and the Implications for Sustainable Corporate Governance and Finance*, 15 J. OF WORLD ENERGY L. & BUS. 1 (2022) (arguing that the transition to net-zero greenhouse gas emissions will result in certain regions suffering substantial employment losses).

long-term shareholder value are likely to be minimal, for two reasons.

First, social issues for which there is a strong social consensus are much more likely to be effectively addressed by law and public policy. Federal and state law, for example, provide powerful controls on corporate conduct to address many social concerns raised by corporate operations, from the safety of motor vehicles, to the health consequences of tobacco consumption, to the emission of particulate matter by industrial activities. Our claim is most certainly not that the political process is perfect or that current public policy fully addresses all social concerns about corporate conduct. Rather, it is that the specific issues for which there is sufficient social consensus such that the social preferences of shareholders form a meaningful component of shareholder welfare are precisely the issues that are most likely to be effectively addressed by public policy. Indeed, since corporate shareholders' preferences put less weight on average on the social concerns raised by corporate conduct than does the overall polity, for reasons given above, it seems likely that for many issues for which there is a strong social consensus, public policy will go well beyond what the company's shareholders would prefer in reining in corporate conduct.

Second, the broad social consensus we are supposing would include not just shareholders but also other classes of firm patrons, including its workers, managers, and customers. The social preferences of firm patrons can provide strong shareholder-value reasons for the firm to act in ways that are consistent with those social preferences. Failing to do so risks inviting a backlash from these other classes of firm patrons that might have major financial consequences.[91]

Consider, for example, explicit and open racism in a firm's treatment of its customers. A recent episode involving Starbucks is instructive. In 2018, a Starbucks employee called the police after two black men entered a Starbucks in Philadelphia and sat down without purchasing anything and, when store employees asked them to leave, declined to do so. The police forcibly removed the men, leading to national headlines, a public apology by the Starbucks CEO, and the hashtag #BoycottStarbucks trending on Twitter.[92] No reference to Starbucks shareholders' social preferences is needed to explain the decision by Starbucks management several days later to close 8,000 stores to conduct racial bias training of employees.[93]

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[91] Barzuza, Curtis, and Webber, *supra* note 65. As BlackRock's CEO Larry Fink put it in his most recent letter to CEOs, "Employees need to understand and connect with your purpose; and when they do, they can be your staunchest advocates. Customers want to see and hear what you stand for as they increasingly look to do business with companies that share their values." Larry Fink, *The Power of Capitalism,* BLACKROCK (2022), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

[92] Matt Stevens, *Starbucks C.E.O. Apologizes After Arrests of 2 Black Men*, N.Y. TIMES (Apr. 15, 2018), https://www.nytimes.com/2018/04/15/us/starbucks-philadelphia-black-men-arrest.html.

[93] Rachel Abrams, *Starbucks to Close 8,000 U.S. Stores for Racial-Bias Training After Arrests*, N.Y. TIMES (Apr. 18, 2018), https://www.nytimes.com/2018/04/17/business/starbucks-arrests-racial-bias.html.

In summary, under the SSP shareholder welfare objective, it is long-term shareholder value that is the key driver of decisions to incur costs to further stakeholder interests, not the social preferences of shareholders, which are conflicted, muted, and often prefer less protection of stakeholder interests than provided by law.

3. Portfolio Value Maximization.

The corporate objective under the PVM approach is diversified shareholders' portfolio value. To evaluate its normative desirability, we maintain for now the simplifying assumption that all investors are fully diversified—that is, they hold the "market portfolio" of all investible risky assets, with each asset weighted in proportion to its value. This is in fact a key assumption underlying the standard model of valuation managers are taught in MBA programs, which is based on the Capital Asset Pricing Model (CAPM).[94] CAPM provides the original intellectual foundations for the specific model of financial management by which managers are supposed to pursue long-term shareholder value. We begin by sketching how that model works in order to frame more precisely how the PVM approach proposes managers should deviate from it.

In the standard model of corporate decision-making, diversified shareholders want managers to follow the "NPV Rule": invest in every project that has a positive net present value (NPV).[95] The NPV of a project is calculated by converting ("discounting") all of the future cash flows associated with the project to their present value and then summing those present values,

$$NPV = C_0 + \frac{C_1}{1+r} + \frac{C_2}{(1+r)^2} + \cdots + \frac{C_T}{(1+r)^T}, \qquad (1)$$

where C_t is the net cash flow received from the project in period t and r is the risk-adjusted discount rate for the project, which is used to capture both the time value of money and (through risk adjustment) the cost of risk bearing.

The assumption of CAPM that all investors are optimally diversified plays a key role in the determination of the appropriate discount rate. To capture the cost to investors of bearing the risk of the project, a "risk premium" is added to the risk-free rate (typically taken to be the return on government obligations) to arrive at the risk-adjusted discount rate. But crucially, CAPM considers the risk of a project from a portfolio perspective. That is, a project's risk is measured not in terms of the degree of uncertainty of the project's cash flows considered in isolation but rather in terms of the increment in *portfolio risk* if the project were added to a diversified portfolio. This matters because one component of a project's risks—the

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[94] *See, e.g.,* RICHARD A BREALEY ET AL., PRINCIPLES OF CORPORATE FINANCE 185–199 (2012).

[95] *Id.* at 101–103.

"idiosyncratic" component—disappears when the project is held in a diversified portfolio. A diversified investor only has to be compensated for bearing the risks that they actually have to bear, which is the undiversifiable, "systematic" component of a project's risk. In CAPM, the only source of systematic risk comes from the correlation between a project's cash flows and the overall market return, which is referred to as the project's "beta." The standard shareholder value approach thus already adjusts the *denominators* of the fractions in the expression for NPV above based on a portfolio perspective. So the idea that corporate managers should take a portfolio perspective on the interests of shareholders is actually an old one and entirely conventional. It forms a core component of standard shareholder value theory.

The PVM approach, however, pushes this portfolio perspective further. It incorporates into the cash flows of the project not just the cash flows received by the firm but also the increment in cash flows paid on any *other* securities in the market portfolio. This entails adjusting not just the denominators of the terms in the expression for NPV but also their numerators. The resulting NPV expression under the PVM approach is:

$$NPV^{PVM} = C_0 + E_0 + \frac{C_1+E_1}{1+r} + \frac{C_2+E_2}{(1+r)^2} + \cdots + \frac{C_T+E_T}{(1+r)^T}. \qquad (2)$$

The numerators in the PVM-modified expression for NPV include *both* the expected cash flows from the project that will accrue to the instant corporation (the C_t's) as well as the "spillover" expected cash flows for other securities resulting from externalities (the E_t's), which might be on net positive or negative in any given period. For most corporate decisions, the bulk of the cash flows at the market portfolio level in fact accrue to the securities issued by the corporation making the decision. The question we grapple with in this Subpart is the extent to which consideration of the additional cash flows to other portfolio securities that the PVM approach requires, assuming no agency costs or information problems, will motivate CSR beyond that justified based on pure long-term shareholder value. We reach an even more negative conclusion than the one we reached in evaluating the SSP objective function: the portfolio value objective will not only produce little additional motivation for CSR, it will also provide new motivations for socially destructive corporate conduct.

First, taking a portfolio perspective on expected cash flows produced by corporate decisions captures only a small portion of the technological externalities of corporate conduct since the bulk of such externalities fall on interests that are not part of the market portfolio. These interests include the health and well-being of consumers as well as those of producers that are not owned in the market portfolio.

To be concrete, consider the facts alleged in *Aguinda v. Texaco*, a class action filed on behalf of residents of certain regions of Ecuador and Peru to recover for property damage, personal injuries, and increased risk of disease allegedly caused by Texaco's improper waste disposal practices in its oil

extraction operations in Ecuador.[96] Plaintiffs alleged that Texaco engaged in a range of wrongful conduct, including dumping large quantities of toxic byproducts of the drilling process into local rivers and landfills.[97] Texaco allegedly did this to save money, netting additional profits of $500,000 to $1 million per well.[98] The pollution released by Texaco poisoned the local ecosystem, causing environment harm, economic losses to local fishermen and agriculture, and serious injuries and disease among local residents.[99]

These allegations represent a paradigmatic case of socially harmful corporate behavior that CSR advocates hope to address. The harms suffered by local residents constituted negative technological externalities that were not effectively controlled through regulation or private law remedies.[100] But they also illustrate a key limitation of the PVM approach: hardly any of these externalities would have manifested as reductions in expected cash flows to securities in the market portfolio. To be sure, the kinds of costs at issue in this example, to human health, ecosystems, and small-scale producers, might ultimately have second-order effects on public companies as, for example, the resulting shifts in supply and demand in various markets affect prices of public companies' inputs and outputs. But those effects on public companies are *de minimis* and, for that matter, could be on net positive if, for example, the resulting fall in production by small-scale producers resulted in a reduction in supply of products sold by public companies. To a first approximation, the E_t's for this project would be zero, despite the sizable social externalities at issue.

This is also true for larger-scale externalities. Consider climate change, which has been aptly described as "the mother of all externalities."[101] Essentially every business project produces some amount of greenhouse gas emissions, the accumulation of which in the atmosphere leads to warming of the planet over time. Climate change is expected to cause a manifold set of impacts on human well-being. The most recent report by the Intergovernmental Panel on Climate Change (IPCC) provides a useful taxonomy of the ways climate change is expected to affect human systems:[102]

1. Impacts on water scarcity and food production.
   a. Water scarcity.
   b. Agriculture / crop production.

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[96] *Aguinda v. Texaco, Inc.*, 142 F. Supp. 2d 534, 536 (S.D.N.Y. 2001), aff'd as modified, 303 F.3d 470 (2d Cir. 2002).

[97] *Jota v. Texaco, Inc.*, 157 F.3d 153, 155 (2d Cir. 1998).

[98] *Jota v. Texaco, Inc.* class Action complaint, p. 19.

[99] *Id.* at 5 – 12.

[100] The class actions brought seeking damages and equitable relief in U.S. courts were ultimately dismissed on the basis of *forum non conveniens*. *Aguinda v. Texaco, Inc.*, 303 F.3d 470, 473 (2d Cir. 2002).

[101] Richard S. J. Tol, *The Economic Effects of Climate Change*, 23 J. OF ECON. PERSP. 29 (2009).

[102] IPCC Sixth Assessment Report: Impacts Adaptation and Vulnerability (2022), https://www.ipcc.ch/report/ar6/wg2/.

   c. Animal and livestock health and productivity.
   d. Fisheries yields and aquaculture production.
2. Impacts on health and wellbeing.
   a. Infectious diseases.
   b. Heat, malnutrition and other.
   c. Mental health.
   d. Displacement.
3. Impacts on cities, settlements and infrastructure.
   a. Inland flooding and associated damages.
   b. Flood / storm induced damages in coastal areas.
   c. Damages to infrastructure.
   d. Damages to key economic sectors.

While some of these categories, especially those under "Impacts on cities, settlements and infrastructure," would include substantial effects on public companies, this taxonomy reveals that the scope of the harms from climate change is far broader than its effects on the value of public companies.

Indeed, the United Nations Environment Programme's Finance Initiative (UNEP FI) recently developed a methodology for assessing the impact of climate change on the portfolios of institutional investors that illustrates the relatively small portion of the costs of climate change that affect the value of the market portfolio.[103] The physical risks from climate change included in the analysis are limited to asset damage and business interruption from extreme weather events, a fairly small component of the myriad social costs of climate change identified by the IPCC.[104] This reflects how limited a perspective the PVM objective function brings to the social costs of even large-scale externalities like climate change.

A similar issue concerns the geographic distribution of the social costs of climate change. Existing estimates show that the costs of climate change will be disproportionately born by lower income regions. For instance, Africa and India are estimated to have aggregate climate damages that are nearly 900% and 1,100%, respectively, greater than those estimated for the

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[103] United Nations Environmental Programme Finance Initiative, *Changing Course: A comprehensive investor guide to scenario-based methods for climate risk assessment, in response to the TCFD* (2019).

[104] *Id.* at 16. Physical risks are what economists would consider the social costs of climate change, including all effects on human society described in the IPCC 2022 report summarized above. Transition risks, on the other hand, refer to business issues raised by the shift from a high-carbon economy to a low-carbon economy induced by technological change and government policy. For example, the risk that an oil company's proven reserves would fall in value due to the imposition of a carbon tax or fall in demand for oil would constitute a transition risk but should not be considered a social cost of climate change in an economic sense. The PVM approach aspires to induce companies to internalize the physical risks posed by greenhouse gas emissions. Tallarita, *supra* note 82, at 6.

United States.[105] In contrast, the market portfolio of public company securities is tilted toward economic activity in North America and Europe. The standard measure of the extent to which a country's economic activity occurs through public companies is the country's market-cap-to-GDP ratio. In general this is much higher for developed economies like those in North America and Europe that are relatively less exposed to the costs of climate change than for the developing economies that face the largest risks.[106]

This geographic mismatch problem also raises difficulties for one of the standard methodologies for estimating the degree to which reductions in carbon emissions would increase diversified investors' portfolio values. For instance, in an influential paper in *Nature Climate Change*, Simon Dietz and co-authors estimated that, relative to a world without climate risk, investors could expect to lose $2.5 trillion due to the impact of climate risk on global financial assets.[107] Madison Condon likewise estimates that if BlackRock could induce Chevron and Exxon to cut industrial emissions such that 1% of industrial emissions were removed each year through 2100, the global reduction in climate damages would have a net present value of $385 billion.[108] Given the size of BlackRock's portfolio, she estimates that BlackRock would therefore avoid damages to its portfolio with a net present value of $9.7 billion, which would be sufficient to offset BlackRock's losses in the equity values of Chevron and Exxon.[109] But to arrive at these estimates, these scholars all utilize William Nordhaus's Dynamic Integrated Climate-Economy ("DICE") model to estimate the impact of climate change on global GDP growth. They then assume that climate change will have a proportional effect on global financial assets given past research showing that aggregate financial returns generally track GDP growth.[110] However, the DICE model integrates the heterogeneous effects of climate change on different countries to produce a single estimate of climate change on global GDP growth, ignoring the fact that the costs of climate change will not be shared equally across all countries. This methodology therefore overestimates the effect of climate change on the growth rate for the market

[105] WILLIAM NORDHAUS AND JOSEPH BOYER, WARMING THE WORLD: ECONOMIC MODELS OF GLOBAL WARMING 91 (2000).

[106] *See* Martin Čihák et al., *Financial Development in 205 Economies, 1960 to 2010*, NBER Working Paper 18946, 12 (2013).

[107] Simon Dietz et al., *'Climate Value at Risk' of Global Financial Assets*, 6 NATURE CLIMATE CHANGE 676, 678 (2016).

[108] Condon, *supra* note 80, at 45–46.

[109] *Id.*

[110] See Dietz, *supra* note 107, at 678; Condon, *supra* note 80, at 46 n. 237. A further problem with Professor Condon's analysis is that she uses the wrong denominator for the fraction of climate change impacts internalized by BlackRock's portfolio under management. Formally, Condon first estimates the present value of the reduction in climate damages on global GDP and then assumes that the value of the damage reduction to BlackRock is based on BlackRock's share of the global economy based on the ratio of BlackRock's assets under management ($7.43 trillion) to global GDP (roughly $80 trillion). Because global GDP is a measure of income, the relevant denominator for this purpose should be global financial assets, or roughly $144 trillion according to Dietz et al. Using the correct denominator, Professor Condon's figure would fall from $385 billion to just $214 billion.

portfolio, which is tilted toward economic activity in North America and Europe.

A related issue with the objective function of PVM is that it discounts future costs and benefits using the opportunity cost of capital. But for costs and benefits that play out over long time scales that span generations, like those of climate change, economists typically apply a discount rate that is much lower than the opportunity cost of capital to account for intergenerational distributional considerations.[111] This results in the PVM approach massively undercounting the costs of climate change, most of which will not accrue for many decades.[112]

To give a rough numerical sense for the magnitude of this issue, note first that the present value of the future costs of climate change, when using social discount rates in the range typically used for climate policy, stems largely from impacts that will occur beyond the year 2200.[113] To simplify, suppose that all of those impacts occurred in 2200, which is 177 years from now. Suppose that the right social discount rate to use to convert those costs to present value is 2%, a number often used by experts.[114] At that social discount rate, each dollar of future climate change costs should be discounted by the factor $1/1.02^{177}$, which comes out to 0.03. A $1 trillion future climate change cost in 2200 would then be considered worth $30 billion in present value terms. But applying the 12% real discount rate typically used by corporate managers, the PVM approach would use a discount factor of just $1/1.12^{177}$, or 0.000000002. Under the PVM approach, that $1 trillion future social cost of climate change comes out to just $1,943 in present value terms. Or in different terms, the PVM approach would capture only the fraction $(1/1.12^{177})/(1/1.02^{177})$, or 0.00000007, of the present value of the costs of climate change in 2200 (and even less of those beyond). Even if managers used a much lower discount rate of 7% under PVM, this fraction still comes out to just 0.0002. Discounting alone thus results in the PVM objective function internalizing only a trivial fraction of the social costs of climate change.

The UNEP FI report also illustrates another conceptual problem with the PVM approach: the methodology incorporates the positive business opportunities created by climate change for companies in the market

[111] Moritz A. Drupp et al., *Discounting Disentangled*, 10 AM. ECON. J.: ECON. POL'Y 109 (2018).

[112] Tallarita, *supra* note 82, at 20–25.

[113] For example, in the influential Stern Review of the Economics of Climate Change, 90% of the present value of the social costs of carbon emissions today stem from impacts that occur after 2200. Nicholas Stern, *The Economics of Climate Change*, 98 AM. ECON. REV. 1, 20 (2008).

[114] Drupp et al., *supra* note 111, at 109–134, 111 (finding that over three-quarters of experts find a 2% social discount rate acceptable). The EPA in a recent analysis of the social costs of carbon similarly used 2% as its central discount rate target. *See* Environmental Protection Agency, Supplemental Material for the Regulatory Impact Analysis for the Supplemental Proposed Rulemaking, *Standards of Performance for New, Reconstructed, and Modified Sources and Emissions Guidelines for Existing Sources: Oil and Natural Gas Sector Climate Review* 2 (2022), https://www.epa.gov/system/files/documents/2022-11/epa_scghg_report_draft_0.pdf.

portfolio.[115] The transition to a low-carbon economy and adaptation to a warming planet will require investment in technologies and infrastructure in a range of sectors. To give one example, consider a concrete seawall installed in New York Harbor to address storm surges caused by climate change. The Army Corps of Engineers has proposed the construction of such a barrier at a cost of some $119 billion.[116] If such a seawall were built in order to deal with climate change, it would count as among the negative externalities of climate change—it is a real resource use caused by the warming of the planet. But from a PVM perspective, the construction of a seawall represents an enormous business opportunity. In other words, while the aspiration of the PVM approach is to incorporate such costs as negative adjustments to expected cash flows for business projects that contribute to climate change (i.e., negative E_t's in the PVM-adjusted NPV expression above), in fact faithful application of the PVM approach would incorporate them at least in part as positive adjustments since the construction of the seawall will produce profits for companies in the market portfolio (i.e., as positive E_t's).

A final problem with the PVM objective function's treatment of technological externalities is with respect to its interaction with public policies designed to address such externalities. Consider for example a pollution externality caused as a byproduct of a certain production process, and suppose the externality is addressed at the public policy level with a Pigouvian tax set at the marginal social cost of the externality. As a result, the private profit-maximization problem facing firms that emit that form of pollution mirrors the social problem of choosing efficient behavior. But consider what would happen if managers of the polluting firms were instead to set firm policy following the PVM approach. Those managers would consider not only the Pigouvian tax but also the portion of the externality that reduced the value of other firms in the portfolio, so that a portion of the externality would be "double counted." As a result, they would, at the margin, be over-deterred from producing pollution. In short, the PVM approach, unlike ESV, does not integrate well with public policy approaches to addressing externalities.[117]

In contrast to these failures with respect to technological externalities, the PVM approach is far better suited to capture pecuniary externalities. One reason is that pecuniary externalities largely involve a company's competitors, a significant fraction of which are public companies. Consider the airline industry, which is dominated by public companies.[118] When Delta

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[115] UNEP FI, *supra* note 103, at 44–45.

[116] Anne Barnard, *The $119 Billion Sea Wall That Could Defend New York ... or Not*, N.Y. TIMES (Jan. 17, 2020), https://www.nytimes.com/2020/01/17/nyregion/the-119-billion-sea-wall-that-could-defend-new-york-or-not.html.

[117] This problem could be mitigated, in principle, by calibrating the level of the Pigouvian tax to be equal to the portion of the externality that falls on interests other than securities in the market portfolio. However, it is not clear how policymakers could determine that amount.

[118] *See* Niraj Chokshi, *Frontier Airlines I.P.O. Signals a Travel Industry Recovery*, N.Y. TIMES, (Apr. 1, 2021) https://www.nytimes.com/2021/04/01/business/frontier-airlines-ipo.html (noting

Airlines cuts its fares on the DC – Boston route and gains market share, it reduces the value of its competitors on that route, which are largely public companies. As we noted above, however, this feature of PVM is really a bug. If companies fully maximized diversified investors' portfolio value, the resulting reduction in competition would harm consumers and workers even as it benefited investors. The PVM objective function thus poses significant harms to firm patrons relative to the ESV baseline.

To summarize, the objective function under PVM is socially perverse. It fails to capture effectively much of the technological externalities produced by corporate activities while at the same time could produce a form of market power that would be socially destructive to firm patrons. By our lights the PVM objective function is unattractive as a normative matter.

B. Feasibility for Corporate Managers

We now consider whether managers would have the information and incentives they would need to pursue the stated corporate objective under each approach. We begin by reiterating the insight that both SSP and PVM effectively build on ESV since long-term shareholder value is a primary component of both shareholder welfare and portfolio value. As such, we first evaluate the information and incentive problems that might confound implementing long-term shareholder value as the corporate objective under ESV. Having established these problems as a baseline, we then turn to analyzing SSP and PVM and ask to what extent managers would have the information and incentives to act on the additional considerations that each adds to the corporate objective in ways that would in practice improve CSR relative to the outcome under ESV.

1. Enlightened Shareholder Value

a. Information. The informational burden of ESV is considerable. Part of the challenge stems from the inevitable uncertainty with respect to contingencies far out in the future. As we have emphasized, ESV arguments for CSR often have a temporal structure in which the company incurs costs in the near term in order to achieve benefits to stockholders that play out over a long period into the future. Consider, for example, investing in renewable energy, shutting down a dirty factory, or auditing the supply chain for safe labor practices. To what extent would sacrificing corporate profits in those ways today enhance shareholder value over the long-term?

While these questions are no doubt complicated, we view the information gathering and analytic challenges posed by ESV as squarely in the wheelhouse of corporate management. First, the intertemporal structure typical of ESV is not unique but rather is standard fare in business management. Corporate managers face similar intertemporal challenges in many other aspects of business strategy unrelated to CSR. Should the firm expand production? Should it invest more in research and development?

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that as of 2021, the ten largest airlines in the U.S. are publicly listed).

Does it have the optimal capital structure? Business schools train managers in analytic techniques—most prominently discounted cash flow analysis—to grapple with such ubiquitous tradeoffs and uncertainties entailed by managing a business.

As well, the specific strategic issues raised by CSR under the ESV approach are today part of the bread-and-butter of business school curriculums. New York University's Stern School of Business, for example, currently offers no fewer than 33 courses under the "Sustainable Business and Innovation" specialization, including course titles such as "Corporate Branding & Corporate Social Responsibility," "Sustainability for Competitive Advantage," and "Sustainable Capitalism: A Longer Term Finance Perspective."[119] From the course catalogs alone, it is clear that ESV is a major part of the analytic toolkit and worldview imparted to MBA students. Indeed, business school professors are among the most vociferous proponents of ESV, writing book after book about how a "stakeholder approach" to management maximizes the long-term value of the corporation.[120]

Stock prices provide an additional source of information for a manager trying to understand the long-term value generated by current corporate policies. Stock markets incentivize the production and aggregation of information about corporate value by stock traders. Even if a manager is concerned that stock prices do not fully reflect long-term value, stock prices surely provide some relevant information to management regarding how to maximize long-term value. For example, the fact that Tesla and General Motors trade today with price-to-earnings ratios of 40 and 6, respectively, must say *something* about the future of internal combustion engines.

In summary, while maximizing long-term shareholder value under ESV puts a substantial informational burden on corporate management, there are good reasons to believe that managers are able to assemble and process a great deal of information about how best to further stakeholder interests so as to maximize long-term shareholder value.

b. Incentives. Although ESV strikes us as substantially feasible from an information perspective, the story is more complicated with respect to managers' incentives. As discussed in Part I, one reason for optimism stems from the structure of corporate law, which is generally designed with the goal of incentivizing management to maximize long-term shareholder value. Furthermore, Delaware courts have *required* corporate boards to put in place

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[119] NYU STERN SCHOOL OF BUSINESS COURSE INDEX, https://www.stern.nyu.edu/programs-admissions/full-time-mba/academics/course-index. By comparison, a mere 10 courses are offered at NYU under the "Real Estate" specialization. *Id.* Not to be outdone, UC Berkeley's Haas School of Business maintains the Institute for Business and Social Impact, which oversees three separate centers focused on corporate sustainability and curates the Michaels Graduate Certificate in Sustainable Business. MBA students at Haas can choose from 29 courses focused on corporate sustainability such as "Climate Change and Business Strategy," "Business and Sustainable Supply Chains," and "Strategic and Sustainable Business Solutions." BERKELEY HASS INSTITUTE FOR BUSINESS & SOCIAL IMPACT, https://haas.berkeley.edu/ibsi.

[120] *See, e.g.,* FREEMAN, *supra* note 26; EDMANS, *supra* note 42.

information and reporting systems designed to safeguard against risks to the company's stakeholders that might ultimately harm shareholder interests through, for example, sullying the company's reputation.[121]

Executive compensation for senior officers also produces substantial incentives for managers to maximize shareholder value. Much of these incentives stem from the significant equity component of managers' pay packages, which directly links the wealth of managers to the wealth of shareholders. For example, for the median CEO of an S&P 500 firm as of 2011, a 1% increase in the value of the company's shares would produce an increase in the wealth of the CEO of about $500,000 due to their holdings of company stock and stock options.[122]

Yet, while corporate governance is very much oriented toward the long-term shareholder value corporate objective of ESV, by no means does our corporate system produce perfect incentives for corporate management to maximize long-term shareholder value. Perhaps most obviously, standard agency cost theory teaches that whenever managers do not own 100% of the firm's residual claims their incentives are not perfectly aligned with those of shareholders.[123] The literature on such incentive problems is vast and we will not rehearse it all here. For present purposes we concentrate on the main incentive problems that result in failure to engage in forms of CSR that would benefit shareholders.

Perhaps the primary incentive problem related to ESV is corporate "short-termism," in which management focuses myopically on short-run profitability at the expense of long-term shareholder value.[124] A key premise of the standard short-termism argument is that the firm's stock price does not fully reflect what management knows about the value of the firm, for example because of information asymmetries between managers and investors.[125] Consider the following stylized example. Suppose that managers had private information that an expenditure of $80 (e.g., additional investment in research and development) would increase expected profits by $100. However, investors—because they lack managers' private information—place only 50% probability on profits increasing by $100 and 50% probability on profits remaining the same from this investment.[126] As a result, investors would view the investment as having an NPV of -$30,

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[121] *See, e.g., Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019).

[122] Kevin J Murphy, *Executive Compensation: Where We Are, and How We Got There*, 2 *in* HANDBOOK OF THE ECONOMICS OF FINANCE 211 (George M Constantinides, Milton Harris, & Rene M Stulz eds., 2013), http://www.sciencedirect.com/science/article/pii/B9780444535948000045.

[123] Jensen and Meckling, *supra* note 10. Concern about this problem, of course, is as old as the business corporation itself. *See* ADAM SMITH, THE WEALTH OF NATIONS (1776); ADOLF A. BERLE JR & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

[124] *See, e.g.,* Who Cares Wins, *supra* note 44, at 5 ("The use of longer time horizons in investment is an important condition to better capture value creation mechanisms linked to ESG factors.").

[125] *See* Jeremy C. Stein, *Takeover Threats and Managerial Myopia*, 96 J. OF POL. ECON. 61 (1988).

[126] This example draws on the formal model presented in Stein, *supra* note 125.

whereas managers would view the investment as having an NPV of $20. In this fashion, the company's stockholders might undervalue a change in a company's operations that would increase long-term shareholder value.

For such market myopia to actually affect corporate decision-making, however, some sort of "transmission mechanism" must exist that induces corporate management to focus on increasing the company's short-term stock price rather than long-term shareholder value.[127] One such mechanism is the corporate takeover market.[128] In particular, managers might be concerned that if the market undervalues the long-term value of a particular strategy, a corporate raider might exploit the temporary mispricing in the company's stock and acquire the company at a price that does not reflect the long-term value of the company, thus deterring managers from undertaking the strategy. In today's corporate landscape, however, a more common version of this concern involves hedge fund activists who take only a minority stake in a target and then agitate for operational or financial changes that might increase the company's share price even if the changes undermine long-term shareholder value.[129] As with corporate takeovers, even just the threat of such activist interventions might produce managerial myopia more broadly by incentivizing management to pay excessive attention to short-term results for fear of the company becoming a target.[130] Even more directly, modern executive compensation packages generally make managers themselves short-term stockholders, and there is some evidence that vesting equity induces CEOs to cut back on long-term corporate investments[131] and to engage in stock repurchases and corporate acquisitions that impair long-term shareholder returns.[132] Corroborating the hypothesis that short-termism might inhibit both firm performance and CSR investments is evidence that both firm performance and investments in stakeholder relationships increase as a result of reforms that improve executives' long-term incentives.[133] The extent of managerial short-termism remains controversial,[134] but it provides a coherent conceptual account for why corporate managers might sometimes fail to engage in CSR that would ultimately increase long-term shareholder value.

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[127] Mark J. Roe, *Corporate Short-Termism—In the Boardroom and in the Courtroom*, 68 BUS. LAW. 977 (2013).

[128] Stein, *supra* note 125, at 63; Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979).

[129] Martijn Cremers, Saura Masconale & Simone M. Sepe, *Activist Hedge Funds and the Corporation*, 94 WASH. U. L. REV. 261 (2016).

[130] Robert Kuttner, *The Truth about Corporate Raiders*, New Republic (1986); *cf* Stein, *supra* note 125.

[131] Alex Edmans, Vivian W. Fang & Katharina A. Lewellen, *Equity Vesting and Investment*, 30 REV. OF FIN. STUD. 2229 (2017).

[132] Alex Edmans, Vivian W. Fang & Allen Huang, *The Long-Term Consequences of Short-Term Incentives*, 60 J. OF ACCT. RSCH. 1007 (2022).

[133] Caroline Flammer & Pratima Bansal, *Does a long-term orientation create value? Evidence from a regression discontinuity*, 38 STRATEGIC MGMT. J. 1827 (2017).

[134] For a skeptical view, *see* Mark J. Roe, *Stock Market Short-Termism's Impact*, 167 U. PA. L. REV. 71 (2018).

Other kinds of agency problems can also inhibit CSR under the ESV approach. For instance, managers might engage in empire-building or otherwise over-invest in ways that harm long-term shareholder value. For firms that operate in high-negative-externality industries—fossil fuel production, say—such overinvestment can harm other interests in society as well. Alternatively, disloyal managers might claim to sacrifice short-term profitability to further stakeholder interests in the name of long-term value creation when in fact they are engaged in a form of self-dealing.

To summarize, management pursuit of ESV is neither hopeless nor a sure thing. We can expect corporate managers to be able to gather and analyze a substantial amount of the information needed to engage in CSR under the ESV approach and to have considerable incentives to do so, but their information and incentives will not be perfect.

2. Shareholder Social Preferences

Consider now the extent to which changing the corporate objective from long-term shareholder value under ESV to shareholder welfare under the SSP approach is likely to make corporate conduct more socially responsible. For this reform to achieve its goal of increased corporate social responsibility, corporate managers need both information about their shareholders' social preferences and incentives to act on that information.

a. Sorting of shareholders. A key premise of the SSP approach is that shareholders have social preferences that make them willing, in aggregate, to sacrifice shareholder value in order for the corporation to act more in line with their values. But as an initial matter, will socially-minded investors actually be willing to hold the stock of companies whose operations raise the greatest social concerns? So far we have maintained the simplifying assumption that all shareholders are perfectly diversified. In practice, however, shareholders' incentives to hold the shares of a particular issuer will in fact depend on their social preferences. This is because shareholders' social preferences are, at least in important part, *associative*. By associative we mean that shareholders prefer not to own shares in (or otherwise be associated with) companies whose business practices they find morally objectionable. One source of evidence for this stems from the portfolios of "ESG" mutual funds that are marketed to appeal to such investors, which are tilted towards companies with high ESG scores.[135] In turn, mutual funds marketed as socially responsible are disproportionately held by more pro-social investors.[136] The result of such shareholder sorting is to further reduce

[135] Quinn Curtis, Jill E. Fisch & Adriana Robertson, *Do ESG Mutual Funds Deliver on Their Promises?* at 32 (2021), https://papers.ssrn.com/abstract=3839785.

[136] Arno Riedl & Paul Smeets, *Why Do Investors Hold Socially Responsible Mutual Funds?*, 72 J. FIN. 2505 (2017). Individuals' direct holdings of stock exhibit a similar phenomenon. In particular, individuals who vote in favor of shareholder proposals pressuring the company to act more responsibly are more likely to hold renewable energy firms and less likely to hold fossil fuel producers. Jonathon Zytnick, *Do Mutual Funds Represent Individual Investors?* at 12 (2021), https://papers.ssrn.com/abstract=3803690 ("[I]ndividuals who vote in favor of SRI proposals are more likely to own renewable energy firms and less likely to own fossil fuel producers.").

the importance of shareholder social preferences in the shareholder welfare objective function for the very corporations for which there is the most at stake in terms of CSR. The shareholders that hold companies that raise the greatest social concerns will be systematically the investors least concerned about those social issues.

Professors Hart and Zingales, in proposing the SSP approach, in contrast adopt a very different assumption about the form of investors' social preferences and how they manifest in behavior. They assume that shareholders care about corporate behavior only to the extent that they feel *responsible* for it.[137] Under their view, environmentalists would have no qualms about owning shares in a coal mining company. Their social preferences would manifest only if they were asked to decide on some specific operational matter that would implicate their environmentalist views. If shareholders were asked to vote on whether the company should adopt a more environmentally responsible mining technique, say, that would lower shareholder returns to some extent, environmentalist shareholders might vote yes, depending on the weight they put on their environmentalist views and the extent of the lower shareholder return entailed. But under Hart and Zingales's view they would not hesitate to invest in the first place, even if there were no prospect for them to influence the firm's environmental practices. Hart and Zingales thus propose an "invest and engage" model of socially responsible investing. But if shareholders' social preferences are strongly associative, as existing evidence suggests, then this model would work only for companies with operations that are already relatively socially responsible, substantially undercutting the potential of SSP to improve corporate conduct.[138]

b. Information. In order for the shift to shareholder welfare as the corporate objective to affect corporate behavior in the intended way, managers must have information about their shareholders' aggregate social preferences. As a preliminary matter, note that the basic economic logic of centralized management would continue to apply under the SSP approach. Diversified shareholders generally lack the information and expertise needed to understand the tradeoffs available between firm value and social concerns, so devolving operational decisions to shareholders to any substantial extent, for example through shareholder voting, would make little economic sense. Put simply individual shareholders are unlikely to know what corporate policies would maximize their utility.

Consider for example the shareholders of a social media company.

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[137] Hart and Zingales, *supra* note 68, at 253.

[138] To be sure, it could be that the current practice of "associative avoidance" rather than "invest and engage" is a function of current corporate governance institutions oriented around shareholder value. Although we are skeptical, it is possible that moving to the SSP regime could cause shareholders to change their sorting behavior and adopt an "invest and engage" model of socially-responsible investment. But such a shift would require that the SSP approach make a substantial difference in corporate behavior, and in what follows we provide further reasons to believe that it would not. *See infra* notes 139 – 153 and accompanying text.

Many of these shareholders might share a belief that the corporation should protect the privacy and data of its users, but they likely have little knowledge of the different corporate policies that could advance those interests and the tradeoffs they would entail. Shareholders could, in principle, inform themselves of the relevant options and their associated costs, but doing so would entail costs that would likely deter diversified shareholders from doing so. This is especially so if those preferences will be elicited by management through some sort of majoritarian voting rule, resulting in a negligible probability that any individual shareholder's preferences will be pivotal.[139]

Consider then instead the possibility that management might learn information just about the content and strength of shareholders' social preferences rather than shareholders' views about specific corporate policies. Even at this raw preference level, however, we are skeptical that shareholders have clear preferences in any meaningful sense about the relevant trade-offs, much less that management could realistically learn much about them. For example, consider again a social media company. Another major social concern about social media is its role in the spread of disinformation. Suppose you, dear reader, were a shareholder of a social media company that had been plagued by such problems in the past. How much return would you be willing to sacrifice in order to reduce this problem? If you are like us, you are having trouble even coming up with a coherent metric for expressing such a preference. Are you willing to sacrifice 50 basis points in return for a reduction of 1 … disinformation unit?

Even if shareholders were able to formulate their social preferences about corporate conduct, there remains the challenge that managers face in eliciting those preferences and acting upon them. Hart and Zingales propose that managers can acquire information regarding shareholder preferences by allowing shareholders to vote on a broader range of corporate activities, but there are limits to the use of voting as a preference elicitation device. For one, the costs to shareholders of engaging in such voting is likely prohibitive. More fundamentally, shareholder voting provides information about the stated preferences of shareholders but not necessarily their revealed preferences. As a result, a risk exists that asking what any given shareholder prefers in terms of social issues and investment returns might result in the shareholder expressing a preference that is inconsistent with the policy the shareholder would adopt if forced to pay directly for the policy adoption.[140]

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[139] Skepticism regarding whether shareholders are well-positioned to evaluate specific corporate policies also appears in the SEC's policy of excluding 14a-8 proposals that seek "to 'micromanage' the company by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment." Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 40,018, Investment Company Act Release No. 23,200, 63 Fed. Reg. 29,106, 29,108 (May 28, 1998).

[140] Economists are traditionally skeptical of using stated preference methods for eliciting individuals' valuations of public goods and the like as a guide for welfare analysis. After surveying the empirical literature documenting biases and inconsistencies in responses to surveys eliciting individuals' valuations of various environmental amenities, Peter Diamond and Jerry Hausman

As well, we might question whether preference elicitation is in the wheelhouse of corporate managers.

These informational challenges facing SSP are not much diminished when we consider intermediation by institutional investors. Hart and Zingales propose that such intermediaries might provide a means of lowering the cognitive load on diversified investors of expressing their social preferences over corporate conduct.[141] Prosocial investors could simply invest in a prosocial mutual fund that will vote its portfolio company shares in order to advance the investors' social preferences. But this essentially just moves the information problem down one level: how can the fund's manager learn about the social preferences of its investors in order to relay that information to corporate managers?

One possibility, suggested by Hart and Zingales, is that investors can "vote with their feet" by sorting into funds that have a track record of voting that investors find attractive.[142] Indeed, Michal Barzuza, Quinn Curtis, and David Webber argue that index fund providers have become increasingly vocal about their voting records on ESG issues in order to compete for millennial investors, who they argue place a significant premium on social issues.[143]

But empirical evidence provides little support for the idea that investors sort into mutual funds based on their voting policies. For instance, using a dataset that contains the voting records of both individual investors and the mutual funds in which they invest, Jonathon Zytnick examines whether mutual funds vote on CSR-related matters in the same way that their investors vote on CSR-related matters when these investors cast ballots as shareholders.[144] Overall, he finds little overlap between investor preferences and fund voting, especially within index funds.[145] Zytnick attributes the

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conclude that the problems with such stated preference methods:

> come from an absence of preference, not a flaw in survey methodology. That is, we do not think that people generally hold views about individual environmental sites (many of which they have never heard of); or that, within the confines of the time available for survey instruments, people will focus successfully on the identification of preferences, to the exclusion of other bases for answering survey questions. This absence of preferences shows up as inconsistency in responses across surveys and implies that the survey responses are not satisfactory bases for policy.

Peter A. Diamond & Jerry A. Hausman, *Contingent Valuation: Is Some Number Better than No Number?*, 8 J. ECON. PERSP. 45, 63 (1994).

[141] Hart and Zingales, *supra* note 68, at 263.

[142] *Id.* at 264.

[143] *See* Michal Barzuza, Quinn Curtis, and David Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance* 93 S. CAL. L. REV. 1243 1265–68 (2020).

[144] Zytnick, *supra* note 136.

[145] One exception is with respect to ESG funds, which typically vote in favor of CSR-related initiatives, which is consistent with how their investors cast ballots as individual shareholders. But note that ESG funds typically focus on screening out firms with poor ESG track records, reflecting our view that investors' social preferences are to a large extent associational.

overall lack of sorting to rational inattention: As in political voting, investors rationally choose not to investigate how an intermediary votes due to the small likelihood that their investment will cause the intermediary's votes to be pivotal.[146]

Hart and Zingales argue that the lack of investor sorting is due to current corporate governance rules that limit the scope of shareholder voting on CSR.[147] However, even in the absence of such limitations, we question whether sorting among funds based on how they vote on social issues would provide meaningful information to managers about their shareholders' social preferences. First, as we argued above, we doubt that investors have sufficiently well-formed preferences about corporate conduct such that it is even possible for sorting to convey information to corporate managers about those preferences. Second, it would remain prohibitively costly for shareholders to evaluate the stated policies of asset managers. It is not as simple as environmentally-minded shareholders buying a "green" mutual fund. As we have emphasized, shareholders' social preferences are heterogeneous, both in terms of their strength relative to wealth in their utility function and in terms of their content. Individual investors will often differ in how they evaluate the tradeoffs entailed when a company implements specific CSR-related policies.

Consider, for example, a fund dedicated to carbon reduction. Across the range of policy-interventions a company might take to reduce its carbon footprint, how will investors know which ones a "Reduce Carbon Fund" will pursue, or how it will evaluate the inevitable tradeoffs implicated by each course of action? While some investors may adopt a "hell or highwater" (hah) approach to carbon reduction, others may condition their support on evidence that the intervention will enhance long-term shareholder value. These problems are further compounded in cases in which a corporate decision involves a tradeoff between competing social values and not just between a single social issue and investment returns. Many shareholders, for example, might have concerns about the implications of a given carbon reduction policy proposal on other stakeholders, such as workers or communities who may be adversely impacted by it.[148]

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[146] Zytnick, *supra* note 136, at 19.

[147] Hart and Zingales, *supra* note 68, at 264. State corporate law, for example, gives the board and not shareholders the legal authority to manage the business and affairs of the corporation. This norm prevents shareholders from restricting the board's substantive decision-making authority by enacting bylaws that direct particular substantive outcomes in terms of CSR. *See CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 234–35 (Del. 2008). In turn, Rule 14a-8 of the federal proxy rules, which gives shareholders the right to put certain shareholder proposals on management's proxy for the annual shareholder meeting, allows management to exclude proposals that are not "not a proper subject for action by shareholders under the laws of the jurisdiction of the company's organization." 17 C.F.R. § 240.14a-8(h)(3)(i) (2022).

[148] Indeed, BlackRock, which is the largest asset manager in the U.S., recently announced a new program called "Voting Choice" whereby it will allow its clients to choose how to vote the portfolio securities of certain BlackRock funds managed on their behalf. *See* BlackRock, "Shareholder Rights Directive II – Engagement Policy" (January 2022), available at https://www.blackrock.com/corporate/literature/publication/blk-shareholder-rights-directiveii-

A final problem with using shareholder voting and similar mechanisms to convey social preference information to corporate management is that shareholders will express their overall preferences about corporate policy, not just the part concerning shareholder value and their social preferences. For diversified shareholders, those overall preferences would include the portfolio effects that PVM—and not SSP—envisions incorporating into the corporate objective. As a result, attempts to implement the SSP approach, to the extent they are successful in tilting corporate decisions toward what shareholders want, will in practice blur into pursuit of the PVM objective, including the anticompetitive aspects of it that are socially destructive.

c. Incentives. As we argued above, shareholder value is a much more important component of shareholder welfare than shareholder social preferences, given heterogeneity and conflicts among shareholders regarding the relevant welfare trade-offs and sorting based on associative preferences. Our analysis also revealed that management has much better information about long-term shareholder value than it has about shareholders' social preferences. In such a setting—with one far more important component of the objective function for which information is readily available, and one far less important component for which information is not available—the best scheme for incentivizing corporate management to pursue shareholder welfare under the SSP approach focuses management attention squarely on the important and measurable component, long-term shareholder value, and thus is essentially identical to the ESV approach.

Our argument builds on insights from "multitask principal-agent problems" from contract theory.[149] These models entail a principal who hires an agent to perform several tasks or, similarly, a single task with multiple dimensions to it. A common problem in such an environment arises when performance on one dimension of the job is easily measurable while performance on another dimension is difficult to measure. Teacher performance is a classic example. Standardized tests can measure one dimension of teacher performance, but other aspects—promoting creativity or communication skills—are much harder to measure. In such a setting, the agent decides how to allocate effort across the dimensions of the job, and an increase in incentives on the more easily measurable dimension of their performance will result in the agent reallocating their effort toward that dimension and away from the others.

In a pathbreaking article working through the implications of such a setting for contract design, Bengt Holmstrom and Paul Milgrom argued that the optimal contract might entail very low-powered incentives, like a fixed

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engagement-policy-2022.pdf. While the initial program includes only institutional clients, the firm has announced that it is "committed to a future where every investor — even individual investors — can have the option to participate in the proxy voting process if they choose." Fink, 2022 Letter to CEOs, *supra* note 91. We suspect that this emerging devolution of voting responsibility to beneficial owners reflects the intractability of the conflicts among shareholders in their social preferences, which undermine the SSP approach.

[149] Bengt Holmstrom & Paul Milgrom, *Multitask Principal–Agent Analyses: Incentive Contracts, Asset Ownership, and Job Design*, 7 J. LAW. ECON. ORG. 24 (1991).

wage, in order to avoid distorting the agent's effort too much in the direction of the more easily measurable dimension of the job.[150] In the application to teachers, the idea is that paying teachers based on a fixed salary would result in better overall teacher performance than paying them based on the performance of their students on standardized tests since the more balanced allocation of teacher effort across the different dimensions of their job that would result is more important than the fall in overall effort from giving up on high-powered incentives on the measurable aspect of their performance.

In our setting, a low-powered incentive contract in the spirit of Holmstrom and Milgrom's analysis would entail giving up on providing managers high-powered incentives to maximize shareholder value in order to induce them to put some effort into measuring and furthering shareholders' social preferences. For example, managers could be paid like bureaucrats, with fixed salaries and no equity-based component to their pay. But this is not the optimal contract here, for two reasons.

First, as we have explained, long-term shareholder value is a more important component of shareholder welfare than is shareholder social preferences—by far—and in addition managers have much better information about how to maximize shareholder value than about how to satisfy shareholders' social preferences. As a result, managerial effort to maximize shareholder value is generally much more productive, in shareholder welfare terms, than is managerial effort to further shareholders' social preferences. Consider, then, how shareholders would ideally want managers to allocate their finite time and attention across those two tasks. For the sake of argument, suppose that management were to focus exclusively on maximizing shareholder value and ignored shareholders' social preferences. From this benchmark, would shareholders' welfare increase if management were to divert some of its attention to figuring out how best to further shareholders' social preferences? We think not. The resulting fall in shareholder value would matter more to shareholder welfare than whatever small improvement management could achieve in better aligning firm policy to reflect shareholders' social preferences.

Second, suppose we are wrong about that, and in fact shareholders would ideally want management to devote at least some attention to furthering shareholders' social preferences. That alone is not sufficient for the optimal incentive contract for management to be one that avoids high-powered incentives to maximize firm value. The optimal design of incentives depends not only on the relative productivity of management's efforts on the two tasks but also on management's intrinsic motivation to pursue the tasks as well as on the availability of good incentive instruments to motivate managerial effort on each of the tasks.

In the application of the Holmstrom and Milgrom multitask model to the problem of incentivizing teachers, a fixed wage contract results in teachers' effort being driven by their intrinsic motivation to help students

[150] *Id.*

learn. In the educational context, it seems plausible that teachers have substantial intrinsic motivation—presumably many teachers enter the profession not because the pay is high (it's not) but rather because they like teaching and care about students. As a result of their intrinsic motivations, the fixed wage contract for teachers results in substantial effort across both the measurable and non-measurable dimensions of their performance.

But in the corporate context, we think intrinsic motivations play a much smaller role relative to extrinsic motivations. As a result, giving up on extrinsic incentives would result in a substantial fall in managerial effort on maximizing firm value, and for little benefit; it is hard to see why corporate managers would have much intrinsic motivation to figure out shareholders' social preferences and seek to further them.

In terms of the availability of incentive instruments, the key issue is whether there are good proxies for the agent's performance to base their compensation on. When an agent is paid on the basis of some performance measure, they will have incentives to increase the performance measure, which might not produce the desired results. The basic analytic point here is captured evocatively in the title of a classic article in the management literature: "On the Folly of Rewarding A, While Hoping for B."[151] In the teacher context, there might not be great proxies even for the relatively measurable aspects of the job. Consider the practice of paying teachers based on their students' test scores. The hope is that doing so will motivate teachers to teach better. But following the introduction of incentive pay based on test scores for teachers in Atlanta, ten teachers and administrators were caught helping students cheat on the test to inflate their scores.[152] Put simply: you get what you pay for.

The implication for the optimal design of incentives is that the fall in effort on the measurable dimension of performance from switching from a high-powered incentive scheme to low-powered incentives depends on how well that dimension of performance can in fact be measured.[153] In teaching, test scores are a potentially problematic measure even of the aspects of teacher performance they purport to measure, as the cheating scandal illustrates in extreme form. This measurement problem then reduces the benefit, in terms of student learning, of paying teachers based on the proxy. In contrast, in the corporate context, we lack this problem of a poor proxy for shareholder value. The shareholder value component of shareholder welfare is ultimately revealed over time as the firm's cash flows are realized. Executive compensation plans make use of that fact by employing equity-

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[151] Steven Kerr, *On the Folly of Rewarding A, While Hoping for B*, 18 ACAD. OF MGMT. J. 769 (1975).

[152] Annie Murphy Paul, *Atlanta teachers were offered bonuses for high test scores. Of course they cheated,* WASH. POST, April 16, 2015.

[153] *See* George P. Baker, *Incentive Contracts and Performance Measurement*, 100 J. OF POL. ECON. 598 (1992) ("[T]o the extent that the performance measure does not respond to the agent's actions in the same way that the principal's objective responds to these actions, the firm will reduce the sensitivity of the incentive contract to the performance measure…").

based pay and explicit bonus schemes tied to accounting measures of earnings to generate incentives to maximize shareholder value. We believe that equity-based pay can provide substantial alignment between management's incentives and shareholder value. Giving up on those incentives would therefore result in a substantial loss in shareholder value.

Finally, we do not believe it is optimal to add explicit incentives for managers to further shareholders' social preferences. The shareholder social preferences component of shareholder welfare is much harder to measure than shareholder value and remains largely hidden. Some crude proxy for shareholders' social preferences, based on surveys of shareholders or the like, would have to be constructed to use as a performance measure in management's compensation scheme. But the measurement challenges here reduce the productivity, from a shareholder welfare perspective, of trying to provide extrinsic incentives to management to take into consideration shareholders' social preferences.

In sum, the optimal incentive scheme under the SSP view focuses squarely on shareholder value, so that the SSP approach would do little to improve corporate behavior relative to the ESV baseline.

3. Portfolio Value Maximization.

Evaluating the feasibility of PVM as an alternative corporate objective requires assessing whether corporate managers might have the information and incentives needed to incorporate the effects of the firm's decisions on the value of their shareholders' portfolios into their decision-making process, above and beyond how those decisions affect the long-term value of the corporation. We show here that there are good reasons to think they will not.

a. Information. A first type of information managers would need under PVM is on the composition of the portfolios held by the company's shareholders. A company's shareholders are likely to vary widely in the investment portfolios that they hold. Indeed, the large number of investment products offered as mutual funds reflects the strong demand for a broad range of investment portfolios with varying investment objectives. As of this writing, Morningstar lists over 1,800 investment funds as providing exposure to "U.S. Equity," and nearly 1,100 investment funds as providing exposure to "International Equity." Moreover, the portfolios of these funds reflect a broad range of investment theses, such as funds focused on "growth" firms, small capitalization firms, low volatility firms, dividend-paying firms, or firms operating in particular regions or sectors. Note as well that it is not enough for managers to determine what institutional investors holds the company's shares. Institutional investors serve as intermediaries for the underlying individuals on whose behalf they ultimately hold the company's shares. In turn it is those individual investors' portfolios that form the ultimate aggregate portfolio the company's managers should be trying to maximize.

To keep things simple, however, suppose corporate management assumed that the company's shareholders are fully diversified so that the

PVM objective is just the value of the market portfolio. This simplifying assumption stacks the deck in favor of the feasibility of PVM, so if PVM is not reasonably feasible under this assumption, then it certainly is not feasible in the real world.

A second type of information a corporate manager would need to pursue PVM is on the expected cash flows that alternative decisions would generate, not only for the company itself but also for other securities in shareholders' portfolios, which again for now we take to be the market portfolio. These expected cash flows to the company and to other securities in the market portfolio are the C_t's and E_t's, respectively, in the numerators of the terms in the PVM version of the expression for the NPV of a project in equation (2) above. In general, corporate managers will have much better information about the cash flows to the company (the C_t's) than they will about the portfolio externality cash flows (the E_t's).

The cash flows to the company are ultimately directly observable and of course directly implicate the business of the company, on which managers are hired to be experts. Externalities, in contrast, involve other businesses that the firm's managers will have much less information about. The information challenges posed by technological externalities are particularly acute. It is not clear how a firm's managers would be able to divine the extent to which pollution emitted by the company, say, would reduce the value of other public companies, which include a diverse array of sectors and industries. In contrast, pecuniary externalities primarily affect the company's competitors, about which firm managers are likely to have substantial information.

b. Incentives. Consider now the implications of the foregoing analysis for the incentives that firm managers have to pursue the PVM objective. The long-term value of the firm's own shares and the pecuniary portfolio externalities produced by the firm are far more important components of the PVM objective function than the technological portfolio externalities produced by the firm. One reason for this is that there exist social institutions, such as environmental regulation, designed to internalize technological externalities of corporate activity. While these institutions are certainly imperfect, they do substantially limit technological externalities. Another reason is that only a fraction of corporate technological externalities actually fall on other public companies' securities, as we explained above. As a result, when managers are considering investing in a new project, typically the primary effect it has on investors' portfolios is through its implications for the company's own value. As well, pecuniary externalities are likely to be far more important to its shareholders than technological externalities for the reasons discussed above. Note that the ordering of these three components of the PVM objective function in terms of their importance to investors mirrors their ordering in terms of the information available to managers.

Incentivizing firm managers to incorporate technological externalities into their decision-making under the PVM approach thus poses a similar

problem to that of incentivizing them to consider shareholder social preferences under the SSP approach. The most productive use of managers' scarce time and attention, in terms of improving the PVM objective function, is in working to increase the cash flows to the firm's own shares and to competing public companies. As a result, we think it likely that diversified shareholders would want managers to focus their limited time and attention on those outcomes. Diverting their attention to addressing technological portfolio externalities would likely be counterproductive for the value of shareholders' portfolios, given their relatively small role in the PVM objective function and the relatively limited information firm managers have about them. The optimal incentive contract for managers under the PVM approach would thus focus squarely on the long-term value component of the objective function and put little or no weight on technological externalities.[154]

These considerations help explain why institutional investors have refrained from pushing managers of high carbon emitting firms to slash emissions in the name of maximizing the value of *other* portfolio firms, as envisioned by Professor Condon. On the contrary, to the extent investors evaluate the impact of climate change on portfolio value maximization, they typically focus on the implications of climate change for each firm's long-term value, and in particular on "transition risks," such as the costs a firm will face as governments seek to rein in carbon emissions and the investment opportunities these efforts will produce.

Indeed, the work of UNEP FI, which was established to advance methodologies for assessing the impact of climate change on the portfolios of institutional investors, is replete with this perspective. Using an investment portfolio consisting of 30,000 global securities, the report's headline results indicate that investors in such a portfolio would face a 13.15% risk of loss due to transition risk, but low carbon technology opportunities offset these costs by providing 10.74% of potential gains. To be sure, the report also estimated the aggregate physical losses to the portfolio arising from climate change to be 2.14%. Yet even in this regard, the report cited investors as using these methods to engage with companies "to encourage greater climate risk resiliency"—in other words, to ensure companies are looking to maximize firm value in the face of these climate risks. Likewise, to the extent shareholder engagement at "Big Oil" firms has resulted in revised compensation plans to address climate change, the revised plans are uniformly designed to reward management for success in managing "transition risk"—a broad category of conduct that includes meeting GHG emissions targets in anticipation of higher carbon costs as well as pursuing alternative energy technologies.[155]

[154] In the absence of antitrust laws, the optimal incentive contract might also seek to encourage managers to create pecuniary externalities by, for example, colluding with the firm's competitors.

[155] For instance, during 2021, Chevron, in response to investor communications, approved the addition of an "Energy Transition" performance category to the Chevron Incentive Plan (CIP) scorecard. According to the company, the "new category will have a 10% weighting, and will

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THE FUTURE OF CSR IS ESV

Shareholder governance holds significant promise for improving corporate social responsibility. But this promise does not stem from any innovation in our basic understanding of shareholders' interests along the lines of shareholder welfarism. Indeed, we have argued that changing the corporate objective in the ways urged by shareholder welfarism would fail to meaningfully improve corporate conduct and might even do the opposite. Rather, the ongoing promise of shareholder governance for CSR stems from the prospect of further reductions in certain agency costs and information problems based on the traditional corporate objective, long-term shareholder value. We suspect that there remain opportunities for corporate management to reform firm policies in ways that both increase shareholder value and improve the firm's social performance, perhaps by addressing the information and incentive problems of ESV we have discussed. But ESV is often misunderstood in the law-and-economics literature. In this final part we begin by addressing those misconceptions and clarifying what we believe to be the most useful understanding of ESV. We then briefly describe a recent episode at ExxonMobil that illustrates recent innovations in the use of ESV arguments by market actors and the potential promise that ESV holds for advocates of CSR. We conclude this part by identifying a set of key questions about ESV that we think form an important research agenda for the field.

A. Clarifying ESV as a Concept

Despite its surging popularity in the business world, ESV has received little sustained analysis in legal scholarship. What attention it has received from legal scholars largely reflects one or both of two misconceptions about ESV that we seek to clarify here.

First, some shareholder primacy theorists misconceive ESV as an alternative to traditional shareholder value as a corporate objective.[156] For

measure Chevron's progress in the areas of GHG management, renewable energy and carbon offsets, and low-carbon technologies." In addition to the 10% weight provided to this Energy Transition metric, the CIP determines annual awards based on three other areas: financial results (weighted 35%), capital management (weighted 30%), and operating and safety performance (weighted 25%). *See* Chevron Corporation, Schedule 14A Proxy Statement, at 45 (May 2022).

[156] *See,* e.g., Bebchuk et al 2022, *supra* note 41 at 1; Lund, *supra* note 9 (contrasting the "traditional" shareholder wealth maximization standard with the "enlightened shareholder value standard"). Relatedly, some CSR-oriented scholars treat ESV as a form of stakeholderism that ultimately requires corporate actions that sacrifice shareholder wealth to further stakeholder interests Virginia Harper Ho, *Enlightened Shareholder Value: Corporate Governance beyond the Shareholder-Stakeholder Divide*, 36 J. CORP. L. 59, 98 (2010) ("[I]t is in the cases …where market forces pressure firms away from social responsibility … that the contrast between shareholder wealth maximization and enlightened shareholder value is clearest. These are cases where a course of action that maximizes profits imposes negative externalities on stakeholders… If permitted by law, such decisions are fully compatible with a shareholder wealth maximization approach. Under an ESV decision rule, in contrast, the firm must assess the potential impact on stakeholders. If a course of action is optimal only when the costs to stakeholders are ignored, then it should not be taken or the firm must absorb the costs."). This is not what we refer to as ESV in this article.

example, in a recent paper Lucian Bebchuk and coauthors examine "the view that corporations should replace their traditional purpose of shareholder value maximization (SV) with a standard commonly referred to as 'enlightened shareholder value.'"[157] After arguing that SV and ESV are operationally equivalent, they conclude that "replacing SV with ESV should not be expected to produce benefits for either shareholders or society…"[158]

But their framing of ESV as an alternative corporate objective is, in our view, a category mistake. ESV is not an alternative corporate objective. The "enlightenment" that ESV calls for involves not an adjustment of the corporate objective itself but rather in how to seek it. ESV is best understood as a reform agenda targeting a particular class of agency costs and information problems that harm not only shareholders but also other corporate stakeholders. Just as one might usefully analyze problems with the design of executive compensation as a distinctive manifestation of and contributor to managerial agency costs,[159] ESV theory identifies a particular class of agency and information problems worthy of study that might point to their own set of interventions.

Why have law-and-economics scholars instead so often viewed ESV as advancing an alternative corporate objective? This framing of ESV might stem in part from the grammatical structure of the label: "enlightened" is an adjective, modifying "shareholder value." Another reason—suggested by Professor Bebchuk and coauthors[160]—is that some jurisdictions have added explicit language to corporate statutes highlighting the importance of operating in a socially responsible manner to the achievement of shareholder value. For example, the United Kingdom Companies Act provides:

> A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its [shareholders] as a whole, and in doing so have regard (amongst other matters) to— …
>
> (b) the interests of the company's employees,
>
> (c) the need to foster the company's business relationships with suppliers, customers and others,
>
> (d) the impact of the company's operations on the community and the environment,
>
> (e) the desirability of the company maintaining a reputation for high standards of business conduct…[161]

But such a provision does not change the corporate objective from maximizing shareholder value. Rather, we suspect that the existence of stakeholderism as a competing conception of corporate purpose may explain the perceived need to add explicit language endorsing such CSR

[157] Bebchuk et al 2022, *supra* note 41 at 1.
[158] *Id.* at 3.
[159] *See, e.g.,* LUCIAN A. BEBCHUK AND JESSE M. FRIED, PAY WITHOUT PERFORMANCE (2004).
[160] Bebchuk et al 2022, *supra* note 41 at 5.
[161] Companies Act 2006, c. 46, § 172(1) (UK).

considerations in pursuing long-term shareholder value. After all, many people believe in stakeholderism, which is indeed a fundamentally different understanding of ends, and not just means, of the corporate form. This leads to several phenomena that might in turn justify explicit acknowledgement of ESV considerations in corporate law.

First, when good faith managers sacrifice short-term profits to act more responsibly in ways that further shareholder value, they might be accused of being stakeholderists! Explicit legal endorsement of ESV can reassure all involved that engaging in CSR is often required to further shareholder value. Second, one could interpret explicit ESV legal language as limiting rather than permissive; it can make clear to corporate managers that they should pursue CSR *only* to the extent that it furthers shareholder value. This is what the Delaware Supreme Court did in the *Revlon* case ("A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders.").[162] Finally, stakeholderists often propagate a caricature of shareholder value theory in which fat-cat capitalists squeeze every last penny out of workers and customers, pollute the environment at will, and otherwise act in outrageous ways all in pursuit of immediate profit.[163] Legal endorsement of ESV helps combat that distorted view of shareholder primacy.

A second misconception about ESV is that it is useless because the behavior of all the key actors in the corporate system is determined by their incentives and so ESV ideas cannot improve it. One version of this critique focuses on the significant extent to which existing corporate governance institutions already provide substantial incentives for management to maximize shareholder value, including through practices that also further stakeholder interests, which raises the question of whether there remain any such opportunities not yet exploited. As Einer Elhauge puts it, "Agitating for corporations to engage in responsible conduct that increases their profits is a lot like saying there are twenty-dollar bills lying on the sidewalk."[164]

Quite the contrary. For one, the mechanisms posited by ESV often involve substantial uncertainty as to how best to optimize long-term shareholder value.[165] That uncertainty is in part a function of the long time horizon over which the firm will receive the ultimate financial benefits of socially responsible conduct. In contrast, the financial costs of such practices are typically both immediate and certain. As a result, there is no reason to think that all such positive NPV investments in social responsibility will be exploited. In many cases firm managers will simply make mistakes in

[162] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986).

[163] *See, e.g.*, LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 7, 11 (2012) ("Conventional shareholder value thinking ... causes companies to indulge in reckless, sociopathic, and socially irresponsible behavior ... In the quest to 'unlock shareholder value' [directors and executives] sell key assets, fire loyal employees, and ruthlessly squeeze the workforce that remains.").

[164] Elhauge, *supra* note 40, at 744–45.

[165] Edmans, *supra* note 42, at Y.

striking these uncertain intertemporal tradeoffs. These mistakes, moreover, might be systematically biased toward social irresponsibility, given the asymmetry that poses certain, immediate costs against uncertain, future benefits of more responsible conduct.[166] More fundamentally, management might face conflicts of interest that produce agency costs in the form of inefficiently irresponsible corporate conduct. As we have explained, the ESV approach is best understood as largely involving concern about a genus of agency costs in the short-termism family.[167] In this regard, the key conceptual challenge for ESV theory is not how to explain all the cash on the sidewalk but rather to identify governance reforms or other interventions that might realistically reduce these agency costs and produce more cash.

In that vein, a second version of this critique takes a glass-half-empty perspective on management incentives. For example, Lucian Bebchuk and coauthors argue that, to the extent that managers fail to engage in shareholder-value-maximizing CSR due to incentive problems that lead to short-termism, ESV offers no way out. As they put it: "[A]s long as corporate leaders have short-term incentives, pontificating to them about the importance of taking into account long-term effects, either in general or with respect to stakeholders in particular, would not address short-termism problems."[168]

Their claim exemplifies what economists have termed the "determinacy paradox."[169] This problem arises when an analyst has a positive model of the actors in a system that generates predictions about how those actors *will* behave, but then nonetheless engages in normative arguments about how those actors *should* behave. If the analyst believes that the actors' behavior is pinned down by the positive model, what exactly is the point of the normative arguments? That is the logical structure of Bebchuk et al.'s critique, and it does indeed pose an important challenge for ESV theory.

But note that, as a preliminary matter, this basic challenge for ESV theory is shared by all normative arguments in corporate law scholarship. Economic analysis of corporate law relies on a rich set of positive models that explain the behavior of key actors in the system—officers, directors, shareholders, and the like. But in addition to all of their positive theorizing, corporate law scholars have a decidedly reformist bent. After diagnosing some set of pathologies in the corporate system, generally with the aid of a positive model, the typical scholarly article about corporate law then turns to reform proposals that aim to remedy the problem.[170] But if all of the relevant

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[166] To be clear, the existence of such a systematic bias is not self-evident, nor is it fundamental to our argument. All that is necessary to make ESV of interest is that there exist unrealized opportunities to reform corporate policy in ways that further both shareholder interests and CSR, not that there are more such cases than there are cases in which corporations engage in excessive CSR from a shareholder value perspective.

[167] *See supra*, Part IV.B.1.

[168] Bebchuk et al 2022, *supra* note 41 at 21.

[169] Brendan O'Flaherty and Jagdish Bhagwati, *Will Free Trade with Political Science Put Normative Economists Out of Work?*, 9 ECON. AND POL. 207, 209 (1997).

[170] *See, e.g.,* Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV.

decisionmakers' behavior is pinned down by incentives, what is the point of this "pontificating"? If the positive model is right, then why would managers or directors, for example, care about the analyst's normative arguments? This is a challenge even for normative arguments about what the law should be, since positive models in corporate law scholarship purport to explain even the content of corporate law itself, for example as the inevitable outcome of state competition for charters.[171] The generality of this analytic challenge for normative arguments in corporate law scholarship has not previously been recognized.[172]

Are all normative arguments about corporate governance hopeless then? Thankfully, no. The way out of the paradox is to identify some set of actors that might ultimately be persuaded by the normative argument. The ability to persuade an actor in turn typically requires that the actor have both something to learn and incentives that align to some degree with the recommendation.[173] Rather than leading to normative nihilism, the "determinacy paradox" should instead discipline us as corporate law scholars to be more explicit about the audiences we have in mind for our normative arguments and to explain why—despite our rich positive models—those arguments will not fall on deaf ears. We need an "unmoved mover" in the system who might be open to the normative argument in order for it to make a practical difference.

Two key audiences who often play that role in corporate law scholarship, more or less explicitly, are institutional investors and government officials. To give one illustrative example, consider Lucian Bebchuk and Jessie Fried's incisive book on executive pay.[174] They argue that a range of common practices in executive pay stem from, and contribute to, managerial agency costs. For this analysis to deliver a practically useful normative payoff, however, requires there to be an audience for their arguments that might be influenced in such a way that the design of executive compensation improves. The authors argue in part that "[t]his is an area in which the very recognition of problems may help alleviate them," asserting that "[m]anagers' ability to influence pay structures depends on the extent to which the resulting distortions are not too apparent to market participants—especially institutional investors."[175] But they also advocate policy changes that would shift power from boards to shareholders, arguing that:

L. REV. 1028 (1982); Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2004).

[171] *See, e.g.,* Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709 (1986) (reviewing positive models of state corporate law based on competition for corporate charters).

[172] In contrast this challenge has been discussed extensively in public law scholarship. *See, e.g.,* Eric A. Posner & Adrian Vermeule, *Inside or Outside the System*, 80 U. CHI. L. REV. 1743 (2013).

[173] O'Flaherty and Bhagwati*, supra* note 169, at 215.

[174] Bebchuk and Fried, *supra* note 159.

[175] *Id.* at 12.

> For there to be changes in the allocation of power between management and shareholders, investors' demand for them must be sufficient to outweigh management's considerable ability to block reforms that chip away at its power and private benefits. This can happen only if investors and policymakers recognize the substantial costs that current arrangements impose—as well as the extent to which solving existing problems requires addressing the basic problem of board unaccountability. We hope that this book will contribute to such recognition.[176]

The determinacy paradox strikes us as easier to surmount for normative arguments in ESV theory than it typically is in corporate governance theory more generally. After all, ESV theory by definition pushes for reforms that are in the interests of both shareholders and other stakeholders so that multiple classes of actors in the system have interests that are to some degree aligned with the reform to corporate practice being urged and might therefore play a role in helping to bring it about.

Normative ESV arguments by academics, for example, might usefully target a range of audiences in the corporate system. Consider Alex Edmans' recent book, *Grow the Pie*, which seems primarily aimed at teaching *managers* how focusing on the social value created by the firm is a surer path to shareholder value creation than seeking shareholder value directly.[177] The book provides a lucid account of the relevant empirical literature on these issues that we suspect has important lessons for managers and independent directors. Institutional investors might also benefit from his analysis and be persuaded to adjust their approach to using ESG factors in their investment process. This could well be an area in which clearer recognition of the agency cost problems that deter managers from considering social value may help alleviate them, as Bebchuk and Fried assert about executive compensation.[178] And to the extent that failures to exploit all opportunities to engage in CSR in ways that benefit stockholders stem from mistakes due to limited information, the potential for ESV arguments to make a difference is even more straightforward.

In sum, the Panglossian argument that nobody could possibly have a useful new idea along the lines of ESV because if it were incentive compatible to adopt a practice that improved CSR in ways that benefit shareholders, corporations would already be doing it, proves too much. As

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[176] *Id.* at 216. But at times the authors leave the identity of the policymaker being appealed to unspecified. For example, after pointing out that "states seeking to attract incorporating and reincorporating firms have had incentives to give substantial weight to management preferences, even at the expense of shareholder interests," the authors write: "Giving shareholders the power to initiate and approve by vote a proposal to reincorporate or to adopt a charter amendment could produce, in one bold stroke, a substantial improvement in the quality of corporate governance. Shareholder power to change governance arrangements would reduce the need for intervention from outside the firm by regulators, exchanges, or legislators." *Id.* at 213. But the identity of the policymaker who they hope will do the "giving" is left unspecified.

[177] Edmans, *supra* note 42.

[178] Bebchuk and Fried, *supra* note 159, At 12.

well, as a positive matter, the increase in the use by various actors in the corporate system of normative arguments about corporate practices that sound in ESV terms is by our lights a phenomenon worth studying rather than simply dismissing. Consider, for example, the ESV argument advanced by Blackrock's Larry Fink in his 2022 "Letter to CEOs": "In today's globally interconnected world, a company must create value for and be valued by its full range of stakeholders in order to deliver long-term value for its shareholders."[179] The audiences for this argument include independent directors, managers, and other investors. Similarly, the recent activist intervention at ExxonMobil, to which we now turn, is instructive and illustrates to us the potential promise ESV holds for CSR as well as raises a range of research questions for further study.

B. The Engine No. 1 Intervention at ExxonMobil

On May 26, 2021, an obscure new hedge fund, Engine No. 1, managed something unprecedented: it won a contested director election to place three new directors on the board of ExxonMobil based on a platform that was heavily critical of the company's failure to grapple with the reality of a rapidly decarbonizing world. This was a stunning outcome. ExxonMobil is one of the most valuable companies in the U.S., and among the largest producers of oil and gas in the world. Climate activists had long decried ExxonMobil as a climate arch-villain. And Engine No. 1 took the management of the company head on: by arguing to investors that management's failure to cut back on investment in oil production was bad for business, not just bad for the earth. With a stake amounting to a mere 0.0016% of Exxon's shares outstanding, Engine No. 1 had to win the votes of other institutional investors in order to succeed. And enough of the largest investors, including Vanguard, State Street, and BlackRock, were ultimately persuaded to side with Engine No. 1 for the hedge fund to win.

From the start, Engine No. 1 emphasized the central importance of climate change and decarbonization for the campaign. As it stated in its opening salvo to Exxon: "It is clear … that the industry and the world it operates in are changing and that ExxonMobil must change as well."[180] But the case it made for change at Exxon was based squarely on long-term shareholder value. As the fund emphasized when it launched its campaign, the company's total shareholder return over the past ten years had been -20%, compared to 277% for the S&P 500, and it also trailed its industry peers.[181] In its investor presentation, Engine No. 1 argued that the stock's lackluster performance reflected a fundamental failure at the company to adjust its business strategy to account for long-term demand uncertainty for oil and gas. In particular, Exxon's long-term business planning "centered

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[179] Fink, 2022 Letter to CEOs, *supra* note 91.

[180] Engine No. 1, *Letter to the Board of Directors* (Dec. 7, 2020) [hereinafter Exxon Letter], https://reenergizexom.com/materials/letter-to-the-board-of-directors/.

[181] *Id.*

narrowly on projections of oil and gas demand growth for decades,"[182] leading it to pursue "aggressive capital expenditure plans to chase production growth" that have left "ExxonMobil far more exposed than peers to demand declines."[183] Additionally, Engine No.1 emphasized that the company's "refusal to accept that fossil fuel demand may decline in decades to come has led to a failure to take even initial steps toward evolution."[184] In this regard, Engine No. 1 excoriated the company for its "total reliance on [the] hope of carbon capture to preserve [its] business model,"[185] which had caused the firm to lack any "credible plan to protect value in an energy transition."[186] This failure to grapple with transition risk was in contrast to its peers who "have shown it is possible to begin gradually diversifying—and embracing long-term total emissions reduction targets—while maintain[ing] focus on core business profitability…"[187]

In short, the central premise of Engine No. 1's campaign was that management's overinvestment in fossil fuels constituted a failure to maximize the long-term value of the company. Moreover, Engine No. 1 emphasized that this failure was due to both a lack of information and a lack of incentives. With respect to information, Engine No. 1 argued that the "Board of ExxonMobil will be addressing the most important questions facing the energy industry for years to come,"[188] but stunningly, not one of ExxonMobil's independent directors had any prior energy industry experience.[189] It was for this reason that Engine No. 1 advanced a director slate that could provide the expertise that it believed the "Board has been missing—directors with diverse yet highly relevant backgrounds who have successfully tackled energy industry challenges and bring decades of experience in conventional and alternative forms of energy to help best position ExxonMobil for greater long-term value creation."[190]

Likewise with respect to incentives, Engine No. 1 criticized the company's compensation plans for creating "misaligned incentives."[191] Engine No. 1 emphasized the inverse relationship between management compensation and stock performance, arguing that the "disconnect results in part from compensation plans that can reward volumes over sustainable

[182] *See* Exxon Mobil Corporation, Schedule 14A Proxy Statement, at 21 (April 26, 2021) [hereinafter Engine No. 1 Investor Presentation].

[183] *Id.* at 9.

[184] *Id.* at 6.

[185] *Id.* at 21.

[186] *Id.* at 14.

[187] *Id.* at 27.

[188] *Id.* at 73.

[189] *Id.* at 19 ("Prior to our campaign, ExxonMobil's Board had no independent directors with prior energy experience.").

[190] *Id* at 73*; see also*: Reenergize Exxon, FAQs, https://reenergizexom.com/faqs ("The four highly qualified, independent individuals we have identified can bring to the ExxonMobil Board much-needed experience in value-creating, transformational change in the energy sector.").

[191] Engine No. 1 Investor Presentation, *supra* note 182, at 57.

value."[192] For instance, in contrast to its peers, ExxonMobil provided little disclosure regarding how managers were held accountable for cost overruns.[193] Nor did the company follow its peers in utilizing a management scorecard with "well defined weights for metrics and targets" that were tied to energy transition risk;[194] instead, the company often resorted to "ad hoc" changes to its compensation plans to encourage investment.[195] As a result, Engine No. 1 argued, "[i]n the same way that ExxonMobil's changes to incentive plans to reward production led to a focus on growth even as returns declined, we believe the lack of material energy transition metrics could discourage a focus on the future."[196]

Thus, Engine No. 1 viewed the financial woes at Exxon as a classic agency problem involving a mix of empire building and short-termism. As it repeatedly emphasized, its central grievance arose from the Board's failure to take seriously a long-term vision of shareholder value due to a combination of poor internal information flows and inadequate compensation incentives. What made the episode standout as implicating CSR was that this failure to maximize Exxon's long-term value centered on the company's excessive capital investment in fossil fuel production and its reluctance to consider transition risk. For this reason, Engine No. 1 believed Exxon's management was insufficiently "enlightened" with regard to the company's long-term shareholder value.

Engine No. 1 ultimately succeeded in its campaign because its message resonated with a critical audience of institutional investors. BlackRock, Vanguard, and State Street, Exxon's three largest shareholders, all voted in favor of at least two of the candidates advanced by Engine No. 1, as did CalPERS, CalSTRS and the New York State Common Retirement Fund, three of the country's largest pension funds.[197] In statements explaining their support for the dissident board candidates, institutional investors concurred with Engine No. 1's critique of the company's performance, particularly its approach to capital allocation, and its "long-term financial underperformance" relative to its industry peers.[198] They also expressed concern about the "board dynamics" highlighted by Engine No. 1,[199]

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[192] *Id.* at 59.

[193] *Id.*

[194] *Id.; see also id.* at 70 (providing examples of "many peer compensation metrics [that] have evolved to incentivize management to create value by looking at the energy transition as an opportunity").

[195] *Id.* at 60.

[196] *Id.* at 70.

[197] Fred Krupp, *A defining moment for ExxonMobil's biggest shareholders — and for the climate*, Environmental Defense Fund (May 21, 2021) https://www.edf.org/blog/2021/05/21/defining-moment-exxonmobils-biggest-shareholders-and-climate.

[198] State Street Global Advisors, *2021 Proxy Contest: Exxon Mobil Corporation (XOM)* (May 27, 2021); CalPERS, SEC Shareowner Alert - Notice of Exempt Solicitation (Form PX14A6G) (May 10, 2021), https://www.ssga.com/library-content/pdfs/global/2021-proxy-contest-exxon-mobil-corporation-xom-client-note.pdf.

[199] The Vanguard Group, Inc., *Voting insights: A proxy contest and shareholder proposals*

particularly its lack of information, with Vanguard highlighting "concerns about the lack of energy sector expertise in its boardroom"[200] and BlackRock stating the board would benefit from "the addition of diverse energy experience."[201] The incentives argument was also referenced, though not as explicitly as in Engine No. 1's critique, with Vanguard alluding to "questions about board independence" that it had raised with Exxon for a number of years.[202]

But to the extent these investors commented on the proxy fight, the primary justification given by each was concern over Exxon's failure to plan adequately for the energy transition: In other words, concerns about value to shareholders in the long-term. In its statement, Blackrock noted that "Exxon and its Board need to further assess the company's strategy and board expertise against the possibility that demand for fossil fuels may decline rapidly in the coming decades," adding that the company's "current reluctance to do so presents a corporate governance issue that has the potential to undermine the company's long-term financial sustainability."[203] Likewise, Vanguard explained that it grounded its "assessment on how any changes to the board's composition would affect [Exxon's] ability to oversee risk and strategy and ultimately lead to outcomes in the best interest of long-term shareholders."[204] In short, by articulating an ESV critique of Exxon's current business strategy, Engine No. 1 successfully enlisted the aid of institutional investors to advance its ESV reform agenda.

C. A Research Agenda for ESV

Engine No. 1's success at ExxonMobil provides hope that the renewed interest in corporate social responsibility in recent years may yet lead to new pathways for achieving social progress through pursuit of enlightened shareholder value. Moreover, the growing popularity of ESV among institutional investors suggests that we should expect to see additional ESV-themed interventions in the future. As with the Exxon episode, however, the ultimate scope for improving corporate conduct through such ESV-motivated reforms is not yet clear. After all, it remains too early to tell whether Engine No. 1's intervention will result in a long-term change to Exxon's investment strategy or to its approach to transition risk. From our perspective, it is this duality of ESV—its prominence among institutional investors as well as its uncertain promise—that makes it a phenomenon worthy of further study. We conclude by briefly outlining a set of research

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related to material risk oversight at ExxonMobil (May 26, 2021), https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/perspectives-and-commentary/Exxon_1663547_052021.pdf.

[200] *Id.*

[201] *Id.*; BlackRock, Inc., *Vote Bulletin: ExxonMobil Corporation* (May 26, 2021), https://www.blackrock.com/corporate/literature/press-release/blk-vote-bulletin-exxon-may-2021.pdf.

[202] Vanguard insights *supra* note 199..

[203] BlackRock bulletin *supra* note 201.

[204] *Id.*; Vanguard insights *supra* note 199.

questions about ESV that we hope future scholarship will address.

First, how big is the gap between "perfect" ESV behavior (i.e., fully realizing all opportunities to further stakeholder interests that also benefit shareholders) and actual corporate behavior with respect to various social issues? In some areas it may be that calls for reforms to corporate practices, even though ostensibly based on ESV considerations, are actually better understood as stakeholderist in nature. It may be that public policy is a better tool for responding to those cases than appeals for CSR. But in other areas there may be substantial scope for further improvements to corporate practice on ESV grounds.

Second, what are the main reasons that corporations fail to realize ESV opportunities? Investigating past episodes of reform to corporate conduct might reveal the extent to which such failures stem from lack of information versus incentive conflicts. For example, has recent empirical research documenting the firm value generated by treating workers well[205] led to the spread of such practices in the corporate world? Diagnosing the underlying causes of failure to engage in CSR in ways that benefit shareholders might in turn provide insights into how to intervene in the system to improve corporate performance.

Third, and relatedly, what are the contours of the ESV "reform agenda" with regard to interventions and corporate governance reforms that might improve CSR in ways that further shareholders' interests? For example, to what extent do governance reforms intended to encourage longer time horizons in management decision-making affect CSR behavior? How can executive compensation arrangements advance ESV considerations? Do popular ESV-oriented interventions—such as enhanced climate disclosures, creating board "risk oversight" or "sustainability" committees,[206] and appointing independent directors with broader experiences—actually affect CSR decision-making?

Fourth, who exactly are the key actors who might be persuaded by ESV arguments for reform to corporate practices? To what extent are managers, independent directors, and institutional investors persuadable on different ESV issues to act to further such reforms?

CONCLUSION

At the turn of the twenty-first century, leading commentators announced an "end of history for corporate law," declaring that "[t]here is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."[207] Yet the last twenty years have witnessed continued developments in corporate law

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[205] *See* Edmans, *supra* note 60.

[206] Lynn S. Paine, *Sustainability in the Boardroom*, HARV. BUS. REV. MAG. (July–Aug. 2014); Lisa M. Fairfax, *Board Committee Charters and ESG Accountability*, 12 HARV. BUS. L. REV. 371 (2022).

[207] Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439–468, 439 (2000).

theory and practice that seek to find new pathways for generating more socially responsible corporate behavior. These include new shareholder-centric perspectives that go beyond shareholder value and focus managers instead on more holistic conceptions of shareholder welfare. And even within the traditional paradigm of shareholder wealth maximization, promising innovations abound, including in ways that might improve broader social outcomes. All of these developments suggest to us that the history of corporate law has not yet been fully written, and in this Article we have tried to assess aspects of this latest chapter. Despite the seeming appeal of conceptualizing shareholder interests in broader terms, on closer examination shareholder welfarism offers little hope for improved corporate conduct. Rather, for those seeking to promote corporate social responsibility, the way forward is through a more thoroughgoing, dare we say enlightened, pursuit of shareholder value.

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