

NEW THINKING ON “SHAREHOLDER PRIMACY”

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Summary

By the beginning of the twenty-first century, many observers had come to believe that U.S. corporate law should, and does, embrace a “shareholder primacy” rule that requires corporate directors to maximize shareholder wealth. In this talk I argue that such a view is mistaken.

As a positive matter, U.S. corporate law and practice does not require directors to maximize shareholder wealth but instead grants directors a wide range of discretion, constrained only at the margin by market forces and the risk of losing a directorship, to sacrifice shareholder wealth in order to benefit other constituencies. Although recent “reforms” designed to promote greater shareholder power have begun to limit this discretion, U.S. corporate governance remains director-centric.

As a normative matter, several lines of theory have emerged in modern corporate scholarship that independently suggest why this pattern of director governance of public firms is desirable from shareholders’ own perspective. In this talk I review six of these lines of theory and explore why each gives us reason to believe that shareholder primacy rules often disadvantage shareholders.

SHAREHOLDER PRIMACY THEORY

- Shareholders “own” the corporation
- Shareholders are sole residual claimants who get all corporate profits—other stakeholders get the minimum required by their contracts
- Shareholders are “principals” who hire directors as “agents” who should follow shareholders’ orders
- Shareholders prefer more power over directors to less

-- The corporate goal is to maximize shareholder wealth as measured by share price

REALITY

- Shareholders own only stock; corporation “owns” itself
- Shareholders are one of many residual claimants who benefit from greater profits or suffer from corporate losses: others include creditors, employees, executives, community
- Directors are not “agents” but fiduciaries who can ignore shareholder requests and serve other interests
- Shareholders (ex ante) prefer less power over directors
- The corporate goal is to survive and grow

EXPLAINING REALITY: THEORIES OF DIRECTOR GOVERNANCE

- **Market inefficiency** (shareholders versus themselves)
- **Market inefficiency** (short term shareholders versus long term shareholders)
- **Capital lock-in** (shareholder A versus shareholder B)
- **Team Production** (shareholders versus creditors, executives, employees, others making specific investments)
- **Universal Shareholder** (undiversified shareholders versus diversified investors)
- **Social Shareholder** (selfish versus unselfish shareholders)

LESSONS FROM US DIRECTOR PRIMACY

- **Shareholder Primacy is a Flawed Theory of the Corporation**
(and certainly not the only good theory)
- **We Can't Assume More Shareholder Power is Better** (the facts matter)
- **Director Primacy May Benefit Investors As A Class, Over Time**
(but it doesn't benefit all shareholders at all times)
- **Serving Other Stakeholders Often Serves Investors** (as a class, over time)
- **The US Shouldn't Export Damaged Goods I** (shareholder primacy is not the secret to US corporate success)
- **The US Shouldn't Export Damaged Goods II** (close corporations are different)

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