# HAVE ALL SEATS IN THE FIRST ROW STILL BEEN RESERVED FOR SHAREHOLDERS?

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## ABSTRACT

Shareholder primacy has gained enormous support among scholars, policymakers and practitioners. Shareholder primacy has become an ideology that has gained considerable momentum. However, the reality of today's global economy shows that companies are governed and structured to achieve different goals other than maximising shareholder value. There is a transition in corporate law from shareholder primacy to other goals, such as portfolio primacy, which means increasing the value of the entity. This transition is evident in Aramco, Blackrock, Facebook and Apple, as well as many other companies. This research explores the concept of shareholder primacy, seeking to situate it within an understanding of its roots and limitations. The contention is that 'the company' should come first. As such, protecting the company and increasing its portfolio should be the primary goal. This is a long-term view that not only allows a company to thrive but is also beneficial to the wider economy. Nevertheless, the underlying argument is that determining a single goal of corporate law is somewhat of an illusion.

## INTRODUCTION

Corporate law has been developed to impose a duty on businesses to maximise profits for shareholders. The focus on shareholder value has become entrenched over many years. However, the reality of today's global economy shows that shareholder value, also known as shareholder primacy, has not been the primary goal of corporate law.

This research argues that shareholder primacy has not been set as a goal ahead of others. This research is divided into three main sections. The first section roots shareholder primacy in literature. The second section critiques shareholder primacy. The third section argues how shareholder primacy has been taken over by other goals. The conclusion answers the question at hand, which demonstrates that corporate law is evolving, with ever-changing goals and purposes.

## THE ROOTS: SHAREHOLDER PRIMACY

Shareholder primacy is rooted in the contractarian theory that views corporate governance law as a complex branch of contract law.[i] Thereby, shareholders have the authority to dictate that a company be run in the shareholders' sole interest. Berle, the grandfather of shareholder primacy, argued that companies exist only to make money for their shareholders.[ii]

Other scholars advance shareholder primacy other than Berle. For example, Easterbrook and Fischel (2022), in their famous series of articles on corporate law, have asserted that corporate governance law is a complex branch of contract law.[iii] These scholars stress that the principal function of corporate law is to provide default rules in corporate contracts to empower shareholders.[iv] These rules are contractual terms that are set in all corporate charters or bylaws, and also imposed by corporate law.[v] Consider the supermajority vote by shareholders to approve certain transactions like takeovers.

A company is identified as a contractual structure with strong property rights to shareholders, which explains why shareholders should be empowered. Thus, shareholders are placed in a dominant position in companies. Hansmann and Kraakman (2017) stated that 'ultimate control over the corporation should be in the hands of the shareholder class; which means that the managers of the corporation should be charged with the obligation to manage it to advance the interests of its shareholders'.[vi]

Accordingly, shareholders are the 'kings of the chessboard' who must be protected at all costs. Shareholder primacy ideology has been rooted deeply in literature for different rationales. Firstly, it is argued that shareholders enter into a notionally incomplete contract with a company.[vii] This is in contrast to the workers or lenders of a company, who are usually able to specify in advance their economic return from the company plus the terms and conditions upon which they agree to advance their respective inputs to the company's production process.[viii]

Since shareholder prominence is fundamentally a market-driven phenomenon that reflects a neo-liberal free market ideology,[ix] shareholder primacy has been perceived as a reflection of a free market economy. Regardless of one's proclivities toward the free market, it is clear that this ideology has been prominent in the literature.[x] Shareholder prominence reflects the orthodoxy of neo-liberalism that has been a reference point for policymakers and investors.[xi] Thereby, shareholder primacy has become the goal of corporate law.[xii]

## CRITIQUES OF THE SHAREHOLDER MODEL

Although shareholder primacy dominates the literature, as shown earlier, it has been challenged by many well-known scholars. Blair and Stout (1999) have made a great contribution to the opponents of shareholder primacy.[xiii] Blair and Stout advocate not only liberating directors from the direct control of shareholders or stakeholders but also that company directors should not be viewed as agents who work for the interest of shareholders.[xiv]

As these two scholars explicitly stated, 'the directors are trustees for the corporation itself'.[xv] Thus, no one group of stakeholders should hold most of the surplus gain, and if one group is not satisfied, they can freely exit the company and invest their resources, whether financing, knowledge, expertise or liquidity, elsewhere.[xvi]

Shareholder primacy has also been challenged by Mark Roe (2001), who directly posed the question, 'why should shareholders prevail over other stakeholders in a company?'[xvii] Roe argues that when the focus of companies is exclusively on maximising shareholder wealth, a market monopoly is created.[xviii]

In other words, a strong shareholder wealth maximisation norm is more likely to induce monopolist managers to lower production in order to raise prices.[xix] According to Roe, it is more important to develop competitive economies and greater investment rather than to maintain strong shareholder wealth maximisation norms.[xx]

Therefore, Roe argues that a weaker shareholder primacy norm is more likely to facilitate greater production and thus greater allocative efficiency.[xxi] The strategy of exclusively maximising shareholder wealth increases the pressure on managers, and consequently, capital market constraints will be weaker in monopoly settings.[xxii] This means less vibrant capital markets, and less investment, which puts economic development at risk.[xxiii]

In my opinion, there are two concerns regarding shareholder primacy, which inevitably jeopardise the interest of the business or the company. The first concern, related to the business and the company, is that when shareholders are too strong, they will exert power if unsatisfied, such as by withholding executive compensation from managers. Managers can be controlled by shareholders, which may negatively affect business decisions.

The second matter of concern is the effect of shareholder empowerment on limiting the sale of shares to better investors.[xxiv] Managers should not face a dilemma when exercising their business judgment, especially when there is a conflict with the view of shareholders.[xxv] Managers should act in the interest of the company, which should come first. This long-term view not only allows the company to thrive but also the economy,[xxvi] which is the approach of Warren Buffett.[xxvii]

This long-term view endorses that corporate value maximisation should be prioritised. Thus, managers are held liable by companies and responsible for maximising their value and portfolios. For example, a merger transaction may allow current shareholders to have greater returns but may not be the best transaction for the company at that time. As such, prioritising corporate value rather than shareholder value is more likely the reason why such a company will make different decisions.[xxviii]

## PROTECTING THE COMPANY

Protecting the company entails increasing its value, growth and portfolio. The company should be considered first. The long-term view not only allows the company to thrive but also the economy,[xxix] which is known, as mentioned earlier, as the approach of Warren Buffett. This argument is heavily rooted in classical economic theory.[xxx]

Accordingly, protecting the company should be the appropriate goal of corporate law. The company has an independent interest of its own in the successful operation of its business. This is measured by the success of the present and expected profit. Therefore, the notion of the best interest of the company refers to this interest in the present and continuing vitality of the company. This goal will ultimately be the most beneficial to the greatest number of corporate constituents, including shareholders and the economy as a whole.[xxxi]

The reality of today's business environment shows that companies work towards increasing their values and portfolios, aiming to be giants of the global economy, as evident in many companies like Aramco, Blackrock, Facebook and Apple, as well as other companies from Silicon Valley and state capitalist markets. There are political and economic goals that a company would pursue other than maximising the interests of shareholders. Different factors play a role in why different goals are set, such as company size, industry, profitability, leverage and growth opportunities.[xxxii]

Therefore, it is nearly impossible for corporate law to have one goal or purpose. Regulators, judges and scholars can't define one single goal and apply it universally. However, there will always be competing views and different interpretations of the goal of corporate law that businesses and companies should work toward.

The metaphor this research uses for these competing views and different interpretations is 'voice.' Regulators, judges and scholars all have voices. However, the voice that should prevail is the voice of the company founders. They should determine the goal and purpose of their companies. However, regulators and judges protect the rights of different stakeholders. Determining and protecting are two different tasks, and understanding this would help change how corporate law is perceived. More fundamentally, such an understanding would help deepen the thesis that the goals of companies are set differently. The deeper question of how different agents such as regulators, judges and scholars cope with these two tasks – determining and protecting – lies outside the ambition of this research, and answering such a question is left for future research.

## CONCLUSION

In conclusion, and to answer the question at hand, not all seats in the first row are, or indeed should be, reserved for shareholders. More research on how corporate law is evolving would contribute to the existing corporate law scholarship, and this would help assess a different set of legal and economic corporate law mechanisms.

## ENDNOTES

[i] Blair, M., (2022). *Shareholder Value, Corporate Governance and Corporate Performance: A Post-Enron Reassessment of the Conventional Wisdom*. p. 57.

[ii] Bratton, W. and Wachter, M., (2022). *Shareholder Primacy's Corporatist Origins: Adolf Berle and 'The Modern Corporation'*. p. 101.

[iii] Easterbrook, F. and Fischel, D., (2022). *The Corporate Contract*. [online] Chicago Unbound. Available at: <https://chicagounbound.uchicago.edu/journal_articles/1164/> [Accessed 27 July 2022], p. 22–24.

[iv] Ibid.
[v] Armour, J., Hansmann, H. and Kraakman, R., (2017). *Foundations of Corporate Law*. SSRN Electronic Journal, p. 6–7.

[vi] Hansmann, H. and Kraakman, R. (2004). '*The End of History for Corporate Law*,' in Gordon, J. N. and Roe, M. J. (eds), *Convergence and Persistence in Corporate Governance.* Cambridge: Cambridge University Press, pp. 33–68. doi: 10.1017/CBO9780511665905.002. p. 3–4.

[vii] Ibid.
[viii] Ibid., p. 34.
[ix] To understand the debates about the role of law in economic life and thus the language of freedom and constraint in the market, see Hale (1923), *'Coercion and Distribution in a Supposedly Non-Coercive State'*, p. 38; *Political Sci Q*, pp. 470–94; Isaiah Berlin (1958), *'Two Concepts of Liberty';* MacGilvray (2011), *The Invention of Market Freedom*, CUP.
[x] Ibid.
[xi] Toru Yoshikawa and Abdul A Rasheed, *'Convergence of Corporate Governance: Critical Review and Future Directions* (2009), p. 17; *Corporate Governance*: *An International Review*, p. 388; Alvaro Cuervo, *'Corporate Governance Mechanisms: A Plea for Less Code of Good Governance and More Market Control'* (2002), p. 10; *Corporate Governance: An International Review*, p. 84, pp. 90–91; Moore (n 70), p. 699.

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[xiii] Blair, Margaret M., and Lynn A. Stout. *'A Team Production Theory of Corporate Law.'* Virginia Law Review 85, no. 2 (1999), pp. 247–328. https://doi.org/10.2307/1073662. pp. 321–326.

[xiv] Ibid., p. 280.
[xv] Ibid., pp. 280–281.
[xvi] Ibid., p. 282.
[xvii] Roe M., *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. Pa. L. Rev. 2063 (2001), p. 2065.

[xviii] Ibid., p. 2063.
[xix] Ibid., p. 2066.
[xx] Ibid., p. 2080.
[xxi] Ibid., p. 2069.
[xxii] Ibid., p. 2079.
[xxiii] Karolyi, G. A., (2015). *Cracking the Emerging Markets Enigma*, pp. 58–60.

[xxiv] Bratton, W. and Wachter, *Shareholder Primacy's Corporatist Origins*, p. 711.
[xxv] Ibid., pp. 713–714.
[xxvi] Lipton, Martin and Rosenblum, Steven A. (1991) *'A New System of Corporate Governance: The Quinquennial Election of Directors,'* University of Chicago Law Review: Vol. 58: Iss. 1, Article 3. Available at: https://chicagounbound.uchicago.edu/uclrev/vol58/iss1/3. p. 216.

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[xxviii] Stout, L., *The Shareholder Value Myth, How Putting Shareholders First Harms Investors, Corporations and the Public*, BK, (2012), p. 25.
[xxix] Ibid., p. 27.
[xxx] Ibid, 30; Lipton, Martin and Rosenblum, Steven A., *'A New System of Corporate Governance'*, p. 220.
[xxxi] Stout, L., *The Shareholder Value Myth*, p. 31–32.
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