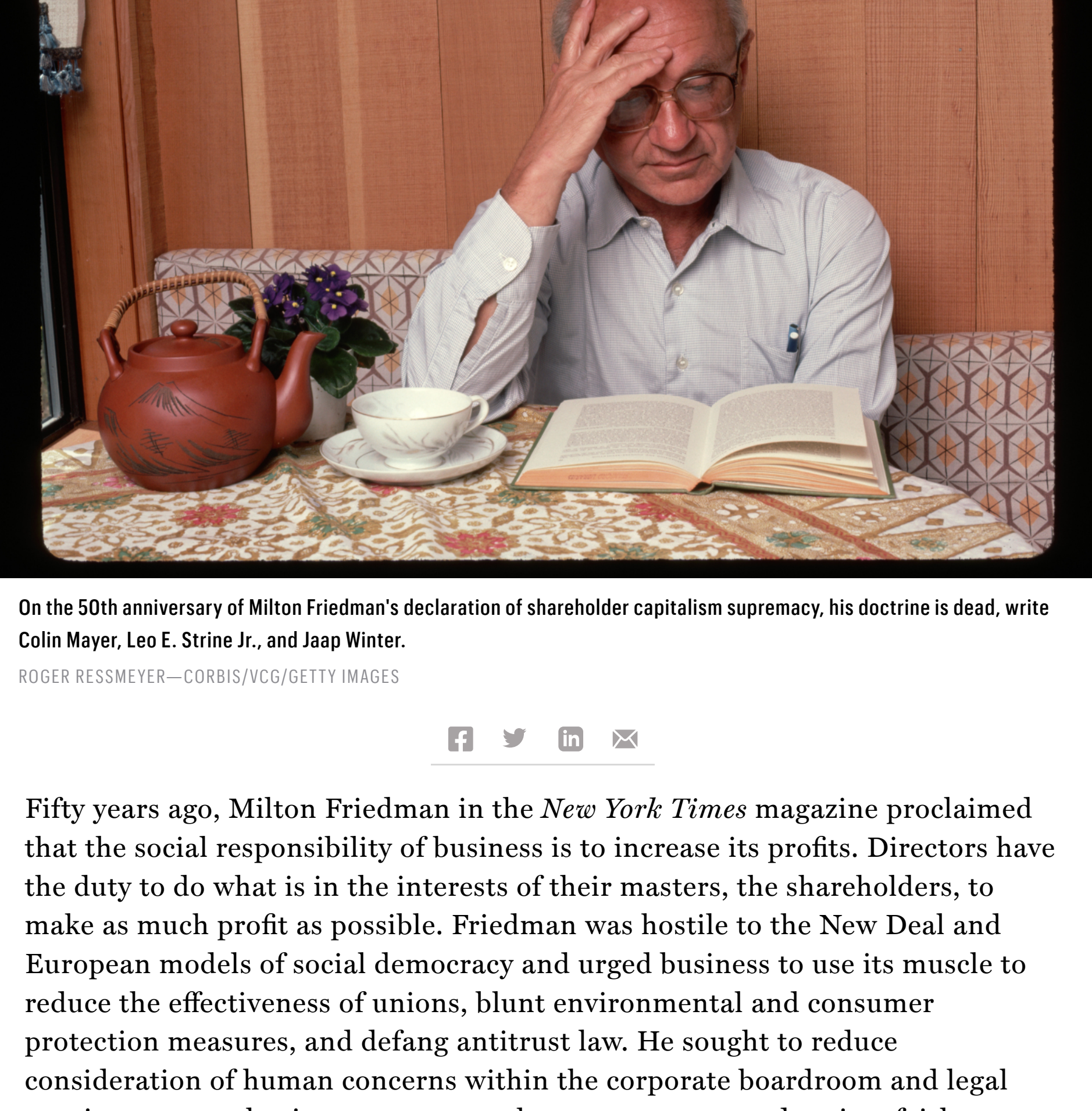


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50 years later, Milton Friedman's shareholder doctrine is dead

BY COLIN MAYER, LEO E. STRINE JR., AND JAAP WINTER September 13, 2020 10:00 AM GMT+1



On the 50th anniversary of Milton Friedman's declaration of shareholder capitalism supremacy, his doctrine is dead, write Colin Mayer, Leo E. Strine Jr., and Jaap Winter.

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Fifty years ago, Milton Friedman in the New York Times magazine proclaimed that the social responsibility of business is to increase its profits. Directors have the duty to do what is in the interests of their masters, the shareholders, to make as much profit as possible.

Over the last 50 years, Friedman's views became increasingly influential in the U.S. As a result, the power of the stock market and wealthy elites soared and consideration of the interests of workers, the environment, and consumers declined.

Under the dominant Friedman paradigm, corporations were constantly harried by all the mechanisms that shareholders had available—shareholder resolutions, takeovers, and hedge fund activism—to keep them narrowly focused on stockholder returns.

Half a century later, it is clear that this narrow, stockholder-centered view of corporations has cost society severely. Well before the COVID-19 pandemic, the single-minded focus of business on profits was criticized for causing the degradation of nature and biodiversity.

Corporate America understood the threat that this way of thinking was having on the social compact and reacted through the 2019 corporate purpose statement of the Business Roundtable, emphasizing responsibility to stakeholders as well as shareholders.

Stockholder advocates are right when they claim that purpose statements on their own achieve little: Calling for corporate executives who answer to only one powerful constituency—stockholders in the form of highly assertive institutional investors—and have no legal duty to other stakeholders to run their corporations in a way that is fair to all stakeholders is not only ineffectual, it is naive and intellectually incoherent.

What is required is to match commitment to broader responsibility of corporations to society with a power structure that backs it up. That is what has been missing. Corporate law in the U.S. leaves it to directors and managers subject to potent stockholder power to give weight to other stakeholders.

Absent any effective mechanism for encouraging adherence to the Roundtable statement, the system is stacked against those who attempt to do so. There is no requirement on corporations to look after their stakeholders and for the most part they do not, because if they did, they would incur the wrath of their shareholders.

If the Roundtable is serious about shifting from shareholder primacy to purposeful business, two things need to happen. One is that the promise of the New Deal needs to be renewed, and protections for workers, the environment, and consumers in the U.S. need to be brought closer to the standards set in places like Germany and Scandinavia.

But to do that first thing, a second thing is necessary. Changes within company law itself must occur, so that corporations are better positioned to support the restoration of that framework and govern themselves internally in a manner that respects their workers and society.

To make this change, corporate purpose has to be enshrined in the heart of corporate law as an expression of the broader responsibility of corporations to society and the duty of directors to ensure this. Laws already on the books of many states in the U.S. do exactly that by authorizing the public benefit corporation (PBC).

The PBC model is growing in importance and is embraced by many younger entrepreneurs committed to the idea that making is money in a way that is fair to everyone is the responsible path forward. But the model's ultimate success depends on longstanding corporations moving to adopt it.

Even in the wake of the Roundtable's high-minded statement, that has not yet happened, and for good reason. Although corporations can opt in to become a PBC, there is no obligation on them to do so and they need the support of their shareholders. It is relatively easy for founder-owned companies or companies with a relatively low number of stockholders to adopt PBC forms if their owners are so inclined.

That is why the law needs to change. Instead of being an opt-in alternative to shareholder primacy, the PBC should be the universal standard for societally important corporations, which should be defined as ones with over \$1 billion of revenues, as suggested by Sen. Elizabeth Warren. In the U.S., this would be done most effectively by corporations becoming PBCs under state law.

Corporate shareholders and directors enjoy substantial advantages and protections through U.S. law that are not extended to those who run their own businesses. In return for offering these privileges, society can reasonably expect to benefit, not suffer, from what corporations do. Making responsibility in society a duty in corporate law will reestablish the legitimacy of incorporation.

There are three pillars to this. The first is that corporations must be responsible corporate citizens, treating their workers and other stakeholders fairly, and avoiding externalities, such as carbon emissions, that cause unreasonable or disproportionate harm to others. The second is that corporations should seek to make profit by benefiting others. The third is that they should be able to demonstrate that they fulfill both criteria by measuring and reporting their performances against them.

The PBC model embraces all three elements and puts legal, and thus market, force behind them. Corporate managers, like most of us, take obligatory duties seriously. If they don't, the PBC model allows for courts to issue orders, such as injunctions, holding corporations to their stakeholder and societal obligations.

Our proposal to amend corporate law to ensure responsible corporate citizenship will prompt a predictable outcry from vested interests and traditional academic quarters, claiming that it will be unworkable, devastating for entrepreneurship and innovation, undermine a capitalist system that has been an engine for growth and prosperity, and threaten jobs, pensions, and investment around the world.

Of course, it will do exactly the opposite. Putting purpose into law will simplify, not complicate, the running of businesses by aligning what the law wants them to do with the reason why they are created. It will be a source of entrepreneurship, innovation, and inspiration to find solutions to problems that individuals, societies, and the natural world face. It will make markets and the capitalist system function better by rewarding positive contributions to well-being and prosperity, not wealth transfers at the expense of others. It will create meaningful, fulfilling jobs, support employees in employment and retirement, and encourage investment in activities that generate wealth for all.

We are calling for the universal adoption of the PBC for large corporations. We do so to save our capitalist system and corporations from the devastating consequences of their current approaches, and for the sake of our children, our societies, and the natural world.

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