BEYOND SHAREHOLDER VALUE: NORMATIVE STANDARDS FOR SUSTAINABLE CORPORATE GOVERNANCE

by

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[The] alignment of the interests of the strategic managers of US public corporations with the demands of the stock market is now typically regarded as a defining feature of the market-oriented US system of corporate governance.¹

From the fourth quarter of 2004 through the third quarter of 2008, companies in the S.&P. 500, as a group, earned revenues of $2.42 trillion and distributed $2.64 trillion to shareholders through dividends and stock buy-backs.²

Abstract

This paper explores whether the modern corporate governance model is sustainable. For many, particularly large, corporations, there is a separation between ownership and management, with an emphasis by management on short-term gains at the expense of long-term sustainability. This paper explores the role of corporate directors, particularly vis-à-vis shareholders, from an interdisciplinary perspective, analyzing legal case law as well as legal, management, and finance literature. This paper then explores emerging trends in expanding notions of corporate governance that incorporate concerns beyond just shareholders, recognizing the interrelationship between business and society. It is suggested that in order to remain viable and competitive, corporations need to normalize longer views of sustainability that encompass numerous stakeholders, rather than simply trying to maximize profits during the current quarter.

Introduction

This paper explores whether the modern corporate governance model is sustainable. The corporation is unquestionably an important element of the United States’ economy. While not the most prevalent form of business—representing less than 20% of business organizations—corporations generate approximately 85% of American business revenues.³ Throughout history, the corporate form has served as the most appropriate vehicle to raise and marshal substantial resources.⁴ From its formal inception, the corporation has offered two principal advantages: legal existence separate from its owners, and transferability of owners’ interests in the corporation. The separate legal existence allows the corporation to own assets, enter contracts, and incur liabilities that are legally separate from those of its owners and managers.⁵ Importantly, not only are the owners’ personal assets shielded from the corporation’s creditors,⁶ but the corporate assets, as well, are shielded from the claims of the owners’ personal creditors.⁷ Transferability of ownership means that the corporation does not need to liquidate in the event one or more owners wish to terminate their interest in the firm.⁸

For many, particularly large, corporations, there is a separation between ownership and management. How can the corporation’s owners (the shareholders/stockholders) be assured the managers (directors and officers) will not pursue their own personal gains at the expense of those of the owners?⁹ The answer is that the managers of the corporation act essentially as trustees for corporate resources and as agents of the owners. Managers may not use corporate resources for their own purposes in conflict with the shareholders.¹⁰

In theory, imposing fiduciary duties upon corporate managers to protect the property interests of shareholders is the preferred approach. But in practice, does it work? As one commentator has asked:

How does it happen that millions of individuals are willing to turn over a significant fraction of their wealth to organizations run by managers who have so little interest in their welfare? What is even more remarkable, why are they willing to make these commitments purely as residual claimants, i.e., on the anticipation that managers will operate the firm so that there will be earnings which accrue to the stockholders?¹¹

Shareholders invest in corporations with the understanding that managers will strive to maximize shareholder value—i.e., maximize profits. But is this theory of profit maximization sustainable? This paper explores issues related to that question, starting with a brief overview of the historical development of corporations and their role in the American economy. The role of corporate directors is considered next, particularly vis-à-vis shareholders, from an interdisciplinary perspective, analyzing legal case law as well as legal, management, and finance literature. Recent trends suggest that the major role of large, publicly-traded corporations is not so much to maximize the wealth of their shareholders, but rather to maximize the wealth of investors—i.e., they exist not necessarily to build a lasting business, but to provide continually increasing short-term profits. It is argued that this approach is not sustainable from a long-term competitive perspective. This paper then explores emerging trends in expanding notions of corporate governance that incorporate concerns beyond...
just shareholders, recognizing the interrelationship between business and society. It is suggested that in order to remain viable and competitive, corporations need to normalize longer views of sustainability that encompass numerous stakeholders, rather than simply trying to maximize profits during the current quarter.

A Brief History of the Corporate Form of Business

The immediate precursor to the corporation can be traced to joint-stock companies that offered transferrable shares of ownership, appearing as early as the thirteenth century. The first English joint-stock company was formed in 1554, and the first joint-stock company to operate in America was formed in 1587. In England, formal chartering of a joint-stock company required special permission by the crown or an act of Parliament. Typical of the joint-stock companies formed during this time was the East India Company, chartered by Queen Elizabeth in 1600, granting a monopoly to an association of merchants trading in the East Indies. Because the expense of outfitting ships for voyages, often taking several years to complete, was too great for individual merchants, the East India Company offered the financial opportunity for “noblemen, gentlemen, shopkeepers, widows, orphans, and all other subjects” to be traders, and employ their capital in a joint stock with profits to be distributed in the same proportion as amounts contributed. “In fact the whole advance of English discovery, commerce, and colonization in the sixteenth and early seventeenth centuries was due not to individuals but to the efforts of corporate bodies.” These early corporations had a direct or quasi-governmental purpose, legitimizing a range of public functions performed by foreign trading companies in organizing terms of trade, setting up local governments, controlling customs, and making foreign policy in their areas of operation. Civil corporations were also formed for the benefit of cities and towns, while “special” corporations were formed to promote special governmental objectives, such as trade, charity, or running hospitals.

Just as the free transferability of stock protects corporations from liquidation demands by stockholders, it also creates a secondary market in that stock. As the number of joint-stock companies grew, secondary trading in their stock increased, to the extent that speculation by “stock-jobbers” in “Exchange Alley” in London became the rage in the early part of the eighteenth century. As an offshoot of rampant speculation in the stock of one charted company, the South-Sea Company, hundreds of joint-stock “Bubble” companies were formed in 1719-1720, many lasting two weeks or less. The number of enterprises seeking to raise capital far outstripped the number of charters Parliament or the crown were willing to grant; therefore, most Bubble companies only imitated joint-stock companies since they lacked a government charter.

In July 1720, the English government tried to tame the speculation by dismissing all petitions for charters and declaring illegal all Bubble companies. Specifically, by passing the “Bubble Act”, Parliament made it illegal to act as a corporation, including issuing transferable stock, without a charter. Thus the world’s first stock bubble was burst.

Although the bursting of the “South-Sea bubble” engendered “great distrust in corporate enterprises …[I]” despite passage of the Bubble Act, unchartered joint-stock companies continued to be created and operate until repeal of the Act in 1825; corporate charters were difficult and expensive to obtain, the fruit of special privilege, and unincorporated joint stock companies conducted business outside the recognition and protection of the law.” According to Mahoney, as a result of the Bubble Act, there was no development of a common law of joint-stock companies until the Act’s repeal.

The Bubble Act was extended to the American colonies in 1741. According to Williston, Pennsylvania was the first colony to charter a corporation in 1768, with only five more charters issued in America prior to 1787. Upon enactment of the United States Constitution the authority to issue corporate charters passed to the individual states. But only a handful of states, such as Delaware, Massachusetts, New Jersey, New York, and Pennsylvania, initially passed legislation providing for corporate charters. Though estimates vary, it appears that less than 335 corporate charters had been granted in the United States by the end of the eighteenth century, 295 of those in the last decade of the century. In contrast to England earlier in the eighteenth century, speculation in corporate securities in America was minimal.

Incorporation in America required a special act of a state legislature until approximately the mid-nineteenth century. Following the economic depression of 1837-1844, many states held constitutional conventions which added provisions separating corporate business opportunities from state politics. Legislatures began to enact general incorporation statutes under which anyone could organize a business corporation by preparing and filing articles of incorporation, resulting in a watershed in the development of the modern American corporation.

And while many of the early American corporations were devoted to quasi-governmental purposes, such as building canals and toll roads, it was the surge of manufacturing businesses seeking incorporation, coupled with the growing railroad concerns needing to raise substantial capital, that drove the need for general purpose incorporation legislation. “By 1886 the corporation… was becoming dominant in important lines of manufacturing and being used to a substantial extent for conducting many other types of business enterprise.”

By the end of the nineteenth century and into the twentieth century, American businesses began to expand into nationwide activities and compete globally in a number of industrial segments, requiring high levels of mass-production. The industrial enterprises that dominated America’s most vital industries by the end of the nineteenth century—the archetypes of today’s large, publicly-held corporations—resulted from the integration of the processes of mass production and mass distribution within a single firm. The corporate form of business was ideal for this environment, providing a means to finance increasing capital costs as well as a mechanism for managing resources.
In 1896 New Jersey adopted what is regarded as the first of the fully modern corporation statutes.\textsuperscript{45} In 1899 Delaware enacted its modernized General Corporation Law.\textsuperscript{46} Although the law was modeled after New Jersey’s corporation statute, Delaware’s General Corporation Law soon became the most popular in the United States because of “three principal features: a simple procedure for formation; low corporate taxes; and a broad statement of the powers granted to the corporation by the State.”\textsuperscript{47} The Delaware 1899 General Corporation Law granted to corporations the power to conduct business in other states, the power to hold stocks and bonds of other companies, the power to merge, and protected shareholders from liability except to the extent of the par value of their holdings.\textsuperscript{48} Liberalization of incorporation laws by (initially) New Jersey and Delaware sparked competition among a handful of states to liberalize their own statutes to compete for corporate charters. In particular, these updated laws allowed those controlling the corporation the opportunity “to write charters and bylaws which gave them the structure and procedures they wanted.”\textsuperscript{49} For example, revisions in the 1920s to Delaware’s General Corporation Law “gave almost unlimited power to directors vis-à-vis investors, … [attesting to] the importance attached to a free hand for those who sat atop broad stockholder constituencies.”\textsuperscript{50}

From the financial perspective, larger businesses needed to raise capital far beyond the capacity of a few investors. For example, capital injected into the railroad network rose from $300 million in 1850 to over $21 billion in 1916.\textsuperscript{51} As a consequence, a financial industry arose to facilitate raising large sums of capital from a large number of people. By the second decade of the twentieth century, most of the leading economic sectors in the United States were financed by way of publicly held stocks and bonds.\textsuperscript{52} By 1912, securities represented 19% of total United States assets.\textsuperscript{53} The combination of relaxed corporation codes and increased need for capital is reflected in the number of incorporations each year in the nineteenth and twentieth centuries. There were never more than 1,000 incorporations in any single year in the United States prior to 1880, with an average of approximately 250 incorporations per year from 1800 through 1879.\textsuperscript{54} Annual new incorporations exceeded 5,000 in 1892 and 10,000 in 1901, peaking at over 45,000 by 1929 before falling precipitously to just over 12,000 by 1943.\textsuperscript{55} After 1943, no one has compiled state-by-state annual incorporations. The United States Census Bureau began tracking the total number of corporations in the United States beginning in 1916. The aggregate data reflect a similar trend, with 340,000 total corporations in the United States in 1916, peaking at 533,000 in 1935 before a decline through 1946.\textsuperscript{56} Since the mid-1940s, there has been a steady increase in the number of corporations in the United States, reaching 1 million in 1958,\textsuperscript{57} and climbing to over 5.5 million in 2005.\textsuperscript{58} And while Delaware has long had the reputation of being the most popular state in which to incorporate,\textsuperscript{59} it was never home to more than 20% of incorporations between 1800 and 1943.\textsuperscript{60} Since the mid-twentieth century, however, Delaware has maintained its prominence, primarily because it initially attained the status as the preferred state for incorporation.\textsuperscript{61}

Recently, the Delaware Division of Corporations has boasted that Delaware is the corporate home of 61% of the Fortune 500 companies and half of all United States firms traded on the New York and NASDAQ stock exchanges.\textsuperscript{62} This is significant because, for example, in 2005, the largest 500 American companies, out of nearly 30 million business entities, generated 28% of total United States business revenues.\textsuperscript{63}

The Nature of the Modern Corporation

As corporations began to dominate economic activity in the United States, commentators began to examine the role of governance in the evolving corporate culture. Writing in 1932, Berle and Means noted the widening dispersion of stock ownership, particularly among the largest corporations.\textsuperscript{64} As a result, they observed, control of the corporation was passing from the shareholders to the directors.\textsuperscript{65} The shareholder was evolving from “a quasi-partner, manager and entrepreneur, with definite rights in and to property used in the enterprise and to the profits of that enterprise as they accrued, …” to essentially a bondholder—merely a supplier of capital with minimal power to participate in management.\textsuperscript{66} Berle and Means argued that this separation of control from ownership led to a perverse logic: any profits exceeding a “fair return” should be distributed to those in control as an inducement for efficient management, resulting in the corporation being operated in the financial interests of management, leaving the shareholders merely as the recipients of the wages of capital.\textsuperscript{67}

Berle and Means were reacting to the fact that the process of raising significant amounts of capital from large numbers of investors led to a separation of equity ownership from strategic control over the allocation of corporate resources, which was increasingly vested in the hands of career managers.\textsuperscript{68} The role of the shareholder began to change from one of “owner” to “investor”, along with a commensurate change of attitude by management toward the shareholder. “Stockholders know nothing about the business nor do they care anything about it. … They are only [buying or] selling a commodity … if it does not yield them adequate returns, they sell their shares.”\textsuperscript{69}

How, then, could the interests of these uninvolved, disinterested shareholders be protected? First, if firms devoted their resources to maximizing profits, shareholders should be satisfied. In the 1960s, the “shareholder value” approach began to dominate corporate practice: “there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud.”\textsuperscript{70} This approach dovetailed nicely with the historic role of management, which satisfied Adam Smith’s concern of ensuring that shareholder interests were protected from managers who had possibly conflicting priorities.\textsuperscript{71}

Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the
corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers.\textsuperscript{72}

Second, a principal-agent theory began to take hold—shareholders, who are unable or unwilling to actively manage the corporation, are principals who appoint directors as their agents to run the business.\textsuperscript{73} The principal-agent theory addressed not only methods to prevent managers from stealing capital from shareholders,\textsuperscript{74} but also provided a methodology to address managers’ self-interest motives that differed with the profit maximization priority of the firm.\textsuperscript{75} “Given information asymmetry between principals and agents—that is, the agents are much better informed both about their own actions and about their outcomes—it is never likely to be optimal for the agents to act in a way that is optimal for the principals.”\textsuperscript{76}

Jensen, Meckling, and Fama argued that shareholders can ensure managers act in the shareholders’ best interest through monitoring and incentives. Incentives for management can be increased to minimize monitoring costs.\textsuperscript{77} As a result, managers have been financially rewarded for maximizing shareholder value in firms. “For most economists and legal scholars, the debate is more about how to implement shareholder value than about its legitimacy. \[¶\] Much of this debate focuses on what constitutes an efficient monitoring structure.”\textsuperscript{78}

The time horizon for management’s incentives is critical. Too short of a time horizon can result in management pursuing high, short-term profits at the expense of future profitability, particularly if the managers leave after the high-profit period.\textsuperscript{79} Granting stock options can lessen short-termism, since stock prices also incorporate anticipated future performance of the firm.\textsuperscript{80} The problem is, however, that since managers’ compensation will potentially decline if the corporation’s share price also declines, managers will therefore become more risk-averse.\textsuperscript{81} Investment in research and development (R&D) is generally a high-risk/high-return strategy that is attractive to stockholders because they anticipate a positive effect on performance and they can reduce the inherent risk by keeping diversified investment portfolios; whereas executives will be reluctant to invest in long-term R&D projects because innovative projects have high failure rates and do not return short-term yields.\textsuperscript{82}

There is evidence that managers are exploiting a flaw in the interrelationship between the principal-agent and shareholder-value approaches. Some commentators have argued that these approaches have distracted corporations from their substantive business models to pursuing increasing share prices.\textsuperscript{83} In a continual attempt to increase share prices, directors resort to share repurchases, restructuring, and reshuffling finances, such as changing inventory valuation methods, accelerating income, deferring expenses and changing pension actuarial assumptions.\textsuperscript{84} For example, from the fourth quarter of 2004 through the third quarter of 2008, companies in the S.&P. 500, as a group, earned revenues of $2.42 trillion and distributed $2.64 trillion to shareholders through dividends and stock buy-backs.\textsuperscript{85} As noted by O’Sullivan, the “alignment of the interests of the strategic managers of US public corporations with the demands of the stock market is now typically regarded as a defining feature of the market-oriented US system of corporate governance.”\textsuperscript{86}

“Innovation is the process through which productive resources are developed and utilized to generate higher quality and/or lower cost products than had previously been available.”\textsuperscript{87} And it is corporate governance that influences how corporations allocate resources and returns; it “shapes who makes investment decisions in corporations, what types of investments they make, and how returns from investments are distributed.”\textsuperscript{88} Tylecote and Visintin found that United States corporations that are directly controlled by shareholders—family- and venture capital-dominated firms—tend to be governed for the longer view; whereas firms with substantial outside shareholder interest tend to focus on maximizing shareholder value and spend relatively less on research and development.\textsuperscript{89} Other commentators have reached similar conclusions: Hayes and Abernathy have argued that lower post-WWII productivity growth in the United States, compared to Germany and Japan, was due in part to management’s focus on short-term cost reduction rather than long-term development of technological competitiveness;\textsuperscript{90} a decade later, Porter concluded that the innovative shortcomings of American businesses were the result of short time horizons, ineffective corporate governance, and high costs of capital—all symptoms of larger problems within the United States’ capital investment system.\textsuperscript{91}

“To be successful, corporations must innovate to provide products and services that their customers prefer to competitive alternatives. This continual innovation is a risk-oriented process which entails the possibility of failure and inadequate economic results.”\textsuperscript{92} Corporate decisions to carry on R&D activities “are typically risky, unpredictable, long-term oriented and multistage, labour intensive and idiosyncratic.”\textsuperscript{93} Studies have identified a relationship between stock ownership and risk-taking; namely, corporations with large numbers of stockholders engage in less (risky) R&D projects. This appeared to be especially critical in the 1980s, as United States firms faced stagnation in productivity, coupled with the emergence of Japanese firms as serious competitors, even in internal markets.\textsuperscript{94} In the 1980s, with American corporations beginning to experience significant competition from overseas competitors, “US corporate managers faced a strategic crossroads: they could find new ways to generate productivity gains on the basis of ‘retain and reinvest’, or they could capitulate to the new competitive environment through corporate downsizing.”\textsuperscript{95} The focus of corporate activities changed:

In the past two decades there has been a noticeable shift in US corporate behavior away from a strategy of retaining both people and money within corporate enterprises towards releasing them onto
labour and capital markets. To account for such actions, US corporate managers have proclaimed that the prime, if not only, responsibility of the corporation is to “create value for shareholders”. For their success in “maximizing shareholder wealth”, these strategic managers receive ample, and often exorbitant, personal rewards, even as most other corporate employees experience lower earnings and less employment stability.

Although studies have indicated that corporations with large numbers of stockholders engage in fewer R&D projects, there is still some debate as to whether diverse stock ownership, particularly associated with institutional investors, helps foster a low-risk, less innovative corporate culture. Institutional ownership of corporate stock grew from 12% of New York Stock Exchange companies in 1949 to over 50% in the 1980s across a number of industry sectors. Some research has suggested that institutions are good investors and look for long-term gains from their investments, and that the large holdings of institutional investors provide an incentive to monitor managers and influence firm actions, if necessary. However, Graves and Waddock concluded that: institutional investors, of necessity, evaluate their holdings largely based on financial performance measures and that only a very small percentage even consider a clear measure of long-term competitiveness in their investment decisions; the very size of the institutional holdings has forced investment managers to become more active in influencing the strategies of their portfolios of companies, so that institutions influence corporate managers not only by their presence but by their advice and influence in major corporate decisions; and that pressures imposed by institutional investors are heavily weighted on the short-term.

Strategies focusing on innovation are often considered high risk because of the high failure rate of most innovations and the risk that a successful innovation may be rendered obsolete by the technological advances of a competitor. As a result, a strategy emphasizing innovation becomes a high stakes gamble that top management is more frequently unwilling to take out of fear that institutional investors will sell their stake in the firm. Short-termism is a disease that infects American business and distorts management and boardroom judgment. But it does not originate in the boardroom. [It] is bred in the trading rooms of the hedge funds and professional institutional investment managers who control more than 75% of the shares of most major companies. Short-termist pressure bred by stockholder power demanded unsustainable ever-increasing (quarterly) earnings growth, possible only via the shortcut of over-leverage and reduced investment, and the dangerous route of excessive risk. Stability and financial strength to weather economic cycles were sacrificed for immediate satisfaction. That short-termist pressure, in the view of many observers, contributed significantly to the financial and economic crises we face today.

These commentators who lament short-termism place the blame squarely on the shoulders of shareholders, particularly institutional shareholders. What they do not acknowledge, however, are directors who bow to short-term pressures to the long-term detriment of their firms.

Modern Corporate Governance Standards—Deference to Directors

Corporate law grants directors and officers significant deference when seeking to maximize shareholder value, even when shareholders lose substantial sums of money. Powers granted to the corporation and its managers have been derived primarily through competition among the states for corporate charters. States have sought to attract corporate charters, primarily for the revenues they generate, by lowering incorporation costs and eliminating restrictions on corporate activities. States that sought to maintain restrictions found that local businesses would simply obtain foreign (i.e., out-of-state) charters. As a result, as one state loosened restrictions, other states followed. This race to the bottom “was one not of diligence but of laxity.” This argument is supported by the history of the development of Delaware’s General Incorporation Law. Delaware corporation law provides significant leadership in United States corporate governance standards because of Delaware’s historic role as the preferred state of incorporation for large, publicly-held corporations—over half the firms that generate 28% of total American business revenues are regulated by the Delaware General Corporation Law.

A director’s fiduciary duty to the shareholders has been characterized as a triad of due care, good faith, and loyalty. “That triparte fiduciary duty does not operate intermittently but is the constant compass by which all director actions for the corporation and interactions with its shareholders must be guided.” As laudable as these duties may be, in practice, they may now actually be anachronistic.

It is argued that “[w]ealth is maximized when corporations are run by directors who know that their decisions will be reviewed by investors, by analysts, by stockholders, and by business partners—but not by the courts.” In determining directors’ fiduciary duties, the Delaware courts balance specific policy considerations, such as the need to keep directors and officers accountable to shareholders, and the degree to which the threat of personal liability may discourage beneficial risk taking. In practice, the Delaware courts have continually granted great deference to director decisions, as long as there was no overt intent to personally profit from the decision or to harm the corporation.

For example, the Delaware Chancery Court recently considered a complaint by Citigroup shareholders that the Citigroup board breached its fiduciary duties by failing to understand the risks associated with the firm’s exposure to the subprime lending market. The court began its analysis by distinguishing “between (1) a board decision that results in a loss because that decision was ill advised or ‘negligent’ and (2) an unconsidered failure of the board to act in circumstances
in which due attention would, arguably, have prevented the loss.”114 In the former case, directors are protected by the business judgment rule and are not subject to judicial second guessing short of evidence of gross negligence.115 In the latter case, to establish liability it must be shown that “the directors knew they were not discharging their fiduciary obligations or that the directors demonstrated a conscious disregard for their responsibilities such as by failing to act in the face of a known duty to act.”116 The Court summarized the shareholders’ claims as attempting to hold the directors personally liable for making (or allowing to be made) business decisions that, in hindsight, turned out poorly for the company.117 This type of decision-making, according to the court, falls within the business judgment rule: “a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.”118 The burden is on the shareholders who are challenging the directors’ decision to rebut this presumption.119 “[A]bsent an allegation of [self-]interestedness or disloyalty to the corporation, the business judgment rule prevents a judge or jury from second guessing director decisions if they were the product of a rational process and the directors availed themselves of all material and reasonably available information.”120

The great deference to management decisions is tempered by the notion that it is the shareholders who ultimately control the board of directors:

The perspective of the corporate law traditionalist is one that recognizes there is great value to the American … approach to corporation law. This approach invests corporate managers with a great deal of authority to pursue business strategies through diverse means, subject to a few important constraints. These constraints—that stockholders approve certain important transactions such as mergers, vote for directors annually, and have access to books and records; that stockholders can hold managers accountable for failing to fulfill their fiduciary duties; and that state and federal policies give independent directors the clout and duty to police corporate insiders—are vital. They provide assurance that managers will not abuse the powers granted them, thereby instilling confidence in investors that capital may be safely entrusted to corporations run by centralized management.121

In theory, “[i]f the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out.”122 Arguably, the fear of replacement by disgruntled shareholders makes directors accountable and provides them with incentives to serve shareholder interests.123 This replacement power is especially important when director decisions are insulated from judicial review.124

But in reality, at least for large, publicly-held corporations, the “powers of corporate democracy” may be missing.125 While shareholders elect the directors, they are actually left with little opportunity to actively participate in the director nomination process.126 One major impediment is Securities Exchange Act Rule 14a-8(i)(8),127 which regulates shareholder proposals that can be included in proxy statements for corporate annual shareholder meetings.128 If a shareholder seeking to submit a proposal meets certain eligibility and procedural requirements, the corporation is required to include the proposal in its proxy statement.129 However, a corporation may exclude a shareholder proposal “[i]f the proposal relates to an election for membership on the company’s board of directors or analogous governing body.”130 The result is that if shareholders wish to contest directors nominated by the existing board, they have to prepare and distribute their own proxy materials.131

Empirical evidence suggests this is a substantial impediment. Bebchuk examined contested director elections for publicly-held corporations over the decade 1996-2005. During the decade, there were only 118 director contests seeking to change the leadership team governing the corporation.132 The majority of the contests involved small firms; there were only 24 such contests within firms with market capitalization exceeding $200 million—and of those, only 8 challenges were successful.133 During the 2008 proxy season, there were 50 contests involving director elections in which shareholders distributed a separate proxy; 11 of the contests were successful.134

**Corporate Governance for the Twenty-First Century**

Anecdotal evidence suggests that shareholder-directors interests are not necessarily aligned and that the current corporate governance structure is not sustainable: a concern that American companies are losing their competitive edge in innovation;135 the (as of now) near-collapse of the domestic American automobile industry;136 the transfer of manufacturing overseas;137 and the stagnation of wages,138 coupled with the exponential rise in executive compensation.139 Regarding the 2008-09 financial crises, one commentator has flatly stated: “There’s no other way of saying it: today’s doctrines of shareholder primacy and managerial self-interest have brought many companies to the brink of self-destruction.”140 These developments lend support to the argument of “[c]apital market myopia … as the determinant of lower levels of investment in innovation.”141 Though not addressing corporate governance directly, Lewis and Einhorn aptly describe the current situation: “Obviously the greater the market pressure to excel in the short term, the greater the need for pressure from outside the market to consider the longer term. But that’s the problem: there is no longer any serious pressure from outside the market.”142

Pressure could come from the courts or shareholders. But the Delaware courts have clearly indicated the business judgment rule is alive and well.143 The Delaware legislature has just enacted an amendment to its General Corporation Law which permits corporations to include in their bylaws provisions requiring the corporation to include in proxy materials directors nominated by shareholders,144 thus potentially eliminating one of the major obstacles to shareholder control over the
actions of the directors. But the amendment only allows corporations to include this provision; it does not require them to do so. It is too early to know whether this change will have significant impact on corporate governance.

Meanwhile, Congress has taken an interest in corporate governance and sustainable business prosperity. It has found that: among the central causes of the financial and economic crises that the United States faces today (2009) has been a widespread failure of corporate governance; both executive management and boards of directors have failed in their most basic duties, including enacting compensation policies linked to the long-term profitability of their institutions and to prioritize the long-term health of their firms and their shareholders; a key contributing factor to such failure was the lack of accountability of boards to their ultimate owners, the shareholders; and providing a greater voice to shareholders while not impinging on management prerogatives is in the best interests of shareholders, public corporations, and the economy as a whole.\textsuperscript{145}

The Shareholder Bill of Rights Act of 2009 (which refers to publicly-traded corporations as “issuers”) would require that: in proxy materials, issuers must provide for an advisory vote on the compensation packages for executives, and in any acquisition, merger, consolidation or proposed sale or other disposition of substantially all of the assets of an issuer, issuers must disclose, and provide an advisory shareholder vote on, any type of compensation for executives of the issuer or acquiring issuer;\textsuperscript{146} the SEC amend its rules to allow shareholders who have owned at least 1% of the company’s voting shares for at least two years to use the issuer’s proxy materials to nominate members of the board of directors;\textsuperscript{147} and in order to remain listed on stock exchanges, issuers must elect a Chairperson of the Board of Directors who is not currently serving, and has not previously served, as an executive officer of the issuer, eliminate staggered boards, elect board members only by a majority of shareholder votes cast, and maintain a risk committee comprised entirely of independent directors, responsible for the risk management practices of the issuer.\textsuperscript{148}

While the Delaware and potential federal legislation are aimed at strengthening shareholder powers, shareholders are not the only constituents that have a stake in a corporation’s activities. Additional interested constituents include employees, suppliers, local citizens and governments, and customers. Justification for maximization of shareholder value is based on the fact that shareholders are the only stakeholder who make investments in the corporation without any contractual guarantee of a specific return. “As ‘residual claimants’, shareholders thus bear the risk of the corporation’s making a profit or loss and have an interest in allocating corporate resources to their ‘best alternative uses’ to make the residual as large as possible.”\textsuperscript{149} The argument is that since all the other stakeholders in the corporation will receive the returns for which they have contracted, “the ‘maximization of shareholder value’ will result in superior economic performance not only for the particular corporation but also for the economy as a whole.”\textsuperscript{150}

Commentators are beginning to recognize, however, that there is an alternative to the shareholder value approach to corporate governance; that corporations have broader social responsibilities which include economic, legal, ethical, and discretionary (i.e., philanthropic) considerations.\textsuperscript{151} Even the classical capitalist ideology—maximizing shareholder value—“logically entails a market morality that makes individuals and firms responsible for maximizing profits so long as they comply with the law, adhere to familiar moral standards of honesty, fidelity and fairness, and respect those individual moral rights that are presupposed by capitalist market arrangements.”\textsuperscript{152}

Many of these broader social responsibilities were recognized over 50 years ago by Bowen, who summarized the historical moral obligations of business people:

1. to observe the rules of property;
2. to honor contracts;
3. to refrain from deception and fraud;
4. to be efficient and to promote economic progress;
5. to protect life, limb, and health of workers and the general public;
6. to compete vigorously, and in case of failure of competition to act with restraint;
7. to accept and respect the economic freedoms of consumers, workers, and owners; and
8. to have regard for the human rights of workers.\textsuperscript{153}

Bowen argued that the system of laissez faire—i.e., a market-based exchange economy—declined because of conflicts between individual and social interests; essentially because business people did not achieve their moral obligations.\textsuperscript{154}

The federal government has served as a source of imposing social responsibilities on businesses, in the form of laws such as the National Environmental Policy Act of 1969,\textsuperscript{155} the Sherman Antitrust Act of 1890,\textsuperscript{156} Title VII of the Civil Rights Act of 1964,\textsuperscript{157} and the Sarbanes-Oxley Act of 2002.\textsuperscript{158} But, as Rodewald notes, “the legal mechanisms through which government must act are an inherently crude, ineffective, costly, and sometimes counterproductive means for controlling corporate behavior[,]” as well as being reactive with a time lag that can result in irreparable damage between recognition of a problem and enactment of legislation.\textsuperscript{159}

Rodewald discusses the difference between the agent-of-capital (maximizing shareholder value) and the agent-of-society, in which managers are morally responsible for considering the likely human, social and environmental consequences of the alternative courses of action open to them, as well as the interests of all those who will be affected by their decisions. In their decisions, managers must integrate a wide range of nonmarket considerations including pollution levels, resource depletion effects, the quality of community life, unemployment, income distribution, wealth, and existing race and sex inequality. Then they must try to identify potential problems and alternatives for solving them, and assess the social costs and benefits of each of their options. Furthermore, they will have to identify individual moral rights and impartially weigh competing claims in
light of the considerations of justice. Ultimately, they should try to pursue the course of action that they con-clude, all things considered, is reasonable to expect will maximize individual and social benefits over costs in a way that is consistent with the requirements of social justice. These are significant responsibilities. Conversely, Mayer expresses the more contrarian—and cynical view—of the corporation’s role in society:

[1] It is no accident that many people react to the notion of “business ethics” as an oxymoron. [The theory that] “good ethics is good business[;]” … advises companies to claim the moral high ground in order to protect their reputations in the marketplace, avoid scandalous shocks to stakeholder value, develop reliable and trustworthy suppliers, and energize loyal employees to be creative and productive team members. As a managerial strategy, this makes sense; but it is clearly an instrumental strategy rather than something worth doing for its own sake. This, in turn, poses the irony that “being ethical” … is subservient to getting ever more money, which has no inherent value. But if society as a whole cannot agree precisely which values should be advanced, why should it be the responsibility of corporate managers?[162] Further, while theories promoting profit maximization may have their flaws for sustaining long-term corporate sustainability, sacrificing corporate profits in pursuit of nonmarket social goals can make a firm uncompetitive and, ultimately, unsustainable.[163]

While the “era of self-interested companies trying to maximize shareholder wealth at any cost appears to have been supplanted by an era of corporate social responsibility,”[164] firms must remain financially viable. Trudel and Cotte found that consumers are willing to pay substantially more for ethically produced goods, implying there is a financial reward for socially responsible behavior.[165] In addition, Trudel and Cotte found that consumers will punish the producer of unethically produced goods more than they will reward a company that offers ethically produced goods: “The negative effects of unethical behavior have a substantially greater impact on consumer willingness to pay than the positive effects of ethical behavior.”[166]

Margolis, Elfenbein and Walsh performed a meta-analysis of the empirical link between corporate social performance and corporate financial performance through 167 studies over 35 years; they found a positive, though small, link.[167] In a follow-up discussion of the meta-analysis, Margolis and Elfenbein suggest that while acting in a socially responsible way may not be highly profitable, doing good does not destroy shareholder value.[168] Porter and Kramer emphasize that business and society are mutually dependent and must make choices that benefit both sides.[169] They aptly describe this interdependence:

Successful corporations need a healthy society. Education, health care, and equal opportunity are essential to a productive workforce. Safe products and working conditions not only attract customers but lower the internal costs of accidents. Efficient utilization of land, water, energy, and other natural resources makes business more productive. Good government, the rule of law, and property rights are essential for efficiency and innovation. Strong regulatory standards protect both consumers and competitive companies from exploitation. Ultimately, a healthy society creates expanding demand for business, as more human needs are met and aspirations grow. Any business that pursues its ends at the expense of the society in which it operates will find its success to be illusory and ultimately temporary.

At the same time, a healthy society needs successful companies. No social program can rival the business sector when it comes to creating the jobs, wealth, and innovation that improve standards of living and social conditions over time. If governments, NGOs [(non-governmental organizations)], and other participants in civil society weaken the ability of business to operate productively, they may win battles but will lose the war, as corporate and regional competitiveness fade, wages stagnate, jobs disappear, and the wealth that pays taxes and supports nonprofit contributions evaporates.[170]

Holcomb has observed that there is “pressure to build a business case for social involvement as an integrated part of firm strategy ….”[171] He notes that “concepts of corporate responsibility and sustainability have gained increasing momentum as measurements of corporate performance[,]” “companies are beginning to embrace the idea that corporate responsibility can be good for business performance[,]” recent surveys indicate a majority of consumers expect firms to be involved with social causes; there is growing belief among global CEOs that “corporate responsibility measures can help firms manage legal liabilities, financial performance, reputation, and relations with stakeholders[,]” reports covering non-financial information (such as sustainability, triple bottom line, and environmental, health, and safety issues) are growing in significance; and “[a]n increasing number of institutional investors are becoming interested in approaches to asset management that include environmental, social, and corporate governance criteria or metrics.”[172]

Commentators are now arguing that for a corporation to be truly sustainable, it will have to adopt a stakeholder, rather than a shareholder, value approach; that stakeholder engagement and collaboration are necessary conditions for a sustainable business model. Wheeler, Colbert, and Freeman argue that for a firm to be sustainable, the notion of corporate social responsibility—an ethical appeal to organizational leaders to minimize the harm done by corporations in the pursuit of profits and, in some cases, to make a case for linking conventional philanthropy to constructive community involvement—must include additional stakeholders. Wheeler et al. recognize that business value creation can be regarded from different perspectives. They believe that “a business model that places value creation at its core will allow concepts
of CSR [(corporate social responsibility)], sustainability and the stakeholder approach to find their natural homes, whether at a strategic or a managerial level.\textsuperscript{176} They have developed a three-tier model to explore how firms may create value across the three dimensions of the aspirational notion of sustainability, i.e. economic, social, and ecological priorities\textsuperscript{177} (also referred to as the “triple bottom line”). Level 1 firms have a compliance culture, where the firm “is not especially engaged with its stakeholders but where basic societal norms are respected and thus the organization seeks to avoid the unacceptable destruction of value (either: economic, social or ecological)[.]”\textsuperscript{178} Level 2 firms have a “relationship management culture, where the firm organization recognizes the instrumental value of good relations with immediate stakeholders… and seeks to provide what value is appropriate in each case, within the limits of what is possible and usually after the demands of investors are satisfied.]”\textsuperscript{179} A Level 3 firm “has a sustainable organization culture, where the organization recognizes the interdependencies and synergies between the firm, its stakeholders, … and society, and seeks to maximize the creation of value simultaneously in economic, social and ecological terms.”\textsuperscript{180}

Wheeler et al. recognize, however, that “embracing stakeholder notions of value and striving for sustainability are consistent but not synonymous.”\textsuperscript{181} Ultimately, they argue, a sustainable business model does not have to be a theoretical ideal. “Whether it is a recognition of the strategic value of reputation, or brand value, few business leaders today ignore the tangible business benefits of loyal, trust-based relationships with networks of customers, suppliers and distributors.”\textsuperscript{182}

Some would argue that the best firms have always sought to leverage their communities of interest for the instrumental purpose of creating value. In many cases they have done this by balancing (or ideally integrating) stakeholder interests and combining them with a clear vision of what is achievable for customers, employees, investors and other stakeholders—whatever their corporate officers may have said to the analysts or investors at annual general meetings.\textsuperscript{183} According to Wheeler et al., “the evidence is now mounting that what is said to one stakeholder group, i.e. the investors, need no longer be in conflict with what is said to employees, customers, supply chain partners and local communities.”\textsuperscript{184}

Criteria have already been established to assist corporations in assessing expanded social responsibility activities. For example, the Global Reporting Initiative has developed a reporting framework in which corporations can: detail their economic, environmental, and social impacts; identify their stakeholders and explain how the corporation has responded to the stakeholders’ reasonable expectations and interests; and present the organization’s performance in the wider context of sustainability.\textsuperscript{185}

While the shareholder value perspective continues to dominate corporate governance, direct incentives can be provided to encourage companies to participate in reporting standards such as those developed by the Global Reporting Initiative. Dividends could be distributed tax-free and/or capital appreciations could be tax-free or taxed at a lower rate for corporations that can certify compliance with social responsibility reporting requirements. In this way, the same market forces that contributed to the unsustainability of corporations can be used to reverse that trend. “Stakeholder capitalism bases our understanding and expectations of business, not on the worst that we can do, but on the best. It sets a high standard, recognizes the common-sense practical world of global business today, and asks managers to get on with the task of creating value for all stakeholders.”\textsuperscript{186}

Conclusion

The corporate form of business organization has a long and important role in the American economy. From its earliest formal origins, investments by shareholders were protected by legally imposed fiduciary duties on corporate directors. Over time, these duties have morphed into a mantra for maximizing shareholder wealth. But lately, maximizing shareholder wealth has meant achieving continuing short-term stock price gains; sometimes to the detriment of the long-term health of the corporation. This paper has suggested that corporations can redirect their focus to long-term sustainability by expanding corporate governance standards to encompass multiple stakeholders, allowing corporations to mitigate their impact on the environment and society so as to increase their odds of long-term survival.

A review of the literature analyzing stakeholder value and corporate social responsibility philosophies reveals wide disparity in approach—from completely altruistic/society first, to simply avoiding harm/unethical behavior/illega activities. Logically, there must be a middle ground in which refined corporate governance norms can be established to promote sustainable business enterprises—for both shareholders and society. A significant amount of empirical and anecdotal evidence suggests that the current mantra of maximizing shareholder value is not sustainable. And since this approach to business is fully supported by current laws, it will require management, and perhaps proactive shareholders, to lead corporations in new, sustainable directions.
Figure 1: Framework for Classifying Organizational Cultures

- **Sustainable Organization Culture**
  - Value maximized and integrated: economically, socially and ecologically. Organization takes a societal level focus and seeks synergistic outcomes between value dimensions.

- **Relationship Management Culture**
  - Value created but typically traded off

- **Compliance Culture**
  - Value preserved consistent with laws and norms

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**Footnotes**

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1. MARY O’SULLIVAN, CONTESTS FOR CORPORATE CONTROL 70 (2000).


6. Id. Contrast with a general partnership form of business in which, for example, a bankruptcy trustee may hold general partners personally liable for partnership debts not satisfied with partnership assets. See, e.g., 11 U.S.C. § 723 (2009); Hansmann et al., supra note 5, at 1339.

7. Hansmann et al., supra note 5, at 1336.


9. Like the stewards of a rich man, [directors] are apt to consider attention to small matters as not for their master’s honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.

10 Directors are “clothed with power to manage the affairs of the company for the benefit of its stockholders and creditors. Their character as agents [forbids] the exercise of their powers for their own personal ends against the interest of the company.” Wardell v. R.R. Co., 103 U.S. 651, 657 (1881). “Directors of a corporation are trustees for the stockholders, and their acts are governed by the rules applicable to such a relation, which exact of them the utmost good faith and fair dealing, especially where their individual interests are concerned.” Lofland v. Cahall, 118 A. 1, 3 (Del. 1922). See also Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. FIN. ECON. 305, 308-10 (1976) (discussing agency costs associated with corporate management).


12 See Charles Sumner Lobingier, The Natural History of the Private Artificial Person: A Comparative Study in Corporate Origins, 13 TUL. L. REV. 41, 58 (1938). Lobingier traces the origins of “artificial relationships” back to fosterage in Roman society (see id. at 42), adoptions, and “blood brother” associations dating back to primitive societies (see id. at 46). See also Samuel Williston, History of the Law of Business Corporations Before 1800, 2 HARV. L. REV. 105, 106 (1888) (discussing the first fictitious legal persons dating back to ancient Rome and Greece) [hereinafter Williston, Part I].

13 See Lobingier, supra note 12, at 58. The American joint-stock company was under an “indenture of grant” from Sir Walter Raleigh to thirteen “of London, Gentlemen”, who were declared a body corporate as “Gouvernour and assistants of the Cittie of Raleigh in Virginia”. Id. (footnote omitted).

14 Parliament seldom exercised this right directly; it generally confirmed charters granted by the crown. Joseph Stancliffe Davis, 1 ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS 6 (Russell & Russell, Inc. 1965) (1917).

15 Williston, Part I, supra note 12, at 109-10 (the formal name of the company was “the Company of Merchants of London, trading to the East Indies”).

16 Id. at 109.

The multiplicity and extent of costs involved in procuring and fitting out vessels, in providing military equipment and all other supplies for mariners and colonists, and in supporting employees and settlers; the long waiting for any returns; the slight development of instruments of credit—these made demands beyond the means of any individual gentleman or group of gentlemen, burdened as they already were by the living expenses of their rank.

Edward P. Cheyney, Some English Conditions Surrounding the Settlement of Virginia, 12 AM. HIST. REV. 507, 511 (1907).

17 Cheyney, supra note 16, at 512.


19 See Williston, Part I, supra note 12, at 110.

20 CHARLES MACKAY, EXTRAORDINARY POPULAR DELUSIONS AND THE MADNESS OF CROWDS 50 (L.C. Page & Co. 1932) (1841); Williston, Part I, supra note 12, at 111.

21 See MACKAY, supra note 20, at 54. Historians have described joint-stock speculation in 1720 as a year “of fantasy, panic, folly, and grotesqueness…” Ron Harris, The Bubble Act: Its Passage and Its Effects on Business Organization, 54 J. ECON. HIST. 610, 610 (1994). Stock trading became such a mania in 1720 London that one prospectus to raise half a million pound sterling described merely, “[a] company for carrying on an undertaking of great advantage, but nobody to know what it is.” MACKAY, supra note 20, at 55 (internal citations omitted). This particular promoter was able to raise 2,000 pound sterling, never to be seen again. Id. at 55-56. It is estimated that nearly one and one-half million pound sterling was won and lost by speculating in these Bubble companies, “to the impoverishment of many a fool, and the enriching of many a rogue.” Id. at 54.

22 Blair, supra note 8, at 415; Paul G. Mahoney, Preparing the Corporate Lawyer: Contract or Concession? An Essay on the History of Corporate Law, 34 GA. L. REV. 873, 887 (2000) (arguing that “[w]hat frequently distinguished incorporated from unincorporated joint-stock companies… was that the former were owned by politically well-connected merchants who had paid a handsome price to secure a monopoly, while the latter lacked the money or connections to gain similar privileges[.]”.

23 See MACKAY, supra note 20, at 57-63.


25 Mahoney, supra note 22, at 887.

26 The bursting of the South-Sea bubble “constituted the first international stock market bust[; a] … crisis that … threatened to unravel the whole web of English public finance.” Harris, supra note 21, at 610. But see Julian Hoppit, Financial Crises in Eighteenth-Century England, 39 ECON. HIST. REV. 39, 48 (1986) (suggesting the South-Sea bubble mostly impacted merchants). “For the business community as a whole, through the length and breadth of England, the Bubble was not a catastrophe.” Id.

27 Williston, Part I, supra note 12, at 112.
Corporation Law, prohibited any further special incorporations. 

enacted from this amendment required a Superior Court judge’s approval (1977).

Id. corporation laws the legislatures were furnishing the framework within which industry and commerce were to be formed under the general laws, versus special acts of the legislature. 

obtaining charters). 

approximately 100 charters had been issued, half in Massachusetts). 

supplies and docks) 11%; and Business (manufacturing, mining, agriculture, land, and commercial) 4%. 

be granted or withheld is always a matter of state policy 

corporate device should be used.” 

corporations and American citizens generally accepted “the legitimacy of [state] legislative determinations as to how far the corporate device should be used.” 

at 22. 

Russell, Inc. 1965 [hereinafter Williston, Part II]. “In colonial days... American corporations for business purposes were few and relatively unimportant.” JOSEPH STANCLIFFE DAVIS, 2 ESSAYS IN THE EARLIER HISTORY OF AMERICAN CORPORATIONS 4 (Russell & Russell, Inc. 1965) [hereinafter DAVIS, Vol. 2]. DAVIS records seven corporate charters during the colonial period. Id. at 22. 

Blair, supra note 8, at 415; Luce, supra note 29, at 1293. The U.S. Constitution makes no mention of corporations and American citizens generally accepted “the legitimacy of [state] legislative determinations as to how far the corporate device should be used.” HURST, supra note 18, at 113 (footnote omitted). “Whether the corporate privilege shall be granted or withheld is always a matter of state policy.” Louis K. Liggett, Co. v. Lee, 288 U.S. 517, 545 (1933) (Brandeis, J., dissenting).

Williston, Part II, supra note 32, at 165; Lobingier, supra note 12, at 67. 

DAVIS, Vol. 2, supra note 32, at 22-23. Massachusetts and Connecticut granted the most charters during this period; a combined 30%. Id. DAVIS also classifies the purposes of charters, from colonial times through 1800: Financial (banking and insurance) 20%; Highway (inland navigation, toll-bridges, and turnpikes) 65%; Local Public Service (water supplies and docks) 11%; and Business (manufacturing, mining, agriculture, land, and commercial) 4%. Id. See also Blair, supra note 8, at 389 n.3. But see Williston, Part II, supra note 32, at 166 (stating that by the end of the eighteenth century approximately 100 charters had been issued, half in Massachusetts).


Luce, supra note 29, at 1294 (noting also that demands for special charters had led to widespread corruption in obtaining charters). New York, for example, amended its constitution in 1846 to allow corporations, in all but limited, special circumstances, to be formed under the general laws, versus special acts of the legislature. See William L. Cary, Federalism and Corporate Law: Reflections Upon Delaware, 83 YALE L.J. 663, 664 (1974) (citing N.Y. CONST. art. VIII, § 1 (1846)).

SEAVOY, supra note 37, at 180. 


E. Merrick Dodd, Jr., Statutory Developments in Business Corporation Law, 1886-1936, 50 HARV. L. REV. 27, 28 (1936). See also infra notes 51-52 and accompanying text. 

Dodd, supra note 41, at 29. “[W]hile individual entrepreneurs and partnerships played a larger part in the economic life of the mid-nineteenth century than they do today, it was already coming to be true that in enacting corporation laws the legislatures were furnishing the framework within which industry and commerce were to be organized.” Id. (emphasis in original).


O’SULLIVAN, supra note 1, at 72-73. 

Cary, supra note 38, at 664 (footnote omitted). 

Act of March 9, 1899, ch. 273, 21 Del. Laws 445. Delaware had twice previously enacted general purpose corporation laws, but they contained numerous restrictions preventing easy incorporation. For example, an 1875 amendment to the Delaware Constitution permitted general incorporations, but only for specific business endeavors, and the legislation enacted from this amendment required a Superior Court judge’s approval of the articles of incorporation; an 1883 corporation act simplified the procedure somewhat, but still required a judge’s approval. See S. Samuel Arsh, A History of Delaware Corporation Law, 1 DEL. J. CORP. L., 1, 4-5 (1976). Meanwhile, the Delaware Constitution still permitted applications to the legislature for special corporate charters. Id. at 5. The 1897 Delaware Constitution, which authorized the 1899 General Corporation Law, prohibited any further special incorporations. Id. at 6.
be able to bargain with the corporation to protect their interests. Maximizing shareholder value also maximizes value for other stakeholders. “Nonshareholder constituencies are presumed to be able to bargain with the corporation to protect their interests. Cary, supra note 38, at 664.

48 Arsht, supra note 46, at 7.
49 HURST, supra note 18, at 149.
50 Id. at 148-49 (footnote omitted).
52 Id. at 223. In 1913, for example: AT&T had raised nearly $350 million in capital from just over 53,000 shareholders; US Steel had just over $500 million in common stock outstanding among just over 44,000 shareholders; and General Motors, small by comparison, had capital stock of $31.5 million held by just under 3,000 shareholders. Id.
53 Id. at 221.
54 GEORGE HEBERTON EVANS, JR., BUSINESS INCORPORATIONS IN THE UNITED STATES 1800-1943 Appendix 3 (1948). Exact numbers of incorporations during the nineteenth century are not available. The U.S. Census Bureau did not begin collecting corporate statistics until 1916. See infra note 56 and accompanying text. Limited figures for total incorporations in specific states during the nineteenth century are available. For example, New Jersey, 1801-1875: 2,300; Pennsylvania, 1801-1860: 2,310; and Wisconsin, 1848-1871: 1,130. HURST, supra note 18, at 17-18. All of these were special charters. Id. This snippet of figures clearly indicates that even with the requirements of special charters, incorporations were growing dramatically in the nineteenth century compared with the eighteenth century.
55 EVANS, supra note 54, at Appendix 3.
57 Id.
58 CENSUS BUREAU Table 722, supra note 3.
59 See, e.g., Arsht, supra note 46, at 1 (noting a general consensus that Delaware has the most popular corporation law).
60 EVANS, supra note 54.
61 In 1956, approximately one-third of the largest industrial, merchandising, and utility companies in the United States were incorporated in Delaware. HURST, supra note 18, at 150.
63 Revenues for the largest 500 American companies based on Fortune 500, FORTUNE MAG., at http://money.cnn.com/magazines/fortune/fortune500_archive/full/2005 (last visited May 15, 2009). Total number of U.S. business entities and their total revenues in 2005 based on CENSUS BUREAU Table 722, supra note 3. Based on these same sources, the top 1,000 firms generated just under 33% of total business revenues in 2005.
65 Id. at 244.
66 Id. at 245.
67 Id. at 302.
68 O’SULLIVAN, supra note 1, at 75. The corporation is an arrangement by which hundreds of thousands of men who would in days gone by have set up in business for themselves put their money into a single huge accumulation and place the entire direction of its employment in the hands of men they have never seen, with whom they never confer.
71 MILTON FRIEDMAN, CAPITALISM & FREEDOM 133 (1963). See Elletta Sangley Callahan et al., Integrating Trends in Whistleblowing and Corporate Governance: Promoting Organizational Effectiveness, Societal Responsibility, and Employee Empowerment, 40 AM. BUS. L.J. 177, 180 (2002) (discussing contractarianism, an environment wherein maximizing shareholder value also maximizes value for other stakeholders). “Nonshareholder constituencies are presumed to be able to bargain with the corporation to protect their interests. Thus, market forces—including the managerial labor market, the product market, and the market for corporate control—provide the ultimate check on organizational wrongdoing by penalizing inefficiencies.” Id. at 180-81 (footnote omitted).
72 See SMITH, supra note 9.
Crisis evidence that by becoming more actively involved in company management); Gary S. Hansen & Charles W.L. Hill, stock are less able to move in and out of their ownership position and therefore try to influence the invest for the shor growth in pension funds following enactment of the Employee Retirement Income Security Act of 1974 (ERISA)).

Corporate Strategy

68 (July

Emphasis was on the disclosure of material facts for the benefit of investors, leaving the “policing” to the markets.

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R&D Strategy

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Importance of remuneration is misguided; that executives are not principally motivated by money in terms of their Performance”

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See also Baysinger et al., supra note 82, at 212-13 (speculating that the prospect of high financial returns attracts institutional investors to companies that engage in long-term R&D strategies, or, in the alternative, institutional investors who own large stakes in a company’s stock are less able to move in and out of their ownership position and therefore try to influence the return of their investment by becoming more actively involved in company management); Gary S. Hansen & Charles W.L. Hill, Are Institutional Investors Myopic? A Time-Series Study of Four Technology-Driven Industries, 12 Strategic MGMT. J. 1 (1991) (finding evidence that higher levels of institutional ownership may be associated with greater R&D expenditures).

Graves & Waddock, supra note 97, at 80.

Directors? How the Proposed Shareholder Director Rule Will Contribute to Restoring Pro

Bebchuk, 81 (int

managers—Dash risks, ultimately it can be viewed as a case of seeking short

Walt Disney Co

“must come from the markets, and not from this Court.” In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 698 (Del. Ch. 2005), aff’d, 906 A.2d 27 (Del. 2006).

In re Citigroup Inc. Shareholder Derivative Litig., 964 A.2d 106, 115 n.6 (Del. Ch. 2009).

Id. at 124. Though the facts in this case may seem a bit ironic, in that Citigroup appears to have taken excessive risks, ultimately it can be viewed as a case of seeking short-term profits at the expense of long-term viability. See, e.g., Eric Dash & Julie Creswell, Citigroup Pays for a Rush to Risk, N.Y. TIMES, Nov. 23, 2008, at A1 (reporting that Citigroup risk managers charged with overseeing deal makers eager to increase short-term earnings—and executives’ multimillion-dollar bonuses—failed to rein them in).

In re Citigroup Inc. Shareholder Derivative Litig., 964 A.2d at 122 (quoting In re Caremark Int’l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996)) (internal quotation marks omitted; emphasis in original).

Id. Gross negligence has been defined as a “reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason.” In re Walt Disney Co. Derivative Litig., 907 A.2d at 750 (internal quotation marks and footnote omitted).

In re Citigroup Inc. Shareholder Derivative Litig., 964 A.2d at 123 (footnote omitted; emphasis in original).

Id. at 124. Citigroup’s stock value dropped 73% from 2007 to 2008. The Pay at the Top, supra note 104.

In re Citigroup Inc. Shareholder Derivative Litig., 964 A.2d at 124 (quoting Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)) (internal quotation marks omitted).

Id.

Id. See also Gantler v. Stephens, 965 A.2d 695, 705-6 (Del. 2009) (holding same).


Id.


Bebchuk, The Myth, supra note 123, at 688 (concluding that even when shareholder dissatisfaction with board actions and decisions is substantial, the evidence indicates that challengers face considerable impediments to replacing boards). See also Rose A. Zukin, We Talk, You Listen: Should Shareholders’ Voices Be Heard or Stifled when Nominating Directors? How the Proposed Shareholder Director Rule Will Contribute to Restoring Proper Corporate Governance, 33 PEPP. L. REV. 937, 941 (2006).

17 C.F.R. § 240.14a-8.


Id.

Id. (quoting 17 C.F.R. § 240.14a-8(i)(8)). On May 20, 2009, the Securities and Exchange Commission voted to propose a new Securities Exchange Act Rule 14a-11 which would permit owners of between 1%-5% of an exchange-traded corporation’s voting stock, who have held the stock at least one year, to be able to include their nominees for director in the
company’s proxy materials unless the shareholders are otherwise prohibited—either by applicable state law or a company’s charter/bylaws—from nominating a candidate for election as a director. Press Release, Securities and Exchange Commission, SEC Votes to Propose Rule Amendments to Facilitate Rights of Shareholders to Nominate Directors (May 20, 2009), at http://www.sec.gov/news/press/2009/2009-116.htm. See also infra, note 147 and accompanying text (discussing a similar provision in the proposed Shareholder Bill of Rights Act of 2009. S. 1074, 111th Cong. (May 19, 2009)); infra note 144 and accompanying text (discussing an amendment to Delaware’s General Corporation Law permitting corporations to include in their bylaws provisions requiring the corporation to include in proxy materials directors nominated by shareholders).

131 Zukin, supra note 126, at 940-41. According to critics of current shareholder powers to challenge boards, there are structural impediments beyond Rule 14a-8(i)(8), such as the cost to mail out separate proxies, staggered boards which result in less than a majority of contested board seats in any one election, and the ability of shareholders to “withhold” votes that do not count as a vote “against.” Bebchuk, The Myth, supra note 123, at 688-91, 694, 701-04. See also infra, note 148 and accompanying text (discussing the proposed Shareholder Bill of Rights Act of 2009, S. 1074, 111th Cong. (May 19, 2009), which would eliminate staggered boards and require that directors be elected by a majority of votes cast).

132 Bebchuk, The Myth, supra note 123, at 685. This is from the universe of firms that filed proxy statements with the SEC during the decade. Id. at 684.

133 Id. at 686-87.


135 See, e.g., Steve Lohr, U.S. Said to be Losing Competitive Edge, N.Y. TIMES, Feb. 25, 2009, at B9; MICHAEL L. DERTOUZOS ET AL., MADE IN AMERICA: REGAINING THE PRODUCTIVE EDGE 1 (1989) (noting that the U.S. buys far more overseas than it can sell in other countries, the U.S. rate of productivity improvement has fallen behind several Western European and Asian nations, and managers are criticized for seeking quick profits rather than pursuing long-term goals).


137 See KEVIN PHILLIPS, BAD MONEY 31 (2008) (noting that United States manufacturing declined from just under 30% of GDP in 1950 to 12% in 2005).

138 See, e.g., Peter S. Goodman, A Shopping Guernica Captures the Moment, N.Y. TIMES, Nov. 30, 2008, § WK (Week in Review), at 3 (noting that wages for most Americans have fallen in real terms over the last eight years).

139 See, e.g., PHILLIPS, supra note 137, at 67 (reporting the top compensation of American CEOs in 1981: $5.7 million; 1988: $40.1 million; 2000: $290 million); The Pay at the Top, supra note 104.

140 Corporate Apocalypse, MGMT. TODAY, Jan. 1, 2009, at 50. See also Grant Kirkpatrick, The Corporate Governance Lessons from the Financial Crisis, 2009/1 FIN. MARKET TRENDS 1, 2 (May/June 2009), available at http://www.oecd.org/dataoecd/32/1/42229620.pdf (concluding “that the financial crisis can be to an important extent attributed to failures and weaknesses in corporate governance arrangements[.]”)

141 Munari & Sobrero, supra note 93, at 5.


143 See supra notes 114-120 and accompanying text.

144 77 Del. Laws 14 (2009); 8 DEL. CODE ANN. tit. 8, §§ 112 & 113 (Aug. 1, 2009). See also supra, note 130 (discussing the Securities and Exchange Commission’s vote to propose a new Securities Exchange Act Rule 14a-11 which would permit qualified shareholders to be able to include their nominees for director in the company’s proxy materials, if also permitted by the company’s charter/bylaws).


146 Id. at § 3.

147 Id. at § 4.

148 Id. at § 5. Although, as of the date of this paper, the Shareholder Bill of Rights Act has only just been introduced, there is already opposition from the Business Roundtable, which represents 160 CEOs from many of the nation’s largest corporations. Dan Eggen, Opponents of “Shareholder Bill of Rights” Reach Out to Sen. Schumer, WASH. POST, Apr. 30, 2009, at http://www.washingtonpost.com/wp-dyn/content/article/2009/04/30/AR2009043002966.html.

149 O’SULLIVAN, supra note 1, at 43.
particular efficacy in limiting corporate wrongdoing).

Enhances individual moral identity by structuring the organization as a community that nourishes moral virtue would have

Responsibility, Sustainability and a Stakeholder Approach in a Network World

122 (2008).

Wayne Norman & Chris MacDonald,

Forum, Vail Leadership Institute, Center for Corporate Change, June 2005, at 3

Corporate Social Responsibility


Redirection of Research on the Relationship Between Corporate Social and Financial Performance

41

Id

See also

21.

See Bowen, supra note 153, at 20. Bowen attributed the decline of laissez faire to additional issues, familiar in modern society:

(1) growth of large-scale enterprise and concentration of economic power; (2) fluctuating general business activity with recurrent periods of unemployment; (3) technological unemployment; (4) personal insecurity of people with reference to sickness, old age, and death; (5) disparities in the distribution of income; (6) disparities in the distribution of economic opportunity; (7) overly rapid and wasteful exploitation of natural resources; (8) materialistic, competitive, and invidious standards of consumption; and (9) frequent disregard for the social costs of economic activity and the social values that might be derived from economic activity.

Id. at 21. See also, Daniel T. Ostash, Cooperate, Comply, or Evade? A Corporate Executive’s Social Responsibilities with Regard to Law, 41 AM. BUS. L.J. 559, 562-63 (2004) (discussing Bowen’s view that the lapse of business ethics contributed to the Great Depression).

42 USC §§ 4321-4375 (2009).


Rodewald, supra note 152, at 453.

Id. at 455 (footnote omitted).


See Rodewald, supra note 152, at 458.

Id. at 463.

Remi Trudel & June Cotte, Does It Pay to be Good?, 50 MIT Sloan MGMT. REV. 61, 61 (Winter 2009).

Id. at 67.

Id. (emphasis in original).


Id.

150 Id.


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Wheeler et al., supra note 174, at 10.

Id. (alteration in original).

Id. at 11. Wheeler et al. “also describe this as a value-neutral or trade-off perspective, typically associated with effective corporate philanthropy and stakeholder communications[.]” Id.

Id.

Id. at 17.

Id. at 19 (footnotes omitted).

Id. at 18 (footnote omitted).

Id.


Wheeler et al., supra note 174, at 11. “Culture” in Figure 1 is defined as “the values, beliefs and assumptions of the organization.” Id. at 12 (citation omitted).