# The Pros and Cons of Stakeholder Capitalism

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## Pick a side and prepare to be conflicted.

by Laura Quaglio

In 2019, Business Roundtable (BRT) released a new Statement on the Purpose of a Corporation, which was signed by 181 CEOs who vowed to consider *all* stakeholders—customers, employees, suppliers, communities and shareholders—when making leadership and business decisions. This stakeholder-focused pledge was groundbreaking: It was the first time since 1997 that principles of "shareholder primacy" were not at the document's core.

When the news broke, Darren Walker, a signatory and president of the Ford Foundation, said, "[It] is more critical than ever that businesses in the 21st century are focused on generating long-term value for all stakeholders and addressing the challenges we face, which will result in shared prosperity and sustainability for both business and society."

A mere two years later, Martin Whittaker, CEO of JUST Capital, wrote in *Forbes* "Stakeholder capitalism's pregame is over. … The American people, desperate to put the woes of COVID-19 and its economic impacts behind them, will demand a recovery that benefits the majority, not just the few." It was also evident at the World Economic Forum's Davos conference that corporate leadership was on board, reports *S&P Global Insider*. In a panel at the event, Claudia Azevedo, chief executive of Portugal's Sonae, a multinational business group, voiced it succinctly: "In the business community, everyone thinks now it is obvious that you should have a vision that is to create economic and social value."



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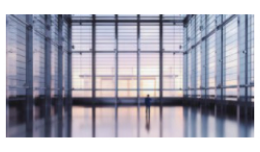

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As with any blanket statement, however, this is not entirely true. Many business pundits still side with Milton Friedman, the late Nobel Prize–winning economist and author of *Capitalism and Freedom*, who published an article in 1970 titled "The Social Responsibility of Business is to Increase its Profits." Interestingly, these two camps were at odds even then, as 1970 was *also* the year of the first Earth Day.

Regardless of where individual leaders stand, Peter Coy, economics editor for *Bloomberg Businessweek*, indicates that it's wise to look at both sides of the coin. "[As] as the ESG (environment, social, governance) movement contends, there are legitimate reasons to take into account the interests of stakeholders *other than* shareholders," he said. "But it takes sophisticated reasoning, not hand-waving, to address [Friedman's] critique."

Here, then, is some grist for the stakeholder capitalism mill.

## THE PROS

Luigi Zingales, a professor at the University of Chicago's Booth School of Business, argues that it's absurd to think that companies can or would cater *entirely* to shareholders. For one thing, shareholders (especially today) care about ESG issues, so they are not looking at only one bottom line. Many experts (including Friedman) note that it behooves companies to act in their best interest in the long term.

"It is going to be hard to make money if the major coastal cities are underwater, half the population is underemployed…, and democratic government has been replaced by populist oligarchs who run the word for their own benefit," writes Rebecca Henderson in her book *Reimagining Capitalism in a World on Fire*.

The biggest reason, of course, that the topic of stakeholder capitalism is all the rage is because consumers are demanding it. Almost 90% of consumers expect corporations to focus on values, not just dollar value. Those who *don't* may risk being left on the shelf, as savvy consumers compare the ESG reports, which are already being produced by nine out of 10 S&P 500 companies.

They also risk missing out on attracting new talent. Over one-third of the U.S. workforce is comprised of millennials, and they are among the most vocal supporters of ESG.


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Businesses can pivot to allow for change—often more rapidly than increasingly gridlocked government. This has happened at times on an international scale, as when retailers pulled certain types of guns and ammunition from shelves, even as governments offered the gun-reform equivalent of "thoughts and prayers." Lessons the C-suite learned during the pandemic have poised leaders to be even more agile in the future—but maybe not so much if they have to cut through red tape.

Others argue *Do you really want politicians to be dictating what you do in ESG?* That may be akin to someone saying, "If you don't wipe that smile off your face, I'm going to wipe it off for you." No one really wants to get "slapped" with additional policies and regulations, particularly ones they had no hand in crafting.

"If I were writing *Reimagining Capitalism* today, I would be both more radical—I would place even greater stress on the need to rebuild our institutions—and even more hopeful," says Henderson. "I thought the pandemic might crush the movements to address climate change and reduce inequality. Instead, they have been dramatically strengthened. It's a very exciting moment, full of promise."

## THE CONS

It's easy to tell where Harvard Law School professors Lucian Bebchuk and Roberto Tallarita side in the stakeholder capitalism discussion: Their recent conceptual, economic and empirical analysis of stakeholderism is titled, "The Illusory Promise of Stakeholder Governance." They cite a variety of concerns, including ones pointing directly at the hypocrisy of the BRT pledge. First, most of the CEOs did not consult their board members prior to signing, which Bebchuk and Tallarita say suggests they did not intend to make meaningful changes. Second, upon reviewing how those CEOs have behaved in the years since, the study's authors found that most continued to follow a shareholder-first approach. (In other words, they did it "mostly for show.")

Another commonly voiced concern related to stakeholder capitalism is its *nebulousness*. There is a general lack of agreement on all fronts, including who counts as a stakeholder, what counts as doing right by them and how to measure success (or failure). "In the absence of clear prioritization among different stakeholders, the result was what management theorists called 'garbage can organizations.' These were organizations that couldn't make up their minds," writes Steve Dennings in *Forbes*. What's more, underperforming execs could chalk up their losses as the "cost of doing good."

"To solve the world's problems, executives must first decide which problems to solve. That isn't a technocratic judgement, it's a moral one," writes Vivek Ramaswamy *in The Wall Street Journal*. "In the end, the opinions of powerful business leaders take precedence over those of everyone else." His words hold weight, as he is founder and CEO of Roivant Sciences, a biopharmaceutical company, and author of *Woke, Inc.: Inside Corporate America's Social Justice Scam.*

In an article in *The Journal of Corporation Law,* Matteo Gatti and Chrystin Ondersma, professors at Rutgers Law School, refer to the "stakeholder approach" as a chimera. Though the concept is full of hope and promise, even if it were to be achievable, it would *detract* from the very people it is meant to support. "There is concern that, thanks to the bigger platform awarded by stakeholder capitalism, executives can justify stepped up lobbying efforts as part of their mandate to consider the interests of all constituents," they explained. "Once fully embraced, stakeholderism would occupy an out-sized portion of legislative and regulatory space. This will make it harder to pass reform that is more likely to improve the position of weaker constituencies."

## FORGING A PATH FORWARD

For those still on the shareholder/stakeholder capitalism fence, a shift in focus may be helpful, as it seems this train has already left the station. In fact, Financial Executives International recently reported that, depending on how you define them, they are essentially the same thing.

For example, "maximizing shareholder value" is defined as "creating and making choices that are most likely to yield the greatest future earnings power, net of investment they require." Similarly, "maximizing stakeholder value" is defined as the "inevitable outcome of delivering value to other stakeholders in ways that fortify the company's future earnings power." Perhaps, at least in some cases, where you fall in the debate over stakeholder capitalism is more a matter of semantics.

Wherever individual leaders land, the following strategies may be helpful moving forward.

**Clarify your purpose.** Passion is at the heart of purpose for many entrepreneurs and leaders. "Whether you make medicine or tortilla chips, every company can and should have a purpose that is important," Joseph Jimenez, CEO of Novartis, told Insigniam in The Purpose-Led CEO. Janeen Gelbart, CEO of Indiggo, agrees, and adds that leaders must be "crystal clear on our shared purpose," starting with employees. Focusing internally first, she says, is the only way your team will successfully execute strategies externally. (Learn more about Purpose-Led Organizations here.)

**Make it a contractual obligation.** In a forthcoming article for Boston University Law Review, professor Kishanthi Parella voices her support for contractual stakeholderism. Here, she suggests leaders focus not on the benefits they provide to others but on the risk of harm to all stakeholders, particularly those who are affected but are not at the bargaining table when contracts are drawn up. "[This] addresses the risk of corporate inauthenticity by making a corporation's commitment to stakeholderism verifiable," she writes on the Columbia Law School blog. "If corporate leaders mean what they say, then they should demonstrate that commitment in their corporation's contracts. It also addresses the risk of impracticality by helping to identify the action that corporate actors should take."

**Get clear about the metrics.** In 2018, the EU created a taxonomy identifying 67 economic areas that can be used to assess how environmentally friendly a particular investment group is. In 2021, JUST Capital created a Corporate Racial Equity Tracker to measure the efficacy of U.S. companies in this space. (The top three are Microsoft, NVIDIA Corp and Apple.) Some experts suggest using the principle of human rights due diligence (HRDD) as a metric, making decisions by evaluating the potential harm of various actions. Whatever the measure, transparency will be key to earning the public's trust.

**Expand your skillset (and/or team).** In early 2020, Bruce Bolger, co-founder and chief development officer for the Enterprise Engagement Alliance, a research and outreach organization, predicted: "The shift to a greater focus on people will give rise to a new type of CEO, selected by boards for emotional intelligence and human capital management skills as much as for strategic, operational or financial expertise." One challenge, adds Gelbart, is that leaders and managers already have plenty of plates spinning. It may make sense to seek opportunities to build on those skills via courses, webinars, TEDTalks and other channels—while keeping in mind that a new position may emerge: chief of ESG. If so, they're sure to be welcomed to the C-suite with open arms.