

CORPORATE SUSTAINABILITY SHAREHOLDER PRIMACY VERSUS STAKEHOLDER PRIMACY



by Zabihollah Rezaee, PhD

Corporate Sustainability

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Shareholder Primacy Versus Stakeholder Primacy

Zabihollah Rezaee

Corporate Sustainability: Shareholder Primacy Versus Stakeholder Primacy

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Description

Corporate sustainability has become an economic, moral, and strategic imperative with the potential to create shared value for all stakeholders. Public companies in the United States have traditionally operated under the corporate model of “shareholder primacy” that makes the board of directors’ judiciary responsible only to shareholders in protecting their interests. Under the shareholder primacy system, the primary purpose of a corporation is to generate returns for shareholders, and thus corporate activities are managed toward creating shareholder value. This shareholder primacy system is also known as U.S. corporate governance model and is being criticized for focusing on generating short-term profits for shareholders while compromising long-term sustainability performance that creates shared value for all stakeholders and promotes innovation, growth, and the social and environmental impacts. The stakeholder primacy system, which is better known as the European corporate governance model, makes the board of directors’ fiduciary responsible to protecting interests of all stakeholders including shareholders, creditors, employees, customers, suppliers, society, and the environment.

Recently, the Business Roundtable (BRT) announced the adoption of a new Statement on the Purpose of a Corporation, signed by 181 high-powered chief executive officers (CEOs), which recommend the move away from the shareholder primacy concept toward the stakeholder primacy concept that promotes sustainability of creating shared value for all stakeholders. Corporate purpose and stakeholder considerations have gained recognition in the business community worldwide. The stakeholder primacy challenges companies to put stakeholders at the heart of a company’s purpose. A shift in corporate purpose from shareholder primacy to stakeholder primacy, reinforced by the U.S. BRT’s Statement on the Purpose of a Corporation. This focus, combined with public pressure for CEOs to engage on social and political topics, and human

capital (HC) (e.g., HC, diversity, immigration, gun control, and gender pay equity), enables corporate America to advance toward business sustainability.

The board's role under stakeholder primacy/capitalism as opposed to shareholder primacy/capitalism is to oversee the managerial function of focusing on the long-term sustainability performance, effectively communicating sustainability performance information to all stakeholders. The board should be informed and understand the stakeholder objectives; rationales for focusing on sustainability factors of performance; risk and disclosure; and managerial strategic planning, sustainable operational performance, and executive compensation in promoting long-term corporate value. The board should also provide oversight, insight, and foresight function on the achievement of both financial economic sustainability performance (ESP) and nonfinancial environmental, social, governance, and ethical (ESGE) sustainability performance driven from financial, human, social, environmental, and manufacturing capitals, as well as innovation, culture, and corporate governance.

Specifically,

1. Present shareholder primacy and stakeholder primacy concepts.
2. Discuss all five dimensions of sustainability performance including economic, governance, social, ethical, and environmental (EGSEE) with a keen focus on economic sustainability performance.
3. Examine all corporate capitals including reputational, financial, manufacturing, environmental, human, and social.
4. Address directors' and executives' roles and responsibilities under shareholder primacy and stakeholder primacy concepts.

Keywords

corporate sustainability; financial economic sustainability performance; nonfinancial environmental, ethical, social, and governance sustainability performance; sustainability risk; sustainability disclosure; stakeholder primacy; shareholder primacy; shareholder capitalism; stakeholder capitalism; sustainability capitals; sustainability standard-setting organizations

Contents

<i>Preface</i>	ix
<i>Acknowledgments</i>	xi
Chapter 1 Introduction to Shareholder Capitalism and Stakeholder Capitalism.....	1
Chapter 2 Corporate Capitals	15
Chapter 3 Shareholder Primacy and Capitalism Model	29
Chapter 4 Stakeholder Primacy and Capitalism Model	41
<i>Notes</i>	55
<i>References</i>	57
<i>About the Author</i>	61
<i>Index</i>	63

Preface

Business sustainability has gained considerable attention from investors, regulators, standard-setters, business organization, academics, and the accounting profession in recent decades. This book defines business sustainability as a process of generating financial economic sustainability performance to create shareholder value, while achieving nonfinancial environmental, ethical, social, and governance sustainability performance in protecting the interests of other stakeholders including creditors, customers, employees, suppliers, government, society, and the environment. The role of business corporations in our society has evolved from profit maximization to creating shareholder value and, in recent years, to create shared value for all stakeholders. This book offers guidance to organizations for choosing between shareholder primacy and stakeholder primacy, and thus presents corporate governance in the context of shareholder capitalism model and stakeholder capitalism model. This book provides insights into managerial initiatives for advancing enterprise sustainability from greenwashing and business branding to creating opportunities for revenue generation, cost management, supply chain, business growth, and product and service innovation.

This book consists of four chapters covering all aspects of corporate sustainability with a keen focus on sustainability capitals, shareholder primacy, and stakeholder primacy concepts. Anyone who is involved with business sustainability and corporate governance, the financial reporting process, investment decisions, legal and financial advising, audit functions, and corporate governance education will be interested in this book. Specifically, corporations, their executives, the boards of directors, board committees, internal and external auditors, accountants, lawmakers, regulators, standard-setters, users of financial statements (investors, creditors, and pensioners), investor activists, business schools, and other professionals (attorneys, financial analysts, and bankers) will benefit from this book.

The primary theme of this book is on the examination of stakeholder primacy/capitalism and shareholder primacy/capitalism. As the book was going through the production and publication process, the International Business Council (IBC) of the World Economic Forum (WEF), in collaboration with the big 4 accounting firms, has released its final recommendations for a set of globally accepted, standardized, and industry-oriented environmental, social, and governance (ESG) sustainability performance metrics and disclosures. These recommendations suggest a move away from shareholder primacy and capitalism toward stakeholder primacy and capitalism. These recommendations are intended to provide guiding principles for focusing on the ESG sustainability factors of performance, risk, and disclosures on governance, people, planet, and prosperity. This book also highlights how people, business, and resources collaborate in a business sustainability and accountability model. This book is intended to cover a variety of issues relevant to business sustainability and their implications for organizations of all types and sizes. I hope you find this book relevant and useful to gain and maintain your business and personal sustainability.

Sincerely,
Zabihollah (Zabi) Rezaee
February 16, 2021

Acknowledgments

I acknowledge the Securities and Exchange Commission, the Public Company Accounting Oversight Board, the American Institute of Certified Public Accountants, the Big Four Accounting Firms and Corporate Governance Organizations, American Accounting Association, Global Reporting Initiative (GRI), International Integrated Reporting Council (IIRC), Sustainability Accounting Standards Board (SASB), United Nations, International Business Council (IBC) of the World Economic Forum (WEF), and other sustainability standard-setting organizations for permission to quote and reference their professional standards and other publications.

The encouragement and support of my colleagues at the University of Memphis are also acknowledged, especially my graduate assistants Ms. Naomi Riley and Vy Nguyen for providing invaluable assistance. I thank the members of the Business Expert Press team and Exeter team for their hard work and dedication in editing the book, including Scott Isenberg and John Wood.

My sincere thanks are due to my wife Soheila and my children Rose and Nick. Without their love, enthusiasm, and support, this book would not have come to fruition when it did.

Zabihollah (Zabi) Rezaee

February 16, 2021

CHAPTER 1

Introduction to Shareholder Capitalism and Stakeholder Capitalism

Executive Summary

Corporate sustainability has become an economic and strategic imperative with the potential to create shared value for all stakeholders. Public companies in the United States have traditionally operated under the corporate model of “shareholder primacy/capitalism” that makes the board of directors’ fiduciary responsible primarily to shareholders with protected interests. Under the shareholder primacy system, the primary purpose of a corporation is to generate returns for shareholders, and thus corporate activities are managed toward creating shareholder value. The stakeholder primacy/capitalism, which is better known as the European corporate governance model, makes the board of directors’ fiduciary responsible of protecting interests for all stakeholders including shareholders, creditors, employees, customers, suppliers, society, and the environment. The 2020 COVID-19 pandemic has been an exogenous shock in the global economy and capital market with substantial impacts on individuals, organizations, and society. The pandemic also demands that business organizations focus on safety, health, and well-being of their employees, customers, and suppliers, and thus a global move toward stakeholder primacy. This introductory chapter describes the models of shareholder primacy and stakeholder primacy, and the next three chapters provide more in-depth discussion of these models.

Introduction

Shareholder primacy is a concept that makes the board of directors' fiduciary responsible only to shareholders in protecting their interests with the main mission of creating value primarily for the shareholders. This shareholder primacy system is also known as U.S. corporate governance model and is being criticized for focusing on generating short-term profits for shareholders while compromising long-term sustainability performance that creates shared value for all stakeholders and promotes innovation, growth, and social and environmental impacts. Corporations can create the right balance between the wealth maximization for shareholders under the shareholder primacy concept, while achieving the welfare maximization for all stakeholders under the stakeholder primacy concept.

Recently, the Business Roundtable (BRT) announced the adoption of a new Statement on the Purpose of a Corporation, signed by 181 high-powered chief executive officers (CEOs), which recommend the move away from the shareholder primacy concept toward the stakeholder primacy concept that promotes sustainability of creating shared value for all stakeholders.¹ Corporate purpose and stakeholder considerations have gained recognition in the business community worldwide. The stakeholder primacy challenges companies to put stakeholders at the heart of a company's purpose. A shift in corporate purpose from shareholder primacy to stakeholder primacy reinforced by the U.S. BRT's Statement on the Purpose of a Corporation. This focus, combined with public pressure for CEOs to engage on social and political topics (e.g., human capital, diversity, immigration, gun control, and gender pay equity), enables corporate America to advance toward business sustainability. This chapter provides a synopsis of shareholder primacy and stakeholder primacy models.

Book Objectives and Sustainability Definition

The primary objective of this book is to focus on shareholder primacy and stakeholder primacy models of business sustainability by contrasting and comparing these models and their relevance in advancing business sustainability. Business sustainability is defined as a process of achieving financial economic sustainability performance (ESP) to create shareholder

value while generating nonfinancial environmental, ethical, social, and governance (EESG) sustainability performance in protecting the interest of other stakeholders. Stakeholders are those who have stake in the organization and take risk and share returns including shareholders, employees, creditors, customers, suppliers, society, and the environment.

Business sustainability can best be promoted under the stakeholder primacy model. The board's role under stakeholder primacy/capitalism as opposed to shareholder primacy/capitalism is to oversee the managerial function of focusing on the long-term sustainability performance, effectively communicating sustainability performance information to all stakeholders. The board should be informed and able to comprehend the stakeholder objectives, rationales for focusing on sustainability factors of performance, risk, and disclosure, and managerial strategic planning, sustainable operational performance, and executive compensation in promoting long-term corporate value. The board should also provide oversight, insight, and foresight function on the achievement of both financial ESP and nonfinancial EESG sustainability performance driven from financial, human, social, environmental, and manufacturing capitals as well as innovation, culture, and corporate governance. The concept of impact investing (II) in achieving desired financial returns for investors while generating social and environmental impacts is relevant and important under the stakeholder primacy model.

Recently, a definition of corporate purpose has been proposed and elaborated to include three key guiding principles as follows:²

1. The proposed definition of corporate purpose for publicly traded business (for-profit) corporations is to measure their actions by what is in the best interests of *shareholders* (the shareholder primacy governance model).
2. In reaching for this new corporate purpose definition, the reality is ignored that the shareholder primacy governance model embraces the ability of directors to consider a broad array of nonfinancial EESG sustainability performance factors.
3. Companies who chose to address EESG/stakeholder-oriented decisions pursuant to the stakeholder interests balancing act

contemplated by the proposed new purpose definition run the risk of losing the valuable protection of the business judgment rule.

The COVID-19 pandemic has brought on many challenges, including focusing on the inequality in our society and the fact that many public companies' primary goal is maximizing shareholder value at the expense of other stakeholders such as employees, creditors, customers, suppliers, and communities. However, under their new corporate purpose definition, directors will have "latitude to make decisions that reasonably balance the interests of all constituencies" and they urge corporations and their shareholders to "recognize that ESG and stakeholder purpose are necessary elements of sustainable business success."³ Thus, public companies should ensure that they have effective corporate governance structure and measures to creating shared value for all stakeholders and serving the interests of all stakeholders including shareholders. Public companies and their elected board of directors and appointed management should be responsible and accountable to shareholders and ensure that they run the company in the best interests of shareholders in creating sustainable and long-term value.

Impact Investing

The relationship between financial/market performance and nonfinancial EESG performance has been extensively yet inconclusively debated in the literature in the past decade, which suggests that investors pay attention to sustainability factors of risk, performance, and disclosure. A growing number of investors are now considering II with a keen focus on financial return and EESG sustainability factors and integrating nonfinancial EESG sustainability factors into their investment strategies.⁴ The Global Impact Investing Network (GIIN) refers to II as "investments made with the intention to generate a positive, measurable, social, and environmental impact alongside a financial return."⁵ Regulators have responded to the demand for environmental, social, and governance (ESG) information and have either mandated ESG sustainability performance disclosure (European Union, EU Directive, 2014) as more than 6,000 European public companies are required to disclose their ESG information in the

fiscal 2017 year and onward or recommended voluntary disclosure of ESG information.⁶

Corporate purpose and stakeholder considerations have gained recognition in the business community worldwide. In August 2019, 181 out of 188 member CEOs of the U.S. BRT signed an amended Statement on the Purpose of a Corporation, moving away from the traditional shareholder primacy of maximizing shareholder returns.⁷ The stakeholder primacy challenges companies to put stakeholders at the heart of a company's purpose. A shift in corporate purpose from shareholder primacy to stakeholder primacy reinforced by the U.S. BRT's Statement on the Purpose of a Corporation. The idea of establishing the purpose for the company beyond profit maximization for shareholders, combined with public pressure from investors and regulators to engage on social and political topics (e.g., human capital, diversity, immigration, gun control, and gender pay equity) has encouraged business organizations to define their purpose and focus on II. The concept of II suggests that corporations achieve a desired rate of returns for their shareholders while generating social and environmental impacts. Although the II concept has often been used interchangeably with socially responsible investing (SRI), the two concepts have important differences. SRI is commonly referred to as the investment strategy that maximizes financial returns while minimizing any negative impact on the society or environment, whereas II is a deliberate investment strategy to achieve both financial returns and social and/or environmental impacts.⁸

The distinction between II and SRI investment strategies is important for several reasons. First, investor sentiment plays a role in firms' commitment to II when investors place a valuation premium on nonfinancial EESG sustainability performance. Second, in the aftermath of the COVID-19 pandemic considering financial and operational challenges, firms, their shareholders, and directors have increasingly become attuned to EESG considerations in allocating scarce resources between II and SRI investments in achieving EESG objectives. Third, investors now pay more attention to EESG initiatives and investments as asset managers of the Big 3 investment families (BlackRock, State Street, and Vanguard) consider EESG risks and opportunities in their investment strategies.⁹ Finally, investors with stronger EESG preferences with a focus on II with

portfolios that tilt more toward green assets earn lower expected returns than investors with a focus on SRI investing in brown assets.

Defining corporate purpose has been a key trend in Europe over the last several years and will continue to spread in 2020. In France, expect more companies to adopt a “raison d’être” (corporate purpose), an expectation which may become a legal requirement. The *raison d’être* gives a sense of meaning to stakeholders and puts EESG at the core of corporate strategy. Climate change and transitioning to a lower-carbon economy are also top priorities for European stakeholders. Boards will need to be able to understand and discuss ESG data—and its impact on key matters such as executive remuneration—with investors. In France, the number of board committees focused on ESG has doubled in the last two years. This is an important development, as EESG is the focus of a quarter of the questions raised at general assemblies and half the resolutions submitted by shareholders. In Spain, investors will begin to exercise their vote on nonfinancial reporting. Spain also is extending its corporate governance principles, which promote key components of EESG, to private companies in 2020. More transparent sustainability disclosures on long-term economic and EESG performance create opportunities to identify and correct operational inefficiencies, reputational and financial risks that would improve economic performance and thus increase the firm value.¹⁰

Investors typically have incomplete financial and nonfinancial information about a firm’s ESG sustainability performance and thus they may not be aware of the firm’s governance effectiveness, ethical culture, and social and environmental commitments. Lack of knowledge on the part of investors reduces the firm’s investor base, which in turn makes risk sharing incomplete and inefficient and thus stocks of these firms are out of line with their market’s fundamentals, which may incentivize firms to obtain certification to influence stock prices. Disclosures of sustainability information however make investors aware of the firm existence and enlarge its investor base, which improves risk sharing and thus make their stocks closer to their market fundamentals. Stakeholders may attempt to pressure and/or motivate firms to disclose sustainability information about their social, governance, and environmental activities and release of such information leads to disclosure of private information. Managers tend to analyze the costs/benefits of obtaining sustainability

ranking to improve sustainability disclosures and how these disclosures are integrated and observed by capital markets.

Sustainability information on long-term economic and EESG performance increases the quality and quantity of the firm's disclosures, and thus more focus on long-term and sustainable performance and fewer incentives for short-term performance that could be detrimental to the long-term sustainability. Given that sustainability disclosing firms provide fewer incentives and opportunities for short-termism, we expect to find a positive relation between sustainability disclosure and its rankings and stock prices.

Investor interest in sustainable investments, products, and services has increased, and policy makers have begun to take a greater focus on this area along with a broad set of stakeholders as well. The demand for sustainability policies and initiatives is growing in velocity and required by some nations. However, other topics must be addressed before discussing the sustainability policies that should be implemented into the business environment. First, a well-regulated sustainable finance ecosystem is needed to support broader sustainability-related policy initiatives at the global level, most pointedly to mobilize the massive amount of capital needed to address climate change. Second, and by no means unrelated, is the concern that robust standards exist to mitigate the risk of “greenwashing”—the risk that either through confusing or outright misleading investment approaches, asset owners cannot make informed choices about the actual sustainability characteristics of their investments.¹¹ The push for sustainability has reached global standards and already proven to be a colossal game changer that even alters the behavior of both institutional investors and companies in various diverse ways. While investors struggle with the challenge of integrating EESG factors into their investment decisions, many companies want to define a meaningful corporate purpose to exploit the full potential of sustainability reporting. These goals can be achieved by the following:¹²

- Doing a more effective job managing relations with institutional investors and shareholders.
- Reshaping corporate reporting to provide a holistic picture of the business and its value drivers.

- Directing shareholders' attention to the company's unique characteristics and values.
- Designating company-specific performance metrics linked to business strategy and value creation.
- Reducing investors' reliance on external one-size-fits-all standards and inappropriate metrics.
- Reducing vulnerability to shareholder activism.

Some estimate that the amount of money being committed to impact the investing strategies used around the world has grown to \$502 billion, according to the analysis by the GIIN. In a white paper published in April 2019, the GIIN estimated that over 800 asset managers now account for about 50 percent of assets focused on II, while 31 development finance institutions manage just over a quarter of industry assets and several large investment firms manage over \$1 billion each.¹³ The Big 3 asset management firms of BlackRock, Vanguard, and State Street have responsibility to manage, monitor, and disclose their role as stewards of their clients' investment by engaging with public companies' board of directors and management on material business issues including financial returns on investment and nonfinancial EESG sustainability factors of performance, risk, and disclosure.

Shareholder Primacy and Capitalism Model

Public companies in the United States have traditionally operated under the corporate model of "shareholder primacy" and "shareholder capitalism," which suggests the primary goal of business organizations is to maximize profit and thus wealth for shareholders. This model makes the board of directors' fiduciary responsible primarily to shareholders in protecting their interests. Under the shareholder primacy system, the primary purpose of a corporation is to generate returns for shareholders, and thus corporate activities are managed toward creating shareholder value. This shareholder primacy system is also known as U.S. corporate governance model and is being criticized for focusing on generating short-term profits for shareholders, while compromising long-term sustainability performance that creates shared value for all stakeholders and promotes

innovation, growth, and the social and environmental impacts. Shareholders have the right to vote to nominate, elect, remove the board of directors, approve executive compensation, mandate the corporate charter and bylaws, approve the appointment of auditors, and approve major transactions including mergers and acquisitions. In general, shareholders are enabled to vote on business matters that are relevant to the protection of their investment including the right to full, fair, and timely information following the guiding principle of “one share, one vote.”

The U.S. capital markets driven by the shareholder primacy and capitalism model have been perceived as promoting shareholder wealth maximization without creating an inclusive and equitable economy for all Americans. However, in recent years, some progresses have been made to promote capital stewardship to preserve market mechanisms in creating shared value for all stakeholders in a more equitable economic system. The prevailing laws, regulations, and culture governing U.S. capital markets are intended to maximize profit for companies and their shareholders, regardless of the damage caused by just focusing on maximizing profit such as negative impacts on society and the environment. This shareholder primacy and shareholder capitalism model should be modified and reformed to promote business sustainability.

Bridgewater Associate, Ray Dalio, states that capitalism is a fundamentally sound system, but that it is not working well for the majority of people in the current times; therefore, it requires revision to provide more equal opportunities. To make the changes, Dalio believes the following is needed:¹⁴

1. Leadership from the top.
2. Bipartisan and skilled shapers of policy working together to redesign the system, so it works better.
3. Clear metrics that can be used to judge success and hold the people in charge accountable for achieving it.
4. Redistribution of resources that will improve both the well-being and productivities of the vast majority of people by:
 - (a) Creating private–public partnerships that would jointly vet and invest in double bottom line projects that would be judged on the basis of their social and economic performance results relative to clear metrics.

- (b) Raising money in ways that both improve conditions and improve the economy's productivity by taking into consideration the all-in costs for the society.
 - (c) Raising more from the top via taxes that would be engineered to not have disruptive effects on productivity and that would be earmarked to help those in the middle and the bottom, primarily in ways that also improve the economy's overall level of productivity, so that the spending on these programs is largely paid for by the cost savings and income improvements that they create.
5. Coordination of monetary and fiscal policies.¹⁵

Many corporate leaders have stronger incentives to give substantial weight to the interests of stakeholders because it betters their own interests, but there is no incentive to advance their interests beyond that to what would benefit the shareholder. An empirical analysis of over 100 private equity acquisitions governed by constituency statutes provides novel evidence that supports clear verdict on the success of these statutes.¹⁶ The advocates of adopting these statutes touted their promise for addressing concerns related to stakeholders, and this promise enabled corporate leaders to obtain the support of labor and other stakeholder groups for the legislation.

The voluntary nature of EESG disclosure under the shareholder primacy system enables managers to exercise judgment in deciding the level of EESG sustainability focus and presenting the type and extent of EESG disclosure. Whether managers exercise such discretion in an efficient manner consistent with long-term sustainable returns and EESG principles to create shared value for all stakeholders or in an opportunistic manner to enhance their reputation and generate near-term returns just for shareholders is debatable. Increased EESG sustainability disclosure can enable stakeholders (e.g., institutional investors, analysts, creditors, government, suppliers, society, and employees) to develop their own independent and informed views on firms' sustainable performance in all areas of economic, environmental, social, ethical, and governance activities. The recent 2020 KPMG survey focuses on the disclosure of these sustainability activities including reporting on climate-related risk and carbon reduction, United Nations Sustainable Development Goals

(SDGs) relevant to societal, environmental, and governance impacts, and the risk of biodiversity loss.¹⁷

Stakeholder Primacy and Stakeholder Capitalism Model

The stakeholder primacy system, which is better known as the European corporate governance model, makes the board of directors' fiduciary responsible for protecting the interests of all stakeholders, including shareholders, creditors, employees, customers, suppliers, society, and the environment. In this era of sustainability-oriented investors, directors, and executives' commitments to sustainability, a major challenge is determining the determinants and consequences of business sustainability. The major determinants of business sustainability are determined by the shareholder primacy and stakeholder primacy system and other considerations including the firm's size, leveraged, maturity, complexity, merger and acquisition activity, restructuring charges, and operate in a more litigious industry, corporate governance measures, and internal control effectiveness. Business sustainability consequences are the three sustainability factors of performance, disclosure, and risk, as well as financial and market performance, earnings quality, and financial reporting conservatism. The stakeholder capitalism model focuses on the II concept of generating desired financial returns on investments by shareholder, while protecting interests of other stakeholders and achieving social and environmental impacts. Under the stakeholder primacy model, while shareholders have the right to protect their investments, they also benefit in the long term where their company is sustainable in creating shared value for all stakeholders. Shareholder welfare creation, rather than shareholder wealth creation, is promoted under the stakeholder capitalism.

Shareholder Capitalism Versus Stakeholder Capitalism

The concept of shareholder primacy where public companies are managed solely in protecting the interests of the shareholders has been debated. There has been a move toward the adoption of the stakeholder primacy concept where business organizations are run in the interests of all stakeholders including shareholders. In the Summer of 2019, the BRT

released an updated purpose of corporation statement that disavows the endorsement of shareholder primacy, suggesting that the corporations should not solely serve its shareholders, but rather all stakeholders. This statement was signed by 181 CEOs of large companies such as Apple and JPMorgan. Much has been written about this statement and its effects on the economy and specifically the shareholders. In one article, the authors state that this transition will cause our economy to suffer due to company cash becoming trapped inside public firms, poorly invested resources, and as shareholder payouts decline the smaller firms will have even less access to capital.¹⁸ The vitality of our economy very well depends on shareholder interests; however, stakeholder interest must now be addressed as well.

In “The Illusory Promise of Stakeholder Governance,” Lucian Bebchuk and Roberto Tallarita reject the idea of stakeholderism stating that it does not benefit stakeholders, shareholders, or society.¹⁹ Bebchuk and Tallarita believe that directors of a company are not motivated enough or even able to promote anything other than shareholder value in this system focused on shareholder profit. Contradiction of this research comes from Colin Mayer who commented on the possibility of a misconceived contradiction of shareholderism versus stakeholderism, by arguing that stakeholder governance is either enlightened shareholder value and nothing more, or that it imposes unmanageable trade-offs on company directors.²⁰ Mayer instead suggests that instead of describing the system as it is known today, we should analyze what it could or should be to provide a more accurate benchmark against which it would be possible to evaluate the stakeholder versus shareholder system.

Several initiatives are taken to move away from the shareholder primacy and toward stakeholder primacy under the new corporate governance model including the following:

1. The board fiduciary duty should be extended to all stakeholders and the board of directors should be accountable to all stakeholders not just shareowners.
2. Corporate purpose statements should specifically state that corporations positively benefit society in the context of creating shared value for all stakeholders.

3. Multiple stakeholders including employees should be represented on corporate boards.
4. Large corporations should be required to charter federally, to enable the accountable governance reforms that require responsibility to all stakeholders.
5. ESG Disclosure Simplification Act (link between ESP and ESG).
6. The Shareholder Protection Act (political spending).
7. Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019 (human rights risks or impacts on the operations).
8. Climate Risk Disclosure Act of 2019 (financial and business risks associated with climate change).
9. Accountable Capitalism Act of 2018 (Senator Warren, Corporations with revenue over \$1 billion would be required to obtain a federal *corporate charter*, two-fifth of the directors shall be elected by employees, and any political spending over \$10,000 has approval of both 75 percent of shareholders).

Conclusion

In a time of high uncertainty, anxiety, complexity, and ambiguity triggered by the 2020 COVID-19 pandemic, business organizations are better off by focusing on the stakeholder primacy concept of creating shared value for all stakeholders. Thus, sustainability strategies have become integral components of business environment and corporate culture. This emerging trend of moving away from shareholder primacy toward stakeholder primacy and index funding has led to a debate centered on the implications of common ownership and main mission of business organizations.

Under the stakeholder primacy model, there is a spread ownership, and the main mission is to create shared value for all stakeholders. Policy makers, regulators, and society have questioned on the fiduciary model of shareholder primacy and advocates moving toward stakeholder primacy. The shareholder primacy model has served investors well in creating value and maximizing wealth for them, but is being criticized for focusing on serving only one group of stakeholders and generating short-term profits at the expense of long-term sustainability performance, innovation, and

growth. This model often ignores the social and environmental impacts of corporations. The focus on shareholder wealth creation may not benefit other stakeholders, such as employees, customers, creditors, suppliers, government, society, and the environment. Business organizations are given rights to operate and generate profits for their shareholders, but with these rights come public interests and societal responsibilities of having social and environmental impacts.

Chapter Takeaways

- Promote profit-with-purpose mission to create shared value for all stakeholders.
- Consider moving away from the shareholder primacy model and moving toward the stakeholder primacy model.
- Achieve II purpose of generating desired financial returns for shareholders while achieving social and environmental impacts.
- Establish measures of both financial ESP performance and nonfinancial EESG sustainability performance.
- Communicate the achievement of both financial ESP performance and nonfinancial EESG sustainability performance to all stakeholders.

Corporate Sustainability

Shareholder Primacy Versus Stakeholder Primacy

Zabihollah Rezaee, PhD

Business organizations have recently been encouraged by investors, regulators, and communities to define their purposes, values, and fiduciary duties of creating shared value for all stakeholders.

Public companies have traditionally operated under the corporate model of “shareholder primacy” with the primary purpose of generating returns for shareholders and thus corporate activities are managed toward creating shareholder value. The stakeholder primacy system encourages directors and executives to focus on managing corporate activities toward creating shared value for all stakeholders. The role of the board of directors under stakeholder primacy/capitalism as opposed to shareholder primacy/capitalism is to oversee the managerial function of focusing on the long-term sustainability performance, effectively communicating sustainability performance information to all stakeholders.

A shift away from the shareholder primacy model and toward the stakeholder primacy model has been gaining momentum worldwide in recent years as investors demand, regulators require, and companies define the “profit-with-purpose” mission in creating shared value for all stakeholders.

This book offers guidance to organizations for considering both shareholder primacy and stakeholder primacy in defining their mission of “profit-with-purpose” and in creating shared value for all stakeholders. It also highlights how people, business and resources collaborate in a business sustainability and the stakeholder primacy model in creating shared value for all stakeholders. Anyone who is involved with business sustainability and corporate governance, the financial reporting process, investment decisions, legal and financial advising, audit functions, and corporate governance education including directors, executives, investors, and auditor will be interested in this book.

Zabihollah Rezaee (Zabi) is the Thompson-Hill Chair of Excellence and professor of accountancy at the University of Memphis and has served a two-year term on the Standing Advisory Group of the Public Company Accounting Oversight Board (PCAOB). Dr. Rezaee holds ten certifications including certified public accountant (CPA). He is currently the editor of the *Journal of Forensic Accounting Research* (JFAR), has published over 250 articles and written 14 books.

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