

Stakeholder Capitalism Needs Gov't Oversight To Work

By **Christopher Dodd and Teresa Johnson** (November 2, 2020, 4:39 PM EST)

Despite the urgent pressure of COVID-19 and other crises brought to us by 2020, stakeholder capitalism — the idea that corporations should take into account the interests of their stakeholders, not just shareholders — has remained at the top of the corporate news cycle.

On the recent 50th anniversary of economist Milton Friedman's essay "The Social Responsibility of Business Is to Increase Its Profits" — which established shareholder primacy as the prime corporate directive — many legal, business and economic leaders challenged Friedman's legacy, favoring stakeholder capitalism over shareholder primacy.

We think that it isn't an either/or situation. Stakeholder capitalism can work to benefit shareholders as well, but there must be collaboration between business and government in order to achieve the desired goals. In fact, a review of recent history shows us that collaboration between business and government is the optimal way to determine what is in the best interests of the stakeholders.

Let's look at what has happened during the pandemic. The U.S. government has interceded in the economy to protect its citizens and businesses, beginning with the Coronavirus Aid, Relief and Economic Security, or CARES, Act stimulus. The stimulus is effectively implementing a version of stakeholder capitalism with forgivable loans and grants intended to soften economic pressures from the lockdowns.

And the government's role in stimulating the economy appears likely to continue, depending on the degree of congressional gridlock.

In 2008, the government had to step in to backstop the financial markets. Without that era's government stimulus, which had bipartisan support, we could have ended up in another Great Depression. After addressing the immediate risk of financial freefall, the next task was to restore confidence in our financial institutions, which had been deeply damaged.

Congress worked to pass the Dodd-Frank Act in order to limit risk-taking behavior and ultimately restore that confidence. The capital requirements and other restrictions imposed by Dodd-Frank a decade ago helped financial institutions weather the COVID-19 pandemic and avoid institutional failures.



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The COVID-19 pandemic has triggered a crisis of confidence in our public health institutions. Combined with the crisis of confidence in our justice system and the intensely partisan political environment, it all adds up to a lack of trust — across the political spectrum — in the government's ability to look after its citizens. Systemic risk now seems to have an even broader meaning than when Dodd-Frank was drafted in 2010.

How can we restore confidence? Stakeholder capitalism can help, by increasing the accountability of institutions for the constituencies they affect. However, in order for stakeholder capitalism to work, the government needs to take a central role, because corporations are not legally accountable to any parties other than their shareholders and the government.

Moreover, corporate leaders are not incented to prioritize the interests of stakeholders, as concluded in a recent study by Harvard professors Lucian Bebchuk and Roberto Tallarita. And under corporate law in Delaware, where most large corporations are incorporated, directors have fiduciary duties to make decisions in the best interests of shareholders — not stakeholders. Delaware public benefit corporations allow directors to weigh a public benefit alongside shareholder interests, but do not provide for broader accountability.

If we are serious about moving toward stakeholder capitalism, there are two steps that can be taken.

First, there needs to be a way for corporations to be held accountable for stakeholder interests. To be successful, any system of accountability needs to have the support of both the government and the business leaders who are raising the alarm about the need for corporations to look after stakeholders.

The government could form a blue-chip working group with leaders of the Business Roundtable, institutional investors and academics, comprising a range of bipartisan perspectives, to design a mutually acceptable approach that could establish the priorities of stakeholder capitalism. The group would be charged with developing an accountability measure for stakeholder capitalism — whether through incentives, modifications in the business judgment rule, disclosure requirements or other methods.

Second, there are existing statutes and regulations that can address the interests of stakeholders. Dodd-Frank establishes broad macroprudential authority to regulate systemic risk, which can include climate change, as argued in a study by Stanford University academic Graham Steele.

The Commodity Futures Trading Commission's recent report on the risks posed by climate change to the U.S. financial system and its ability to sustain the American economy exhorts the Financial Stability Oversight Council, the U.S. Securities and Exchange Commission and other regulators to use their authority to address climate risk in the financial system.

Other systemic risks, such as the broader economic impacts of redlining underrepresented communities for mortgages, could also be regulated under Dodd-Frank. And these are just a few examples.

If the government will work with business and thought leaders to develop policy solutions to benefit stakeholders and use the laws already at its disposal to further stakeholder interests, that can help facilitate longer-term decision making on the part of corporations. It could also provide protective mechanisms to help minimize the risks posed by the next crisis.

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