



**Aspen Institute-UCLA School of Law Roundtable**  
*Rethinking “Shareholder Value” and the Purpose of the Firm*  
September 29-30, 2011  
UCLA SCHOOL OF LAW | LOS ANGELES, CA  
**Reflections from the Roundtable**

On September 29-30, a group of 43 business professors, legal scholars and executives convened for a dialogue about the purpose of the firm and the role of “shareholder value” in corporate governance and evaluation of firm performance. Facilitated and hosted by the Aspen Institute Business and Society Program (Aspen BSP) and Professor Lynn Stout of the UCLA School of Law, roundtable discussions addressed key questions that have profound consequences for both corporations and the long-term health of society. This roundtable took a critical look at the current dominant paradigm of corporate purpose, “Shareholder Primacy” (aka “Shareholder Wealth Maximization”) and sought to identify the characteristics of a new paradigm to take its place. Several key themes emerged:

1. The dominant paradigm of corporate purpose—that firms exist primarily to maximize financial benefit of shareholders—is not enshrined in law and can be harmful in practice.
2. We currently lack a common language on corporate purpose in the fields of law and business. Both business and law remain challenged to incorporate authority, accountability, identity, and social utility into a unified narrative of corporate purpose.
3. Metrics for corporate performance are not universal, but rather they should be firm-specific and context-specific.

### **Why shareholder primacy is insufficient**

Many attendees voiced concerns that the current dominant paradigm of “Shareholder Primacy” is problematic both descriptively and normatively. Issues raised include:

1. Shareholder primacy greatly oversimplifies the complexities of business, and in practice it has contributed to harmful consequences for firms and the economy as a whole. (*ex. Research suggests that the pressure to maximize share price compels many managers to sacrifice long-term value-creating projects to meet short-term shareholder expectations.*)
2. Corporate law does not require firms to maximize shareholder profit, but rather allows for significant manager discretion in business judgments to serve a variety of interests and the long-term health of the enterprise. Disagreement remains over the normative question: *should* firms prioritize the financial gain of their shareholders over other interests?
3. Shareholders neither own nor control the firm (“Corporations are independent entities. They are not owned by shareholders.” And “shareholders are residual claimants.”)
4. Shareholder primacy offers a weak decision rule for managers because “stock market expectations are unbounded and managers come to realize they cannot keep expectations rising forever.”
5. Executives note that, in practice, business leaders must constantly manage the interests of many stakeholders and that shareholders should be considered one of many stakeholders.

6. Stock price is an inadequate measure of shareholder interest. Today's "retirement capitalism" mobilizes capital through "long chains of complex conflicts of interest" from asset owners with different time horizons, values, and interests. Simply put, shareholder interests vary too widely to be captured by a single metric.

### **What do we mean by "corporate purpose?"**

Among participants, the term "corporate purpose" was interpreted quite differently. At least three different levels of analysis were used in descriptions of corporate purpose:

1. *Legal obligations* of corporations
2. The *identity* of an individual organization
3. The *role society assigns* to corporations

The nature of corporate law focuses the field on the legal relationship between shareholders and management, often in terms of ownership and control of the firm. As such, issues of authority and accountability are central concerns of theories of the firm from the legal perspective.

Business practitioners repeatedly described purpose as a firm's identity—what it sets out to do (mission and objectives), how it sets out to do it, and its "spirit"—suggesting that corporate purpose is firm and context-specific. Purpose, in this light, precedes other strategic decision making and informs how a firm creates its own structures for accountability—governance structures, metrics, decision rules, et cetera. One practitioner stated flatly that shareholders "are buying a ticket to ride" as the company pursues its self-determined purpose.

Still others raised the question of corporate purpose on a societal level: in the words of one executive, "Companies harvest huge investment from society. Society is the largest shareholder...what does a corporation owe to their largest shareholder?" Like legal theories, this perspective begs questions of accountability, but to a different category of stakeholder.

A new narrative that accounts for **authority, accountability, identity, and social utility** of firms may provide much needed sophistication to our understanding of business. Broad agreement emerged that a clearly articulated purpose is a prerequisite for measuring performance and for encouraging accountability and that the law allows for managers of corporations to exercise fairly wide discretion when making business decisions.

### **What metrics can we use to measure corporate performance?**

Shareholder primacy suggests that share price is the best metric of corporate performance. Many attendees disagreed. While a single metric such as share price can provide guidance for managers in a narrow sense, many acknowledged that the complexity of business decisions renders any single metric of little use when assessing overall performance. A range of performance metrics can be used depending on the objective a company is measuring.

Share price only “reflects collective expectations about future performance,” not necessarily how well a company is doing in making and/or selling goods and services. It is one of dozens of metrics that a company can use to measure its financial performance. Selecting the right metric depends on what goals the company is pursuing and what factors are critical to the company’s success over the long term.

An open question remains--which “other metrics” should be used, and when? Choosing metrics requires clearly articulated goals, leading several practitioners to offer that purpose needs to come first and all metrics should follow. The underlying tension between the need for director discretion to exercise sound judgment and the need for some kind of decision rule that ensures accountability was left unresolved. This tension offers opportunity for further dialogue, and perhaps broader dialogue – other disciplines, particularly finance, can (and must) contribute as we strive to assess corporate performance in more context-specific ways.

### **What We Teach Matters**

Teaching about corporate purpose is an opportunity for business and law faculty to develop students’ capacity to deal with ambiguity, recognize choices within context, and exercise judgment. As they enter careers in business, students will grapple with complex problems with far-reaching consequences that are unlikely to fit neatly within the constraints of hard and fast decision rules. Instead, they will need to balance multiple interests over different time frames, and exercise discretion, leadership, and good judgment.

The theme of *choice* emerged in the closing sessions as one potential cornerstone to a new narrative of corporate purpose. Manager discretion *is* enshrined in corporate law and is exercised by corporate leaders everyday. Said one practitioner: “It’s a powerful idea that companies can *choose*.” A scholar affirmed, “The law gives discretion to choose...There are different purposes for different firms.” However, choice must be accompanied by *leadership* (“Making judgment is the messy reality of leadership”), and *accountability* (companies “need to disclose what they are doing. They can choose purpose but they have to communicate it”).

A new theory that embraces choice will elevate questions about uncertainty, risk, accountability, leadership, and judgment. It will challenge law and business schools to teach students to integrate their thinking on legal boundaries, leadership and judgment, communication, accountability (governance), and metrics (financial and others). Lastly, it may prepare students to exercise good judgment amidst the ambiguity of real world decision-making and help them weigh trade offs they will face as business managers and legal advisors.

## Some Open Questions As We Move Forward

*“We are still two tribes living on two (if not more) islands. Canoes are being built.”*

- As we craft alternative conceptions of corporate purpose, how much *should* shareholders matter?
- Which metrics are best at assessing performance, risk and integrity? In what context? Over what time frame?<sup>1</sup>
- If we measure performance differently, how do incentive structures change and how do we ensure accountability?
- Is a “theory of the firm” intended to provide a decision rule for corporations, or a heuristic to help interpret real world situations?
- What does the narrative look like if we start from the premise that corporations choose their purpose within the constraints of the law?
- What are the *risks* of choice?
- How are the interests of risk-bearing stakeholders, including shareholders, protected in a regime of manager choice?
- How does the idea of director choice connect to director responsibility?
- Are different skills needed by corporate leaders if they are required to balance interests and timeframes (rather than maximize stock price) as their primary job responsibility?
- How and when do we teach about ambiguity in the business and law classroom? Is there a role for new kinds of pedagogy and experiential learning if “difficult choices” are a part of the curriculum?

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<sup>1</sup> “Restoring Trust in Corporate Governance: Six Essential Tasks of Boards of Directors and Business Leaders” Policy Brief, Policy and Impact Committee of the Committee for Economic Development, January 2010

## Appendix: Participant List

1. **Iman Anabtawi**, Professor of Law, UCLA School of Law
2. **Constance Bagley**, Professor in the Practice of Law & Management, Yale School of Management
3. **Stephen Bainbridge**, Professor of Law, UCLA School of Law
4. **Zoë Baird Budinger**, President, Markle Foundation
5. **Robert Bartlett**, Assistant Professor of Law, UC Berkeley Law
6. **Tamara Belinfanti**, Associate Professor, New York School of Law
7. **Antonio Bernardo**, Professor of Finance, UCLA Anderson School of Management
8. **Nicole Woolsey Biggart**, Professor of Management; Former Dean, UC Davis Graduate School of Management
9. **Margaret Blair**, Professor of Law, Vanderbilt University Law School
10. **Ryan Bubb**, Assistant Professor of Law, NYU School of Law
11. **William (Bill) D. Budinger**, Founder, Rodel Inc. & Co-Founder, Rodel Foundations
12. **Anne T. Chapman**, Vice President of the Fund Business Management Group, Capital Research & Management Company
13. **Peter Conti-Brown**, Fellow, Rock Center for Corporate Governance at Stanford University
14. **Thomas Donaldson**, Professor of Legal Studies & Business Ethics, Wharton School of Business
15. **Jonathan Feigelson**, General Counsel, TIAA-CREF
16. **Martin Gelter**, Associate Professor of Law, Fordham University School of Law
17. **Kent Greenfield**, Professor of Law, Boston College Law School
18. **Henry B. Hansmann**, Professor, Yale Law School
19. **James Hawley**, Professor, St. Mary's College of California, School of Economics & Business
20. **Ben Heineman, Jr.**, Senior Fellow, Harvard Law School
21. **Andrew Kassoy**, Co-founder, B Lab
22. **Prasad Krishnamurthy**, Assistant Professor of Law, UC Berkeley Law
23. **Lloyd Kurtz**, Chief Investment Officer, Nelson Capital
24. **David Langstaff**, President and CEO, TASC Inc. #
25. **Jay W. Lorsch**, Professor of Human Relations, Harvard Business School
26. **Nick Main**, Global Leader, Climate Change & Sustainability Services and Chief Sustainability Officer, Deloitte Touche Tohmatsu
27. **Roger Martin**, Dean, Rotman School of Management, University of Toronto
28. **John Morley**, Associate Professor of Law, University of Virginia Law School
29. **Eric Orts**, Professor of Legal Studies, Business Ethics, and Management, Wharton School of Business

30. **Miguel Padró**, Project Manager, Aspen Institute Business & Society Program
31. **Lynn S. Paine**, Professor of Business Administration, Harvard Business School
32. **Gail Pesyna**, Vice President for Human Resources & Program Management, Alfred P. Sloan Foundation
33. **Elizabeth Pollman**, Fellow, Rock Center for Corporate Governance, Stanford University
34. **Tom Quaadman**, Vice President, Center for Capital Markets Competitiveness, US Chamber of Commerce
35. **Roberta Romano**, Professor of Law, Yale Law School
36. **Judith Samuelson**, Executive Director, Aspen Institute Business & Society Program
37. **Lynn Stout**, Professor of Corporate & Securities Law, UCLA School of Law #
38. **Leo Strine Jr.**, Chancellor, Court of Chancery of the State of Delaware
39. **Klaus Weber**, Associate Professor of Management & Organizations, Kellogg School of Management
40. **Simon Wong**, Partner, Governance for Owners and Adjunct Professor, Northwestern University
41. **Edward Zajac**, Professor of Management & Organizations, Kellogg School of Management

**OBSERVERS:** Rebecca Darr (Senior Fellow) and Claire Preisser (Senior Program Manager),  
Aspen Institute Business & Society Program