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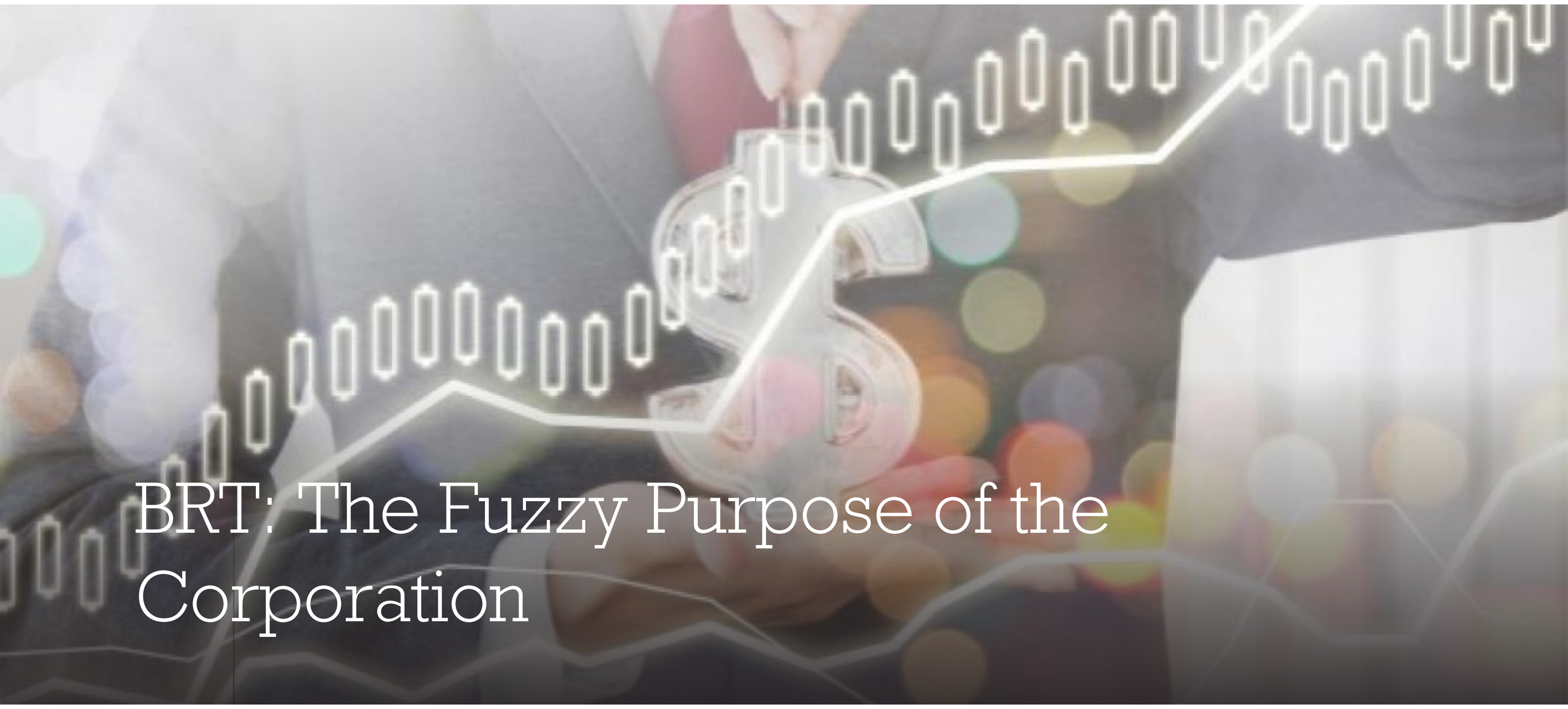

BRT: The Fuzzy Purpose of the Corporation

The Business Roundtable's statement confuses rather than clarifies.

The Business Roundtable updated its definition of the purpose of the corporation this week. Shareholders are no longer number one, and now companies have a commitment to all stakeholders. It seems like the group of CEOs just endorsed the governance model of the **left wing** of the Democratic Party.

Initially, I was alarmed by this statement for two reasons. First, I mainly invest in US stocks because I don't trust European companies which have a stakeholder value governance model. Should I sell my Amazon shares because firms are now supposed to "*support the communities in which they work"*? Amazon has wreaked devastation upon retail in the US, destroying a prominent part of American suburban community life: the **shopping mall**. With CEO Jeff Bezos on the BRT, does this statement signal a fundamental change in Amazon's strategy? The fact that Amazon as well as US markets rose after the release of the Business Roundtable report is reassuring that the statement is just a PR exercise that will have no real consequences.

Second, the stakeholder value model is a practically useless concept as it does not provide guidance on how managers should make decisions. A particularly vexing dilemma this model leaves unaddressed is how to trade off the interests of various stakeholders. Fuzziness is all over the statement: firms are supposed to *"exceed customer expectations*". How do managers deal with a situation that exceeds customer expectations but at the same time disappoints other stakeholders? Suppose BMW exceeds customers' expectations by offering the new 5-series with a 20 percent discount off the old model. Shareholders' expectations in this case will clearly not be met but why should they be less important than customers?

The importance of *"dealing ethically with suppliers"* is highlighted but there is no mention of ensuring ethical dealings with investors. All those who have invested in US firms were led to believe that the implicit understanding was that US firms maximize shareholder value. Changing this contract now *ex-post* is, in my view, unethical.

The document states that employees should be "*fairly compensated*", but who is to judge whether Business Roundtable's Chairman Jamie Dimon's US$30 million compensation is fair?

The BRT statement lacks clarity about how corporations can juggle the needs of all these stakeholders and what happens if shareholders decide to take their much-needed cash elsewhere.

A glimmer of hope

Only at the end of the announcement do I see a meaningful statement that most finance professors could agree with: Firms should create long-term value for shareholders. If the market is efficient, the current stock price should reflect the firm's long-term value. In this case, maximising shareholder value is the same as maximising the stock price.

Finance professors do not necessarily agree with Milton Friedman's notion that we should maximise "profits", which is a short-term measure of performance. Shareholder value is the present value of expected cash flows from now until the end of time, so there is no such thing as short-term shareholder value. Of course, we who support shareholder primacy *already incorporate* the interest of consumers and workers in our discounted cash flow (DCF) spreadsheet. For example, customers and workers may be more loyal if we care about externalities such as the environment, which translates into higher shareholder value. But, unlike politicians, managers should not be in the business of arbitrarily *trading off* the interests of various stakeholders.

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