Governance book of the year: Lynn Stout's *The Shareholder Value Myth*

Lynn Stout (pictured below) is the Distinguished Professor of Corporate and Business Law, Clarke Business Law Institute, at Cornell Law School. She is not the first to push back against the notion of shareholder value as the primary if not sole driver of management and board action. But her 2012 book, *The Shareholder Value Myth,* inspired renewed examination of this governing theory and sparked important, and some would say much-needed, debate about its true primacy. One prominent challenger was *New York Times'* columnist Joe Nocera, who cited the book in a column titled "Down with Shareholder Value." He wrote: "Over time, 'maximizing shareholder value' became viewed as the primary task of the corporation. And, well, you can see the results all around you. They're not pretty."

Because of the book's role in provoking renewed analysis of the shareholder value mandate and its legacy effects, Directors & Boards has selected *The Shareholder Value Myth* as the Governance Book of the Year. For this spotlight, we asked John C. Wilcox, a longtime Directors & Boards author and colleague, to offer his evaluation of Prof. Stout's book. Throughout his career Wilcox has specialized in corporate governance, investor relations, proxy voting, and capital markets regulations, and now is chairman of Sodali Ltd., which advises listed companies in Europe, Asia, and developing markets on a range of governance matters.

— *James Kristie*

One myth dies and another is stillborn

By John C. Wilcox

HEATHER AINSWORTH

Lynn Stout's *The Shareholder Value Myth* is really two books in one. The first (Part I) is a closely argued refutation of the widely endorsed theory of "shareholder primacy." The second (Part II) is an effort to blame shareholders for the misdeeds of the business community that were perpetrated under the guise of shareholder primacy. Part I is successful — Stout effectively demolishes the shareholder value myth. But Part II is not — her reductionist theory of shareholder culpability is unconvincing.

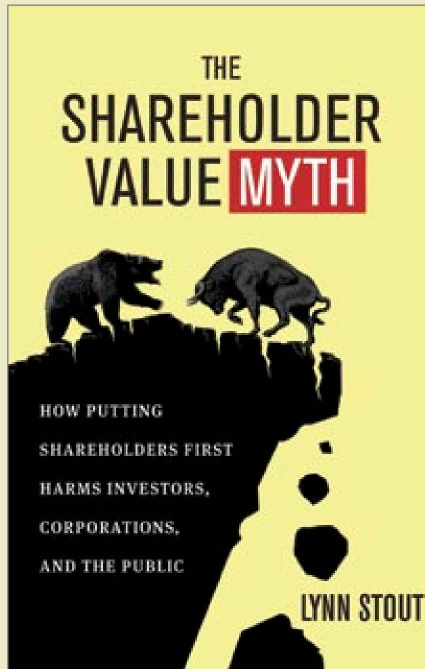
This useful little (at 134 pages) book has implications far broader than the narrow ideological disputes of governance professionals. As Stout explains, the narrow focus on shareholder value creation influenced an entire generation of business leaders and provided the rationale for conduct that ultimately led to the global financial crisis. Systematically and with barbed prose, she deconstructs the misguided logic of lawyers, economists, academics, financial advisors and regulators who transformed the theory of shareholder primacy into a business axiom. In four short chapters she builds a convincing case that the practice of running businesses exclusively with an eye on stock price and short-term profit was an epic misdirection that, in her words, caused companies "to engage in reckless, sociopathic, and socially irresponsible behaviors."

These first 60 pages should be required reading for CEOs and corporate directors, not to mention academics, lawyers, institutional investors and other professionals (including politicians and regulators) whose decisions led to disastrous consequences for companies and the global economy.

Unfortunately, Stout abandons her intellectual rigor when she gets to Part II, cryptically entitled "What Do Shareholders Really Value?" Here she seems to argue that shareholders are primarily responsible for an array of activities — including accounting fraud, abusive compensation practices, and various forms of "financial engineering" — that were rooted in the shareholder value myth.

In her effort to have it both ways — to discredit shareholder primacy while holding shareholders primarily accountable for the actions of listed companies and the financial markets — she subjects the reader to pages of theoretical musings, mythological analogies, and other eso-

The myth of governing for shareholder value



Back when I was a law school student in the early 1980s, my professors taught me that shareholders "own" corporations and that the purpose of corporations is to "maximize shareholder value." I was just out of college at the time and not very familiar with the business world, so this made sense enough to me. When I first began lecturing and writing in business law myself, I incorporated the shareholder value thinking that I had been taught into my own teaching and scholarship.

It soon became apparent to me there was a problem with this approach. The more I read business law cases, the more obvious it became that U.S. corporate law does not, in fact, require corporations to maximize either share price or shareholder wealth. My first reaction was puzzlement and frustration. Shareholder value thinking was almost uniformly accepted by experts in law, finance, and management. Why then, I asked myself, wasn't it required by the actual rules of corporate law?

Put bluntly, conventional shareholder value thinking is a mistake for most firms — and a big mistake at that. Shareholder value thinking causes corporate managers to focus myopically on short-term earnings reports at the expense of long-term performance; discourages investment and innovation; harms employees, customers, and communities; and causes companies to indulge in reckless, sociopathic, and socially irresponsible behaviors. It threatens the welfare of consumers, employees, communities, and investors alike. This book explains why.

From **The Shareholder Value Myth** *by Lynn Stout. Copyright ©2012 by the author. Published by Berrett-Koehler Publishers Inc. (www.bkconnection.com).*

terica that read almost like a parody of the distorted thinking she so effectively skewers in Part I. In her zeal to get companies off the hook, she creates her own new myth: "Corporations are Real, Shareholders are Fictions." But her political agenda is apparent. She is conducting a rear-guard action to revive management-centric governance, discourage scrutiny of boardroom decisions, discredit shareholder activism, and resurrect traditional corporate defenses such as classified boards and dual-class common stock. Stout's myth of shareholder culpability is no more valid than the myth of shareholder primacy she so ably discredits.

John C. Wilcox

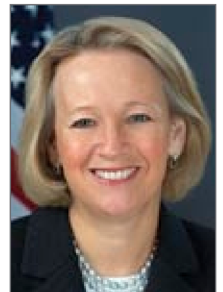
Conveniently for the reader, the value of this book can be obtained by reading Part I with attention, scanning Part II, and concentrating on the brief but excellent conclusion where Stout offers nuanced and realistic ideas for company boards, managers and shareholders to work together in pursuit of common goals. Even though Stout half-heartedly tries to convince us that shareholders are to blame, she understands, as we all do, that the buck stops with the board of directors.

that they will not run a proxy contest at the company's 2013 annual meeting.

Private company governance: More than two-thirds of private companies (71%) have a formal board of directors, according to PwC US's latest "Private Company Trendsetter Barometer" survey. Although formal corporate governance isn't a regulatory requirement for most private businesses, a large majority (80%) are adopting elements of corporate governance for the business benefits, according to the survey.

NOVEMBER

Speculation abounds as to what **Barack Obama's reelection** means for business. Will it be "the start of a promising new political era for business or the beginning of another four years of bickering?" the *WSJ* asks, and answers: "To hear it from America's chief executives, they hope it's the former but fear it's the latter."


Mary Schapiro

Mary Schapiro announces her resignation as chair of the SEC. The agency "was in disarray" when she took over in January 2009, writes former SEC chair Harvey Pitt in a *WSJ* op-ed, adding that she "leaves the place better off, but the next chairman will be dogged by the effects of Dodd-Frank."

FCPA clarity: The U.S. Department of Justice and the SEC issue a report that helps clear up what kind of payments would be considered illegal under the Foreign Corrupt Practices Act. The SEC also issues a report urging the boards of the credit ratings agencies to tighten oversight of their businesses, citing "several dozen instances of poor corporate governance and failure to follow company policies" *(FT)*.

More than 3,000 tips: That's the number of whistleblower tips the SEC reveals it has received in the first year of the