Beyond Shareholder Primacy: Embracing Stakeholderism for Sustainable Success in the 21st Century.

In today's rapidly evolving business environment, the dialogue around stakeholderism versus shareholder primacy has become increasingly critical. As companies confront intricate socio-economic challenges, the urgency to align business strategies with broader societal interests is paramount. This report advocates for stakeholderism as the essential strategy for contemporary corporations, suggesting that adopting an inclusive approach—considering the welfare of employees, customers, suppliers, communities, and the environment.

Our advocacy for stakeholderism is built upon a comprehensive understanding of business impacts and the interdependence of market entities. We begin by debunking the myth of shareholder primacy, showcasing through the case studies of corporations like General Motors and Boeing—whose oversight has led to the loss of 337 lives.

Anticipating counterarguments, we assert that prioritizing stakeholders does not detract from a company's competitiveness or financial viability. Indeed, addressing stakeholder needs and maximizing long-term shareholder value are not conflicting objectives but are, in fact, synergistic, ensuring a balanced and sustainable path to success.

Historical Evolution of Corporate Governance Models:

Over the last century, the ideology underpinning corporate governance has evolved significantly. Initially, corporations operated under managerialism, with boards of directors prioritizing a range of stakeholders over the relatively powerless shareholders. This changed in the 1970s, influenced by the Chicago school and thinkers like Milton Friedman, who argued for shareholder primacy, positing that businesses' sole responsibility was to their shareholders. This view was further supported by Jensen and Meckling's 1976 work, emphasizing shareholders as the primary stakeholders (Stout, 2013). However, in 2019, a paradigm shift occurred when the Roundtable issued a new statement, expanding corporate responsibility to include customers, employees, suppliers, communities, and shareholders, aiming for long-term value for all stakeholders (Business Roundtable, 2019). This modern philosophy reflects a nuanced approach to corporate governance.

Debunking Shareholder Supremacy:

The critique against shareholder primacy examines the intricate dynamics between corporate ownership and control, contesting the view that shareholders should have supreme governance priority. This argument overlooks the fundamental legal and operational framework of corporations, where shareholding does not imply ownership. Notably, Vanderbilt Law Professor Margaret Blair's work highlights that corporations are independent legal entities, contradicting the notion that shareholders are the principal owners. This insight challenges the conventional justification for favoring shareholder interests, especially considering shareholders' limited liability and absence of operational oversight (*ChangeThis | A 50-Year-Old Fallacy: The One-Legged Stool of Shareholder Primacy*, n.d.).

Legal structures further clarify the distinction between ownership and control, weakening the case for shareholder supremacy. The restricted rights of shareholders, compared to the complete legal personhood of corporations, show that shareholders lack intrinsic governance authority. This shift in understanding, towards acknowledging a broader stakeholder spectrum, indicates a movement away from shareholder-centric approaches toward more inclusive, sustainable models. It advocates for a balanced approach that accommodates the interests of all stakeholders, reflecting the complex legal and ethical dimensions of corporate governance (*ChangeThis | A 50-Year-Old Fallacy: The One-Legged Stool of Shareholder Primacy*, n.d.).

Additionally, the conflict stemming from shareholders' diverse investment timeframes is crucial. The contrast between long-term investors, like individual shareholders with retirement or education savings goals, and short-term speculators, such as hedge funds practicing "flash trading," creates conflicting board pressures. Short-term investors often push for strategies that may boost share prices temporarily but risk long-term corporate health and growth (Stout, 2013).

The Case of General Motors: Shareholder Primacy's Pitfalls:

The General Motors (GM) case underscores the drawbacks of strict adherence to shareholder primacy, influenced by Milton Friedman's short-term profit maximization philosophy. The 1970 GM Annual General Meeting (AGM) marked a pivotal moment, with the shareholder group Campaign G.M. pushing for corporate responsibility in vehicle safety and pollution controls overshadowed by Friedman's critique advocating for shareholder value (Clarke, 2020).

Friedman's doctrine effectively steered GM away from investing in electric vehicle (EV) technology and pollution control at a time when it could have established global leadership (Clarke, 2020).

This strategic oversight had tangible consequences. GM's reluctance to innovate in the EV space allowed new entrants like Tesla to outpace it in market valuation. By 2019, Tesla's market capitalization of $53.5 billion surpassed GM's $50.5 billion, despite having only 1% of GM's sales volume. This shift highlighted the market's preference for innovative and sustainable business models over traditional ones focused on immediate returns (Clarke, 2020).

GM's journey underscores the importance of aligning corporate strategies with future-oriented technologies and societal needs, rather than focusing solely on short-term financial metrics(Clarke, 2020).

The Boeing 737 MAX: A Case Study in Prioritizing Profit over Safety:

The Boeing 737 MAX incidents, which led to 337 fatalities over two accidents within five months between 2018 and 2019, underscore the dire repercussions of valuing shareholder interests above safety and engineering integrity. Boeing, traditionally celebrated for its engineering acumen, compromised its foundational principles by expediting the 737 MAX's market introduction to rival Airbus's A320neo, neglecting essential safety protocols and pilot training to cut costs and hasten its rollout(Clarke, 2020). The company's omission in informing both the Federal Aviation Administration (FAA) and its clientele about the Maneuvering Characteristics Augmentation System (MCAS) issues, along with the exclusion of MCAS information from pilot manuals, highlights a deliberate oversight of safety for financial efficiency. Boeing's financial fallout was substantial, with losses and compensatory costs amounting to $10 billion in 2019, representing 13% of its yearly revenue. The protracted grounding of the 737 MAX, marks the most extended suspension for any U.S. commercial aircraft (Clarke, 2020).

Boeing's financial downturn, with a net loss of $636 million in 2019 — its first in two decades — and the estimated $19 billion in direct and indirect costs related to the 737 MAX fiasco, reflect the extensive financial and reputational damage inflicted. The aftermath led to significant legal challenges, the CEO's ouster, and a historic downturn in aircraft orders, marking a record negative for the first time in 30 years, illustrating the grave consequences of prioritizing financial interests over safety and ethical standards (Clarke, 2020).

Shareholder Value vs. Stakeholder Focus in the Auto Industry:

In the automotive sector, entities such as Fiat, PSA (Peugeot SA), Renault, and Volkswagen (VW) have adeptly navigated the interplay between adhering to shareholder primacy and balancing the interests of broader stakeholders. This delicate equilibrium has profoundly influenced their strategic trajectories and fiscal health, with each corporation adopting divergent levels of emphasis on enhancing shareholder value, thereby impacting their operational and financial decision-making processes (Jürgens et al., 2002). Fiat initiated a robust Value-Based Management strategy in 1996, designed to create value exceeding the cost of capital. This strategy led to a strategic alliance with General Motors, focusing on improving financial indicators. PSA, under substantial family influence, incrementally incorporated shareholder interests into its corporate strategy, prioritizing profitability and growth while ensuring a harmonious relationship with its industrial development goals. Post the financial challenges of 1984-86, Renault embraced shareholder value principles, establishing harmony between financial aspirations and industrial progress, a focus intensified under Carlos Ghosn's leadership to align with shareholder expectations without compromising industrial objectives. VW, traditionally inclined towards stakeholder interests, cautiously integrated shareholder value principles, seeking to align financial objectives with wider corporate responsibilities (Jürgens et al., 2002).

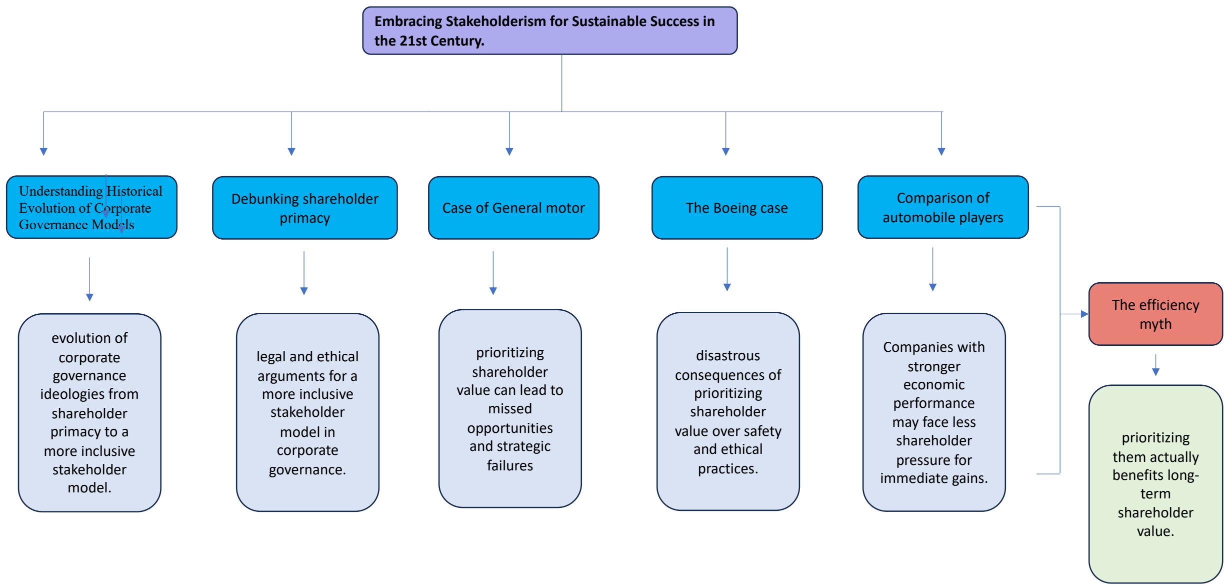
In conclusion, the companies (Fiat and Renault) which vigorously adopted shareholder primacy demonstrate less favourable outcomes. Fiat Group, which saw its gross profit margin erode from 4.9% in 1996 to a modest 1.8% by the end of the period in question. Renault's performance mirrored this trend, with gross profit margins plummeting to -3.1% in 1996 and only partially recovering to 4.3% by 2000. Conversely, PSA and VW AG, which adopted a more measured approach to financial metrics, reported stronger results. PSA's gross profit margin witnessed a substantial increase from 0.4% in 1996 to 5.0% in 2000. VW AG also exhibited a consistent upward trend, with margins expanding from 2.0% in 1996 to 4.8% in 2000 (Jürgens et al., 2002).

Debunking the Efficiency Myth:

A major challenge faced by stakeholderism is the inherent competitive landscape and investment dynamics. It is argued that entities that prioritize maximizing shareholder value, are often perceived to operate and invest with greater efficiency (*Milton Friedman's Wisdom Endures: Companies Should Be Run for Shareholders*, n.d.).

However, The doctrine of Instrumental Stakeholderism posits that aligning with the interests of all stakeholders can ultimately enhance shareholder returns. This version of stakeholder capitalism suggests that the treatment of non-shareholder stakeholders has a direct impact on shareholder value. Strategic investments might temporarily diminish shareholder value but are likely to yield significant dividends in the long run. Conversely, neglecting stakeholder interests may provide short-term gains to shareholders but could lead to adverse outcomes over an extended period. For corporate leaders focused on maximizing shareholder value, incorporating other stakeholders' interests is crucial for a sustainable business model that enhances long-term profitability and stability by strengthening stakeholder relationships, ultimately boosting shareholder returns (Paine, 2023).

Argument map



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