Why America's CEOs have turned against shareholders

By Katharina Pistor
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The chief executives of America's largest companies made news this month by coming out against a model of corporate governance that has for decades prized shareholder value over all other considerations. But no one should assume that corporate America has finally seen the light.

The Business Roundtable, an association of the most powerful chief executive officers in the United States, announced this month that the era of shareholder primacy is over. Predictably, this lofty proclamation has met with both elation and skepticism. But the statement is notable not so much for its content as for what it reveals about how US CEOs think. Apparently, America's corporate leaders believe they can decide freely whom they serve. But as agents, rather than principals, that decision really isn't theirs to make.

The fact that American CEOs think they can choose their own masters attests not just to their own sense of entitlement, but also to the state of corporate America, where power over globe-spanning business empires is concentrated in the hands of just a few men (and far fewer women). As a matter of corporate law, CEOs are appointed by a company's directors, who in turn are elected by that company's shareholders every year. In practical terms, though, most directors remain on the board for years on end, as do the officers they appoint.

For example, Jamie Dimon, the chairman of the Business Roundtable's own board of directors, has been at the helm of JPMorgan Chase for over 15 years. During most of that time, he has served as both CEO and chairman of the board of directors, in contravention of corporate-governance principles that recommend separating these two positions. By capturing the process to which they owe their own positions, American CEOs have made a mockery of shareholder control. The Business Roundtable itself has long favored plurality over majority voting, which means that incumbent board members need only receive more votes than anybody else, rather than a majority. At the same time, the organization has fought the Securities and Exchange Commission tooth and nail to block a rule that would allow shareholders to write in their own candidates when votes are solicited. And it continues to try to weaken shareholders' ability to propose agenda items for shareholder meetings.

In short, for the Business Roundtable and the CEOs it represents, shareholder primacy has never meant shareholder democracy. Instead, the shareholder-value model has given CEOs cover to avoid discussing corporate strategy, especially when it comes to considering alternatives to the share price as a metric for corporate performance. For CEOs, the share price is everything, because it protects the company from takeovers (the greatest threat to incumbent managers), and it increases their own remuneration.

Why, then, would CEOs come out against a *status quo* that has allowed them to reign almost unchallenged, in favor of a stakeholder-governance model that puts employees and the environment on an equal footing with shareholders? The answer is that revolutions often devour their children. Share-price primacy has not only ceased to protect CEOs in the way it once did; it has become a threat.

After all, it is one thing to champion shareholders when they are too dispersed to organize themselves. It is quite a different matter when shareholders have assembled into blocs with effective veto power and the ability to coordinate in pursuit of common goals.

Some 74% of JPMorgan Chase's shares are held by institutional investors, five of which – including Vanguard, BlackRock, and State Street – control one-third of total shares. And JPMorgan isn't alone. Recent research in the US shows that the same few global asset managers are top shareholders at almost all of the largest financial intermediaries, Big Tech firms, and airline companies.

For CEOs, the emergence of powerful shareholder blocs has changed the corporate-governance game. With trillions of dollars of savings that need to be invested, institutional investors simply cannot be ignored. Even if asset managers do not actively involve themselves in corporate governance, they can still send a powerful signal to the market simply by dumping shares.

For years, the shareholder-primacy model led CEOs to eke out profits through outsourcing or labor-force downsizing, regulatory and tax arbitrage, and stock buybacks that shower cash on shareholders at the expense of investing in their companies' future. But now, they have finally realized that these strategies are better for institutional investors than they are for the sustainability of firms.

Confronted with the headwinds they themselves generated, American CEOs seem to have concluded that best defense is a good offense. But if they are serious about abandoning the shareholder-primacy model, public statements will not suffice. They must also support legal reforms, particularly the measures needed to hold corporate directors and officers accountable to the principals they serve. That could mean extending board representation to employees and other stakeholders, or it could take the form of special audits, along the lines of those to which public benefit corporations submit.

Either way, if the new stakeholder model is going to amount to more than the old charade of "shareholder democracy," the principals themselves must be involved in setting up the new regime. If we leave it for the agents to decide for themselves, we will end up right back where we started.

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