AGENDA

Under the Bus Go Stakeholders, Say Harvard Researchers

By Tony Chapelle September 4, 2020

Corporate executives and board directors take good financial care of themselves and shareholders when they negotiate the sale of their companies to private equity firms, according new research from a **Harvard** law professor and fellow academics. Yet seldom do the corporate leaders appear to look out for the interests of their employees, customers, and local communities in those deals, the research finds.

That conclusion comes from **a recent study** about whose interests it appears corporate leaders bargained for during the past two decades at companies that are governed by so-called constituency statutes. Such laws were passed in more than 30 states back in the days of corporate raiders and allowed boards to consider other stakeholders during sale negotiations. But those constituency statutes did not have any meaningful impact, according to the study, **which was posted** on the Harvard corporate governance blog by Harvard's corporate governance program director **Lucian Bebchuk** and two co-authors, **Kobi Kastiel**, an assistant law professor at **Tel Aviv University**, and **Roberto Tallarita**, the associate director at Harvard Law's governance program. "[C]onstituency statutes failed to deliver the benefits to stakeholders that they were supposed to produce," the trio asserts.

The researchers found that "in 95% of cases corporate leaders did not negotiate for any restrictions to the freedom of the private equity buyers to fire employees, and that even in the handful of cases in which such restrictions were found, the deal terms denied employees any power to enforce these constraints.

"Furthermore, we find that corporate leaders generally did not negotiate any constraints on buyers' post-deal choices that could pose risks to several other notable stakeholder groups — consumers, suppliers, creditors, or the environment."

Bebchuk writes to *Agenda* in an e-mail, "The evidence we have gathered should inform the debate over stakeholder capitalism, which seeks to rely on the discretion of corporate leaders." He and his colleagues argue in the study that those leaders have incentives not to protect stakeholders beyond what would serve shareholder value. As a result, Bebchuk claims, the growing concept of stakeholder capitalism, or "stakeholderism," which has been widely lauded since 181 CEOs signed a pledge with the Business Roundtable last year, should be expected to fail to deliver, as have constituency statutes.

"Stakeholderism therefore should not be supported, even by those who deeply care about stakeholders," Bebchuk and his colleagues opine.

Bebchuk adds that corporate leaders should reflect on why the stakeholder-focused mandate in constituency statutes hasn't led to choices that have protected stakeholders and that they should thus contemplate whether stakeholder capitalism won't suffer a similar fate.

But directors and governance observers are still split on the debate about the worth and meaning of "stakeholderism."

"Stakeholder capitalism is how organizations were first formed. It was about [concern for] the suppliers and customers," says **Evelyn Dilsaver**, an audit committee chair at two public companies and the privately held apparel store chain **Aeropostale**. "Then it got morphed when **Milton Friedman** and **Carl Icahn** emphasized that it wasn't the larger community that [companies] needed to focus on; it was just the shareholders.

“But now it’s coming back to stakeholder capital. Investors realize you have to take care of customers, employees and vendors. If you’re not growing your customer base, if you don’t have happy employees, if you don’t have good relations with suppliers in your supply chain, you’re out of luck in having them meet your supply needs in a crisis. If you don’t have those good relationships, you’re not going to last.”

At the same time, Dilsaver empathizes with corporate leaders who don’t keep employees from being fired or ensure that suppliers get retained after a sale. Management can face a tough climb when they have to sell, she says.

“I was on the board of Longs Drugs in 2008 when we sold to CVS Caremark [now **CVS Health**], and we wanted to make sure our employees were taken care of. I specifically asked a question of our lawyers that Bebchuk asked in his article: ‘Is our only obligation to the shareholders, or can we think broader and [try to get protections or concessions] for our customers and others?’” she recalls.

Unfortunately, says Dilsaver, the federal government thought the addition of 541 more stores to CVS could impede fair trade and competition. So the combined company had to shut down some of its sites, a move that displaced hundreds of employees.

“So how do you enforce it when you are no longer a player in the game? Likewise, if a supplier isn’t meeting the demands of the new owner, they shouldn’t be forced to keep them on. I wouldn’t want that. And for all of these concerns, if there’s only one buyer, you may not have leverage in negotiating for stakeholders.”

Peter Thies, the president of consulting firm **The River Group** and a former leadership practice partner at search firm **Korn Ferry**, doesn’t believe that stakeholders overall necessarily get a bad shake just because employees get turned out or others lose their current benefits.

“If the company gets stronger, by consequence, many stakeholders will benefit. So I don’t see the black and white that serving shareholders doesn’t serve stakeholders.”

He doesn’t agree that stakeholder capitalism is doomed or dead. Instead, he recommends that, anytime regulators have to oversee or approve a merger or purchase, they should institute a review of how the deal will impact stakeholders such as workers and communities. “You could make more explicit criteria.”

Andrea Bonime-Blanc, who’s founder of consulting firm **GEC Risk Advisory**, writes in an e-mail that the observations about mergers and acquisitions generally ring true.

“The overwhelming weight of corporate governance and law favors maximizing price and financial value in a transaction and that frequently collides with the interests of employees, customers and other stakeholders,” writes Bonime-Blanc, who is author of *Gloom to Boom: How Leaders Transform Risk into Resilience and Value*. “Those in private equity, boards and management of target companies are also into maximizing their personal financial takeaway. So…unless there are regulations or laws that properly (not toothlessly) incentivize boards and management to not only maximize shareholder financial returns but also consider…other stakeholders, we will see more of the same.”

But like Dilsaver, she also thinks that human nature is the reason that stakeholder capitalism will win out.

“In this highly complex world, those who consider the expectations and needs of their key stakeholders are likely to gain a competitive advantage over those who don’t.”