What Should Companies and Asset Managers Maximize?

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Background

- Conventional wisdom among economists, people in finance and lawyers: companies should maximize profit or market value (SVM—shareholder value maximization).
- Why? This makes their shareholders (the "owners") wealthy and they can use their wealth to do good in the world if they want.
- In many jurisdictions, including, I understand, Latin American ones, the fiduciary duty of company boards as well as asset and pension managers is also interpreted to mean pursuing SVM

- But in some case companies have a comparative advantage in doing good or avoiding harm and socially-minded shareholders may be willing to sacrifice some profit to have them do this.
- Luigi Zingales and I have proposed replacing SVM with SWM: shareholder welfare maximization.

- See Eleonora Broccardo, Oliver Hart, Luigi Zingales: Exit vs. Voice, JPE, December, 2022.

Oliver Hart and Luigi Zingales, The New Corporate Governance, U.Chicago Business Law Review, 2022.

Oliver Hart and Luigi Zingales, Companies Should Maximize Shareholder Welfare Not Market Value, Journal of Law, Finance, and Accounting, 2017.

- To understand how SWM and SVM differ, consider an oil company that can reduce carbon emissions at the expense of profit.
- This might be bad for the company's bottom line, but shareholders may want it to happen for three reasons:

(a) They may hold shares in other companies whose profitability is diminished by carbon emissions.

(b) They may not want to live in a hot world, or may not want their children or grandchildren to do so.

(c) They may care about other people affected by climate change.

- As another example, the same oil company may be lobbying regulators or making campaign contributions to politicians to prevent the imposition of carbon taxes.
- These efforts may be good for the company’s bottom line but may be contrary to the shareholders’ wishes: good for SVM but bad for SWM.

- How can shareholders get companies to pursue SWM?
- One way is by using their voting power, e.g., through shareholder resolutions/board elections.
- We call this “voice.”
- But it is not so easy for shareholders to express voice in practice.

- Today many stocks are owned through mutual funds (e.g., Vanguard, Black Rock, State Street, TIAA).
- These institutions do the voting for their investors.
- Most institutions take the view that their fiduciary duty (duty of loyalty) to their investors requires them to consider only long-run financial return. (In the case of U.S. pensions this is a legal requirement.)
- So they might feel obligated to vote against reducing carbon emissions, or lobbying efforts or campaign contributions, to the extent that these reduce profit or market value.

- My co-authors and I think this makes no sense. Fiduciary duty (however it is currently defined in the law) should surely mean finding out what shareholders want. And perhaps learning that they want the company *not* to pursue SVM in some cases.
- How to do this?

- At least three approaches are possible. The first one is to push down the voting decision to the level of individual investors. This is a strategy that BlackRock is trying to implement now with its major investors. Thus, if the New York State Common Retirement Fund invests in BlackRock S&P500 ETF, it will have the right to vote pro-rata the shares it indirectly owns in all the S&P500 companies.

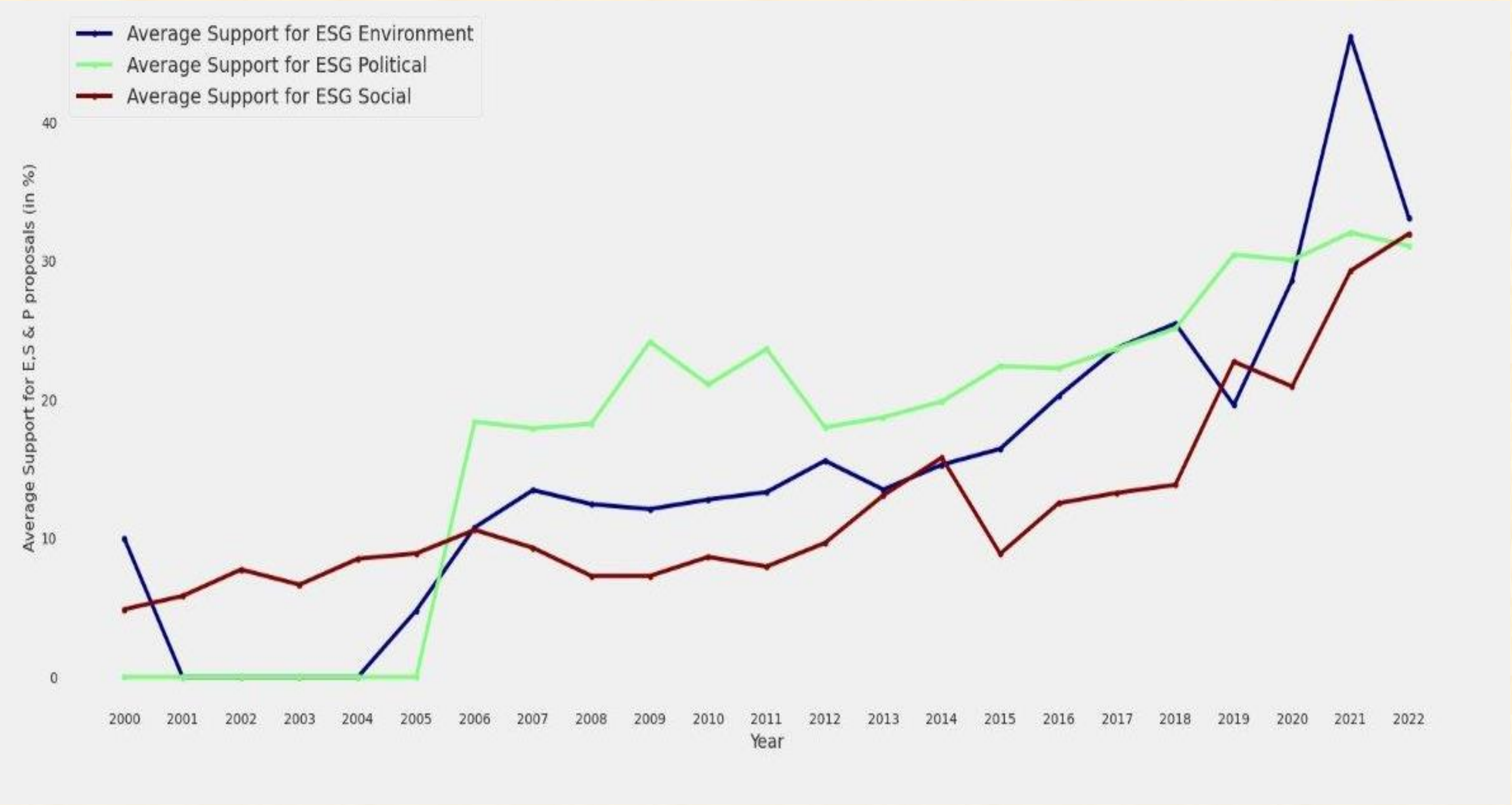
- This strategy might work well for major pension funds and endowments, but it is unreasonable for individual shareholders. We cannot expect shareholders to express an opinion on all ballots of all the companies they own.

- Fortunately, there are solutions. Today many institutional investors buy proxy advising services customized to specific needs. For example, Institutional Shareholder Services (ISS) has “specialty” proxy voting guidelines – each geared toward a specific special interest group: Taft-Hartley Advisory Services, Public Fund, Socially Responsible Investment (SRI), Catholic Faith-Based, Sustainability, Climate.

- It would be relatively simple for each investor to choose one type of guideline and ask that her shares be voted accordingly.
- New developments are also taking place that allow guidelines to be personalized. For example, you can sign on with a company called Iconik. You fill out a survey that elicits your preferences and then Iconik uses an algorithm to vote your shares according to these preferences.
- You could also tell the algorithm to vote in line with As You Sow’s recommendations, say.

- The second strategy would be for asset managers to elicit investors’ preferences and then cast their votes based on an aggregation of these preferences. This raises interesting questions. Suppose 45% support a resolution, 30% are against and 25% do not respond.
- Should the asset manager vote all the shares in favor, 60% in favor and 40% against, or 45% in favor, 30% against and 25% according to the asset manager’s preferences?

- The third strategy is for mutual fund companies to offer investors funds with a very clear and predetermined voting strategy and let investors choose among them.
- This is actually happening. See Engine No. 1’s VOTE fund.



Average Support for ESG Environment
Average Support for ESG Political
Average Support for ESG Social
Average Support for E,S & P proposals (in %)
0
10
20
30
40
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
Year

Summary

- SVM, although the established criterion, does not generally represent what shareholders want. It should be replaced by SWM.
- One way to do this is to make it easier for shareholders to express their preferences on environmental and social issues, e.g., by voting.

- The meaning of fiduciary duty should be reconsidered. This may require changes in the law.
- Trade-offs should be acknowledged. It’s not all win-win!

- Thank you!