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The Shift to Stakeholder Governance

For more than a century, corporations have essentially chosen one of two paths to define their overarching goals and objectives: the shareholder model (**shareholder governance**) or the stakeholder model (stakeholder governance).

Shareholder Governance / Shareholder Primacy

In 1919, the landmark case ***Dodge vs. Ford Motor Company*** determined that Henry Ford was obligated to run his company strictly in the best interests of its shareholders. This historic ruling ushered in the **shareholder primacy** norm for businesses and boards of directors in the United States.

Shareholder primacy is a theory that's spent a long time at the center of corporate governance. It's a legal and economic framework that states a company's priority is maximizing value for shareholders. The idea of shareholder primacy holds that the monetary value to shareholders (stock prices, dividends, etc.) is the sole measure of a company's success, with little regard for social responsibility.



its shareholders are a company's most important stakeholders—and therefore businesses must prioritize providing returns for the owners of the company. From a strictly economic perspective, this point of view makes sense: to continue to maximize value for shareholders, a

company needs to do what it can to survive. And since the shareholders bear the risk of any bad decisions made by the board or company executives, it's fair that their interests are prioritized.

Proponents of shareholder governance believe that it's what keeps managers, executives, and boards of directors accountable, and that it encourages the free flow of capital throughout the economy. They suggest that shareholder primacy is the backbone of companies' legally binding corporate charters, cementing the company's fiduciary responsibilities to the shareholders.

Companies are under no obligation to adopt or continue with a shareholder governance paradigm. But if a company does subscribe to the shareholder primacy model, its managers are bound to work to increasing the value for the shareholders.

Pros of Shareholder Primacy

- Shareholders can be sure that the company is upholding its fiduciary duty to increase profits for them.



process.

Cons of Shareholder Primacy

- There could be a high payout ratio, with too much going toward paying dividends and insufficient investment in continued growth.
- Companies prioritizing profits with little regard to social consciousness could have a negative impact on workers, their communities, and the **environment**.
- Short-term incentives like increasing profits can obstruct long-term planning and success.
- Opposing interests between shareholders and creditors.

Stakeholder Primacy or Stakeholder Governance

On August 19, 2019, Business Roundtable announced a new statement on the **purpose of a corporation**. The redefined definition supported the increasing momentum of **stakeholder governance**. It put the interests of a company's stakeholders—its investors, employees, customers, vendors, suppliers, communities, and the environment—on the same level as its shareholders. It was signed by 181 CEOs, including Jeff Bezos, Tim Cook, Mary Barra, and Doug McMillon.

In the statement, the CEOs outlined how they personally guide their company's strategy to create value for all their stakeholders, not just their shareholders, and challenged that other companies should be doing more.



“The World Economic Forum is releasing a new Davos Manifesto, which states that companies should pay their fair share of taxes, show zero tolerance for corruption, uphold human rights throughout their global supply chains, and advocate for a competitive playing field.” Klaus Schwab, Founder and Executive Chair, World Economic Forum



These events elevated the discussions that were already taking place about stakeholder governance. As corporations have more and more influence on economies, the environment, and society, many are being encouraged—by their investors, regulatory bodies, and their communities—to consider their impact more holistically. For example, the shareholder primacy model holds that shareholders provide the necessary capital for the business to operate, so they should be the priority in terms of return on that investment. However, this theory ignores the fact that the company’s employees are the *human* capital upon which the company also depends. The pandemic accelerated the switch from **shareholder to stakeholder** governance, as corporations consider the needs of all their stakeholders, not only increasing the price of the stock, when they’re outlining the company’s vision.

Stakeholder governance encourages executives and boards of directors to consider the best interests of their customers, workers, suppliers, communities, other investors, and the environment, when they’re determining their overall corporate values, strategy, and direction. Stakeholder governance recognizes that all the company’s stakeholders are affected by the company’s operation in some way, including detrimental effects on the environment, perpetuating structural racism, and promoting the spread of disinformation.

Stakeholder governance holds that stakeholders are as responsible for the company’s success as the shareholders, so their interests should also be represented in the board room and in the c-suite.



company's actions have on all its stakeholders.

Pros of Stakeholder Primacy

- Encourages ethical behavior, promoting fairness for everyone

involved in the company's lifecycle.

- Directors have a clear objective when planning the company's vision, strategy, and goals: work to benefit all the stakeholders.
- It promotes social wealth for everyone, as it prioritizes economics *and* **ethics** .
- Consumers seek out products and services that are created by **socially conscious companies**.

Cons of Stakeholder Primacy

- Many of the CEOs who signed the Business Roundtable's statement, effectively solidifying the era of stakeholder governance, have **not lived up to the promises** they made in the statement.
- Stakeholders may act in their own best interests.
- Too many stakeholders can lead to a lack of agreement and inability to make decisions on anything.



The Continued Growth of Stakeholder Governance

The momentum of the shift from shareholder governance to stakeholder governance seems to be growing. As corporations' impact on their communities and the environment become clear, executives and boards are focusing on nurturing the relationships between all their stakeholders.



To be sure, reconciling the often-conflicting interests of disparate stakeholders is a governance challenge. Executives and boards need to consider how their governance and corporate activity affects all their stakeholders—not only the shareholders. And consumers are paying attention. They're recognizing that companies have been putting profits first, with little regard to the fact that those profits come at the cost of economic and social inequality and environmental damage.



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