The Impact of Shareholder Primacy: What it Means to put the Stock Price First
Hearing of the Joint Economic Committee
March 16th, 2022

Mr. Chairman and Members of the Committee, I am Judy Samuelson, Executive Director of the Aspen Institute's Business and Society Program. Thanks for the opportunity to join you today as you delve into a topic that I care a lot about, and that will benefit from more exposure.

For close to twenty-five years, the Business and Society Program at the Aspen Institute has engaged business executives, directors, scholars, leaders in labor and corporate governance and those who both advise and critique business in pursuit of our mission: **to align business decisions with the long-term health of society**.

We believe that businesses—especially globe-hopping, talent-rich corporations, from consumer products companies to financial institutions (and the deep infrastructure of B2B companies that produce critical goods and services in support of the big brands)—embrace the capacity and problem-solving skills needed to address the most pressing problems in the modern world. Corporations are important and influential institutions, akin to the power of the Church in the middle-ages.

How can we harness this capacity for the public good?

In 2001, in the wake of the sudden and shocking implosion of Enron Corporation, we began series of conversations among business leaders that ultimately led to a set of principles dubbed the Aspen Principles on Long Term Value Creation. The principles were designed to unpack how Enron, then a high-flying stock, could practically disappear overnight. The Conference Board, our partner in the early rounds of dialogue, had used the term "short-termism" in the report of a Blue-Ribbon Commission on the failure of the company. We convened around this idea, engaging hundreds of individuals over the course of five years, as we dug into the management practices and protocols and narrative about corporate purpose that contributed to such a spectacular failure of a global enterprise, and significant employer.

This business failure disrupted many lives and the retirement savings of thousands of employees. It also ultimately sent the most senior executives to prison. It reminds us that the problems we are confronting in this hearing have been building over decades. Yes, shareholders expect and deserve a return on their investments, and of course companies need profits to survive and thrive, but our obsession with shareholder return—measured ultimately by the stock price—squeezes out common sense principles of management and critical investment in our future.

And while stockholder primacy has been criticized by many, it remains the dominant view in the financial community and much of the business world and return to shareholders—now measured as

Total Shareholder Return, or TSR[1]—is the primary way we (1) measure corporate performance, (2) structure executive compensation[2], and (3) perceive the role of directors[3]. Even in the current and growing conversation over a corporation's responsibilities to others, the pretense is that the actions taken must serve both the constituent and the shareholder. If there are tradeoffs involved, and there most always are, the shareholder is considered the most important to appease.

We-the-people grant corporation the license to operate. We are back to first principles. Whom does that license benefit?

It is fair to say that in a company that is truly managing for the long haul, the lines converge, and everyone can or will benefits from wise stewardship of a corporation's capacities and resources and labor and talent, but the obsession with the stock price and short-termism are intertwined. A board's definition of "long-term" today is about three years. We are eating our seed corn.

The nature of the conversation about shareholder primacy concerns the conduct of publicly traded companies, but as Senator Baldwin and others have pointed out, the short-term pressures to enrich investors first and foremost are also present in private capital markets, a growth area as more companies rely on private investors and never truly go public or rely on public markets.

I want to share some examples of how shareholder primacy plays out in the markets and the costs to the health of business and to wider society, starting with the growth in inequality, but moving on to broader concerns. Though these examples I also hope to explain how the system of rewards, incentives, assumptions and common-practices keep Shareholder Primacy in place.

The consequences of our focus on the stock price—return to shareholders—aka, shareholder primacy—play out in multiple domains. These problems are on the minds of business executives as well as members of this body.

Growing Inequality:

In the last decade, business leaders have joined the chorus of those who observe and are deeply concerned about the unsustainable level and growth of economic inequality in the United States. The Business Roundtable's 2019 restatement of the purpose of the corporation is a case in point.

When the BRT restated its mission with great fanfare In August 2019, the then-Chairman of the BRT, Jamie Dimon, Chairman and CEO of JP Morgan Chase, observed, "The American dream is alive but

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[1] The dominant measure of shareholder return is Total Shareholder Return—or TSR—dividends plus increases in the stock price. The increases in the stock price come about because investors like what they see, but also when the company decides to repurchase its own shares to reduce the shares outstanding and increase the value of the stock to those investors who remain in the stock.

For a public company to repurchase its own stock was viewed as stock manipulation and was illegal in the US until 1982. https://corpgov.law.harvard.edu/2020/10/23/the-dangers-of-buybacks-mitigating-common-pitfalls/#:~:text=Buybacks%20were%20largely%20illegal%20until,over%20the%20next%2020%20years.

[2] The top executives in public companies and many directors continue to receive the overwhelming amount of their compensation in stock.

[3] The primary reason directors are challenged by shareholder activists, or the company earns a 'no' vote in the so-called Say on Pay vote is because the company's stock price is considered inadequate when measured against certain of its peers and/or the company's "intrinsic" value.

fraying." The BRT statement on the Purpose of the Corporation affirmed the commitment of nearly 200 CEOs of America's largest companies to deliver more inclusive prosperity. Notably, the new statement of Corporate Purpose **overturned** a 22-year-old mission statement that defined a corporation's principal purpose as maximizing shareholder return. (The idea that we are all better off if the shareholder is placed at the center of the business is still taught in finance classrooms as good management practice.)

We praised the BRT's statement at the time. It felt like a watershed moment. It also felt to me like a return to common sense: executives of large corporations with tens of thousands or even hundreds of thousands of employees, operating across dozens or hundreds of regions and countries around the globe, cannot succeed with a single objective function. To succeed requires an extremely long-term view, strategy, complex relationships up and down the supply chain and an array of management objectives that respond to changing circumstances and are critical to survive, compete, and attract talent—and to earn public trust, and the license to operate wherever the company hopes to operate.

And yet, despite our early enthusiasm, and work behind the scenes to encourage the BRT to take a fresh look at their commitment to so-called Shareholder Value as the organizing principle for the firm, the most common question I continue to be asked is whether business is in fact living up to its commitments. And the answer to that question, clearly, is no.

Despite the public declaration of many of the most powerful business leaders in the world, and the importance of business as the wealth creators, and especially, despite having business executives enjoying many levers to influence the distribution of wealth, economic inequality has continued to get worse. Indeed, in the two years after the BRT statement, for the top 1% in the U.S., wealth grew by over $11.5 trillion versus $1.6 trillion for the bottom 50%.[4]

In the battle against inequality, inequality is winning in a rout.

And how is this possible? Many of us see headlines about wages growing as companies compete to attract and retain workers. For example, Target just received praise for a commitment to invest $300 million in wages and benefits for employees. Isn't this evidence of progress? Shouldn't such an investment combat inequality? The answer, unfortunately, is no.

If we look a little deeper—we see that just six months ago, before the announcement about committing $300 million (including bumping the minimum wage as high as $15/hour and up to $24/hour is some parts of the country and increasing access to health care) Target announced a $15 *BILLION* program of stock buybacks. This use of cash to raise the stock price through the repurchase of shares was lauded by Wall Street analysts—even though it is *fifty times* the investment in the workforce. (At the end of the day, maybe 20% of the workforce will have access to healthcare as it initially only applies to those who work at least 30 hours a week.)

This is the flywheel that drives inequality.

And Target is hardly an exception or rogue player. Checking the morning newsfeed as I was about to hit send on the written form of this testimony, I saw that Amazon had announced a 20-for-1 stock split that would mean distributing $10 billion to shareholders. The move, which is subject to shareholder approval in May, would be Amazon's first stock split in more than 20 years, and is taking place as the company continues to resist the creation of a union at a plant in Alabama.

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[4] https://www.federalreserve.gov/releases/z1/dataviz/dfa/distribute/table/

These companies require scrutiny. **But they are also following the logic and incentives of our current model of capitalism.** Over the last decade, 93% of all corporate profits of the S&P 500 have been returned to shareholders via stock buybacks and dividends.[5] *This is what boards, CFOs and CEOs are incentivized to do*. And the only people that have formal power to challenge these decisions are the shareholders themselves, who are obviously complicit in the use of profits that we have come to expect from public companies.

Buybacks are a symptom of the short-term focus on the stock price—shareholder primacy.

Compounding this picture is the fact that **inequality is baked into the stock market itself** since the vast holdings of the market are highly concentrated — held by a tiny fraction of shareholders.[6] Simply stated, shareholder primacy fuels greater income inequality *because gains in stock prices benefit those who own stocks, and most stocks are owned by the wealthy*—in fact, the biggest share of stocks are owned by people who are already extremely wealthy.

Shareholder primacy also drives inequality by actively discouraging wage growth. Consider the market reaction to Walmart's announcement back in 2015 that it planned to increase its minimum wage to $10/hour. (It now pays $12/hour and is moving to $15/hour over time.) In addition to the raise, the company would invest in worker training, and technology to improve jobs and productivity. In response to these plans, investors punished the company with a $20 billion dollar loss in stock value.

At $10/hour, a full-time employee was making $20,800 a year—well below the federal poverty line. But the commitment to increase wages at the time, and for the largest retailer in the world, was at odds with a system that *expects* companies to minimize labor costs. Fortunately, Walmart persisted, bolstered by family control of most of the company's stock but even with that buffer, the message from the stock market was clear.

With all the hype today about so-called ESG investment, i.e., the attention paid to "environmental, social and governance" practices of companies, the reality is that the market still rewards actions like laying off workers or putting jobs out to contract—and punishes companies that do the reverse—invest in their workforce.

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[5] The $5.3 Trillion Question Behind America's COVID-19 Failure - The American Prospect

[6] Note: from David Berger, Esq, Wilson Sonsini: According to the latest study by the Federal Reserve, the bottom 50% of American families owned 1% of overall equities (and 0% of direct stocks), while those in the 50%-80% of net worth held just 6% of overall equities. In contrast, the top 1% held 38% of overall equities and 51% of direct ownership of stock. https://www.nytimes.com/2021/01/26/upshot/stocks-pandemic-inequality.html. This has three very practical effects. First, it means that while the S&P 500 increased by over $4 trillion in value in 2020 and even more in 2021, essentially none of this wealth went to the poorest half of Americans who own essentially no equity, and just about 6% went to 80% of Americans. Second, the top 1% increased their wealth by trillions of dollars, as they controlled not just 38% of the value of all stock accounts but also 51% of the value of accounts that directly hold stocks. Third, a major reason why the stock market continues to grow regardless of events in the real world—whether covid, economic growth, political gridlock or even war—is that over the last 40 years, consistent with and fueled by the theory of shareholder primacy, there has been a shift in the share of corporate profits given to capital versus the amount given to labor. (link to a recent paper demonstrating this practice: https://www.nber.org/system/files/working_papers/w25769/w25769.pdf).

This problem is not limited to retail. It happens across the economy. In 2017, several years after emerging from bankruptcy and a reorganization to reduce costs, American Airlines announced raises for its employees to bring their pay back in line with competitors. In response Wall St. analysts slammed the company. One analyst from JP Morgan bemoaned it as a “transfer of wealth from shareholders to labor groups,” labeling it “a worrying precedent, in our view, both for America and the industry.” Major investors agreed and airline stocks across the board took a hit on the fear that increasing wages would make airline stocks bad investments.[7]

In 2011, when Google announced its intention to create 1,600 new jobs, the stock price fell 5% overnight.

In the tech sector, it is now commonplace to reduce costs by replacing employees with contractor laborers, at lower wages and benefits, but also with less security, economic mobility and rights. Lower cost contract workers are a way of life. Google’s ‘shadow’ work force tops 130,000, and by most measures is greater than the employee base. It is estimated that ~10% of this number may eventually make it on to the payroll, to realize the kinds of opportunity for advancement that come with a regular job.

With employment models like this, it is no coincidence that tech companies like Apple, Microsoft, Alphabet, Amazon have among the highest stock market valuations in the world.

This incongruity, the failure of the market to reward a company’s investment in its own workforce, or to recognize these investments in employees as good for the economy, is in and of itself sufficient reason to continue to hammer away at the scaffolding that keeps the shareholder at the top of the company’s priorities. If we want to address the root causes of inequality—and other externalities of the form of capitalism in play today—we must unwind the system of incentives, informal norms and nudges, and formal rules that keep corporate shareholders as the center of attention.

For example, when it comes to rule-making, it is worth noting that the SEC just closed a comment period on the idea that the SEC should be even more insistent that senior executives be principally rewarded for Total Shareholder Return.

While we must ensure that investing institutions and the many intermediaries in the financial system are as accountable to the interests of society as we expect corporations to be, the pressure in public companies to continue to pump up the stock price is real, incredibly short-term oriented, and unrelenting.

I wish to clarify one point about governance and share ownership that is commonly misunderstood. When it comes to redressing shareholder primacy—it is important to note that **shareholders don’t own the corporation itself**. They own shares of stock that come with discrete and important rights and privileges, but the company, its assets and its liabilities, are not the property of shareholders. To unwind shareholder primacy has nothing to do with property rights. The corporation owns itself; shareholders don’t own the corporation, and we don’t need to treat them as such.

What’s holding us back from a real renaissance in business—from seeing the Business Roundtable’s restatement of corporate purpose catalyze a real change in behaviors in boardrooms and the C-suite—is

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[7] https://www.cnbc.com/2017/04/27/airline-shares-decline-amid-worries-the-stocks-will-become-a-poor-investment-again.html

a set of practices and protocols that dominate public companies—and that keep shareholders in a favored position.

Through years of dialogue and the work of networks of scholars, business leaders, some investors and governance experts, we have succeeded at disrupting the narrative that took hold in the 1980s and continues to dominate finance classrooms and law schools, aka, "The purpose of the corporation is to maximize shareholder value." But the *scaffolding of shoulder primacy* is still firmly in place.

To question the common belief in shareholder primacy, as the BRT has done, is a critically important first step, but the system is complicated to unwind. There are winners and losers when real change takes place, and the losers would include wealthy investors who benefit from the status quo, i.e., who have massive holdings in the public markets and are loathe to give up their primary position. To continue to challenge the narrative about corporate purpose remains important, especially to challenge the assumption that shareholder primacy is embedded in law—and is a core principle of good management.

Shareholder-first thinking also persists because of the practice of "aligning" the CEO with the shareholders—a tenant of the design of Pay practices in almost all public companies.[8] These practices make many CEOs extremely wealthy and contribute to growing inequality within companies and within markets.[9]

Despite the myth that CEOs are just trying to keep up with baseball players and Hollywood stars, the data is clear. There are many social factors and other contributors to the growth of inequality, but the most obvious is that a small number of people make large amounts of money.

These so-called "mega-rich"—the top .1 of 1 percent earners—drive most of the inequality; between 1980 and 2014, they represented three-fifths of the income growth within the top 1%, and 40% of all income growth. (And the growth in inequality continues.) What might come as a surprise is that **business executives constitute most of this class of earners**—CEOs, certainly, but also other executives and professionals in finance and beyond.

And no surprise, there's not a lot of motivation among CEOs or boards to change the system that has made them so wealthy. Further, Boards—even if they began to contend with their own role in perpetuating a massively unfair and inequitable system—are disinclined to disrupt the status quo; they fear putting their own CEO in a bad light by suggesting their CEO is less worthy than his or her peers.[10]

But the motivation to change is also strong—and growing. The costs of shareholder primacy are steep, and they are shouldered by all of us. Inequality is corrosive, and too many citizens have lost faith in "the system." Employees are making their voices heard and are able connectors between internal policy and external costs and realities. Executives are listening to them. And there are many reasons beyond

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[8] that is reinforced by proxy advisory firms like ISS, that advise mutual funds and large investors on how to vote their shares at the annual meeting

[9] —given the high concentration of holdings in the hands of a tiny percentage of stockholders. [I will not address the latter issue – wealth concentration in the public markets, but

[10] https://www.aspeninstitute.org/programs/principles-of-pay/ See the Aspen Principles for Sensible and Effective CEO Pay, developed in partnership with Korn Ferry. The **Modern Principles for Sensible and Effective Pay** are the product of over two years of research and dialogue among board directors, investors, scholars and experts in governance and compensation working to assure the long term health of business and capital markets.

concern for inequality and, even the state of our democracy, for righting the ship and unwinding the obsession with return to shareholders.

Capital Allocation:

A critically important cost of the status quo is about capital allocation, or the pressure to divert capital to shareholders over other important investments—yes, to the employees that create the wealth, but well beyond to include under investment in infrastructure, R&D, innovation, and climate change, and the kinds of reserves that are helpful in a time of crisis, like the pandemic. Instead, we witness companies investing precious management time and money on tax avoidance and seeking protection for an industry or enterprise.

Corporations earn accolades for philanthropy and public commitments on all kinds of causes, while deploying tax subsidiaries across the globe to avoid paying taxes for these same needs at home and using their voice in Washington and at the state level to keep it that way.[11] The bottom line is that CEOs can appear to offer what BlackRock's CEO Larry Fink seems to call for—serve a public purpose, execute against a well-thought strategy, and a long-term view—while still deploying extreme measures to avoid taxes and dodge the cost of public goods, including infrastructure and decarbonizing the energy mix to avoid a climate catastrophe.

The fixation on Total Shareholder Return—TSR—distracts from the actual job of corporate executives: the exercise of good judgment across a complex and constantly shifting set of relationships (especially including your own employees)—not merely to focus on the demands or expectations of shareholders.[12]

If the market has already priced a company's stock appropriately, even the best and most responsible CEOs may find it hard to generate more TSR. Pressuring them to do so invites risky or nefarious behavior.

Narrowly focusing executives on TSR was at the heart of the most dangerous of corporate scandals from Boeing's 737 Max tragedies to Wells Fargo's fraudulent sales practices.

When corporations put the return to the shareholder at the center of the business model, it leads to diminished investment in other critical needs—investment in both workplace and product safety (think Boeing), climate change and conservation of vital resources (think VW and the "dieselgate" scandal), and R&D and innovation and skills transfer for the workforce.

It also contributes to our tepid response to climate change.

Members of this committee are surely grappling with how to fund important investments in our country's future. Take the threat of climate change as one example. One of the barriers to addressing climate change has been the price tag. It is telling that data on share repurchases for S&P 500

[11] Per the Joint Committee on Taxation, the average effective tax rate of US multinational corporations in 2018 on US profits was 7.8%, down from 16% in 2017, a result of the 2017 tax cuts.

companies exceeds annual climate related spending in the Bipartisan Infrastructure Bill several times over.[13]

Over the last five years, repurchases for high carbon emitters exceeded $400 billion. For the last decade, share repurchases are over five times the next ten years of the climate centered investment planned for in the BIB (II&JA).

In theory, long term investors—including large institutional investors like Blackrock and Vanguard that invest the capital of pensioners and those saving for retirement—balance out the impulses of short-term traders, who only think of today, but the reality is we are all complicit. Investors want return and pensions are under the gun to maximize return as well. Consumers are bound by price and convenience, and both carry extraordinary externalities. The stock price goes up when the company reduces costs and goes down when it invests capital in the company for the future or prioritizes the broader system or public goods on which the company depends.[14]

It's not all bad news out there; there are many companies, some private, some pubic, that manage to do things differently. Often their business model resides on the primacy of employees in order to achieve a superior customer service model, like the one that secured Southwest's reputation as a disrupter, or Delta's decision to create a bonus plan for all employees to advance their prospects coming off bankruptcy, or the legendary example of Herman Miller, that put design, and the designer, at the center, and then positioned the company to advance sustainability in design as a competitive advantage.

But these are the exceptions that buck the system as it operates now. To combat inequality—and climate change—we need a system that shares prosperity and invests in the future *by design*.

A society and economy need more than hyper-efficiency in the present. We need stability in the face of shocks. We need to be equipped for proverbial "rainy days" and downturns. We need to prepare and invest in changes that correct for past mistakes and to enable a brighter future. But the logic of shareholder primacy—extracting maximum returns for shareholders—isn't designed for balance, stability, or to reward risky long-term investment in an uncertain future, or to the cushion us through the hard times.

Let me end with this thought: Despite public cynicism, business corporations are neither bad, nor good. They are not moral, or immoral. *Corporations are amoral*—a function of the rules and protocols and incentives that drive behavior. We the people license corporations to create goods and services—and when done well, wealth is created, and ideally is shared with the wealth creators along with those who have wisely invested with a long-term view of performance.

We, as a country, have remarkable talent, and tremendous resources. We have what is needed to do great things. The way forward requires a closer look at the "G" of ESG – to what end boards and executives allocate capital in support of human endeavor and our collective future. [See next page]

[13] For high carbon emitters within the S&P 500, annual share repurchases by higher emitting sectors are multiples of the annual climate related spending proposed in Infrastructure Investment and Jobs Act--$77 billion versus ~$15 billion.

[14] https://hbr.org/2017/02/finally-proof-that-managing-for-the-long-term-pays-off This article uses a research framework that enables investors to identify companies that are short term oriented.

Resources and Policy Recommendations:

The Aspen Business & Society Program focuses on **business** as the agent of change – and we are thus particularly interested in actions and choices that lie within the control of executives and boards.

However, over the course of two decades we have produced policy-oriented recommendations that are consistent with the need to rethink corporate purpose, reward long-term thinking and assure that boards and executives listen to and embrace those who bear the consequences of their decisions.

Products of dialogue and business engagement include:

2009: The Aspen Principles of Long-Term Value Creation
https://www.aspeninstitute.org/publications/aspen-principles-long-term-value-creation-guiding-principles-corporations-investors/

2016: The American Prosperity Project: A Non-partisan Framework for Long-Term Investment
https://www.aspeninstitute.org/programs/business-and-society-program/american-prosperity-project/

2019: The Aspen Principle for Sensible and Effective Payhttps://www.aspeninstitute.org/programs/principles-of-pay/

2021: A Policy Foundation to Revive Worker Voicehttps://www.aspeninstitute.org/publications/policy-foundation-worker-voice/