RECONCILING SHAREHOLDER THEORY IN THE AGE OF ESG

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Abstract

In August 2019, the Business Roundtable released a new Statement on the Purpose of a Corporation, signed by 181 CEOs, in which it endorsed the proposition that companies should pursue policies designed to create benefits for all stakeholder groups, including customers, employees, suppliers, communities, and shareholders. The 2019 Statement superseded all previous pronouncements issued by the Business Roundtable since its founding in 1972, in which it had consistently endorsed the principle of shareholder primacy. The Business Roundtable's new position appears to have popular support, as most polls reveal that a majority of respondents agree that managers should consider stakeholder and societal interests when making business decisions.

The discussions regarding the misalignment of stakeholder and shareholder theory are well documented (Karpoff, 2021; Denis, 2016; Chassagnon & Hollandts, 2014; Jackson, 2011). Environmental, social, and governance (ESG) strategies and their relation to shareholder value are not new and have been a major evolving component in the modern corporate governance arena (Wirawan et al., 2020). As affirmed by the 2019 Roundtable Statement, ESG is no longer looked at as a siloed approach with mostly costs for the firm and little benefit for shareholders

but can be combined in a companies' analysis of strategic, operational, and financial risks and opportunities to bring value to the firm.

All stakeholders, including shareholders, are interested in ESG and its impact on firm value and social good. The idea that ESG and shareholder theory are incongruent is a fallacy. To reconcile shareholder theory to stakeholder theory, we model the corporate decision-making process using a holistic risk management approach. This approach reveals that ESG considerations do not necessarily conflict with shareholder theory. Firms will include considerations whose benefits bring value to the firm when looking at all types of risks and opportunities, not just financial ones.

According to Segal (2012), operational and strategic risks need to be included in addition to the traditional models of financial risk in assessing a value-based approach to managing a firm's risks. Using a holistic approach that includes strategic, operational, and financial risks allows companies to incorporate those strategies like ESG that historically are hard to quantify and yet if ignored could result in catastrophic losses in the value of the firm. The key to understanding how to analyze those risks is to include a group of educated stakeholders that would have key knowledge of those variables and how they could affect firm value.

The goal of this study is to construct a framework where we reconcile shareholder theory, as traditionally defined, with stakeholder theory and the goals of the ESG movement. Within this framework, the main prescription of maximizing expected shareholder value remains unchanged. Our investigation should be interesting to both researchers and corporations alike.

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