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The Maximands of Corporate Governance:

A Theory of Values and Cognitive Style

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ABSTRACT

This paper considers the *raison d'être* of corporations as it is reflected in the maximands of corporate governance. The debate over stockholders' versus stakeholders' interests as such maximands has been raging for decades. Advances in economic theory have not only failed to resolve this debate but have established that the problem is graver than what many may have estimated. This paper turns this debate on its head: Instead of asking What or Whose interests should corporations maximize, the real question is Why is this debate taking place at all? Aiming to extend current economic analyses of the maximands issue, this paper puts forward a new theory about the factors that determine these maximands. Recent advances in psychological research point to value emphases at the individual and societal levels and to the need for cognitive closure as such factors. The theory proposes the notion of value complexity as an organizing element that may associate certain value emphases with cognitive style. Overall, this theory provides explanations for various sticky points in the stockholder-stakeholder debate in the United States and in international settings, identifies gaps in other theoretical accounts, and generates testable hypotheses for empirical research. Extant evidence supports this theory.

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I. INTRODUCTION

For nearly a century now, lawyers and scholars in other fields have been debating the question Whose interests should corporate fiduciaries maximize? Michael Jensen, among the founding fathers of modern corporate governance theory, recently argued that “200 years’ worth of work in economics and finance indicates that social welfare is maximized when all firms in an economy maximize total firm value,” which is defined as the value of equity plus other financial claims.¹ Others, however, call for “corporate social responsibility,” holding that in addition to shareholders’ interests, corporate officers must give weight to the interests of other corporate and societal constituencies. The latter are commonly called “stakeholders.” The list of such potentially eligible stakeholders includes creditors, employees, customers, local communities, and the environment. This stockholder-stakeholder debate has reached such scope that some critics remarked, not entirely without merit, that these issues have now been debated *ad nauseam*.²

This paper asks a new question that turns this debate on its head. Instead of asking What or Whose interests should corporations maximize I ask Why is this debate taking place at all? Unearthing the roots of the stockholder-stakeholder debate has become crucial not only in the United States but in many other countries as well. Prominent international bodies and numerous national ones have promulgated codes of principles for optimal corporate

¹Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 7 EUR. FIN. MGMT. 297, 302 (2001). Versions of this article appeared in 14J. APPLIED CORP. FIN. 8 (2001); 12 BUS. ETHICS Q. 235 (2002); BREAKING THE CODE OF CHANGE 37 (Michael Beer & Nithan Nohia, eds. 2000); UNFOLDING STAKEHOLDER THINKING _ (Joerg Andriof et al., eds. 2002).

²Henry N. Butler & Fred S. McChesney, *Why They Give at the Office: Shareholder Welfare and Corporate Philanthropy in the Contractual Theory of the Corporation*, 84 CORNELL L. R EV. 1195, 1195 (1999)

governance. These codes invariably call for giving priority to shareholders' interests while acknowledging the interests of other stakeholders.³ Yet they give no guidance as to how can this target be met.

This paper maintains that two hundred years were not enough for resolving the debate over the maximands of corporate governance.⁴ My goal is twofold – both constructive and critical. In the constructive mode, this paper advances a new theory on the maximands of corporate governance, that identifies crucial but heretofore neglected elements that engender this problem. In the critical mode, this paper advances a new reading of existing analyses of corporate constituencies as corporate governance maximands.

Theoretical analyses thus far have failed to provide a satisfactory answer to the maximands problem. A careful reading of the seminal debate between Adolf Berle and E. Merrick Dodd indeed shows that several commentators may have misinterpreted this debate. Contrary to common wisdom, this paper shows that Berle agreed with Dodd that the interests of non-shareholder constituencies should be advanced by corporate fiduciaries in tandem with shareholders' interest. Their disagreement revolved over whether and how this task could be implemented. Both scholars, however, were unable to answer these questions. As it happens, the legal literature has made very little progress since Berle first identified this implementation problem in the early 1930s.

(“For centuries legal, political, social, and economic commentators have debated corporate social responsibility *ad nauseam*.”)

³ See below Section V.B.

⁴ The use of the term “maximand” in this context follows FRANK H. EASTERBROOK AND DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 35-39 (1991).

The traditional law and economics perspective holds that in determining the maximands of the corporation, exclusive priority should be given to its residual claimants. This, in essence, is the basis for Jensen's view, in addition to other important commentators.⁵ This principle appears elegant and appealing at first glance. At each point of time, one only needs to identify the corporate constituency that holds the residual claim on the corporation. This residual claim should be the maximand for corporate fiduciaries. By definition, there can only be a single residual claimant – shareholders in the regular course of business and creditors during insolvency. Q.E.D.

Well, not quite. The fundamental flaw in this back-of-the-envelope economic analysis lies in its reliance on the notion of residual claim. This concept is easy to grasp and employing it is largely consistent with central doctrines of corporate law. Yet this analysis hides an implicit assumption, that apart from the residual claim all other claims on the corporation—or, more accurately, the interests of other stakeholders—are fixed and well defined. Hence, they are assumed away from the analysis such that only the residual claim remains to be maximized. This assumption is unrealistic, however. A more sensible analysis—reflected in modern economic theory of the firm—acknowledges that the corporate enterprise comprises several constituencies whose interests are both interdependent and indeterminate. As a result, legitimate *bona fide* disputes can arise with regard to the scope of entitlements in particular situations. As these interests may be conflicting with one another—e.g., those of shareholders, creditors, and employees when the firm faces financial or business hardship—corporate decision makers are forced to consider them all simultaneously. In fact, these interests must be reconciled on an on-going basis if the firm is to keep functioning.

⁵ See below Section III.E.1.

The corporate governance problem therefore is not one of maximizing over a single factor (the maximand). Rather, it calls for optimizing over several factors simultaneously. 200 years' worth of work in economics and finance are of little help for this task. Ironically, it is not even needed. Even high-school level calculus provides that one cannot maximize an expression with more than a single unknown variable. In a rare treatment of this subject by economists, Erik Berglöf and Ernst-Ludwig von Thadden opine that the economic approach to corporate governance should be generalized to a model of multilateral interactions among a number of different stakeholders. Such a model must also take into account how a country's legal and political system affects this delicate balance.⁶ Important as it may be, these scholars argue, shareholder protection may not be sufficient for sustainable economic development, especially in transition economies.⁷

Economic theory currently fails to offer a framework for dealing with multiple stakeholders of firms that are run by agents. Recent advances in behavioral economics may bring some progress in this regard. But, as Berglöf and von Thadden note, in order fully to generalize the economic analysis of interactions between different stakeholders, this analysis has to integrate factors that operate at the societal level in addition to the individual level. Law and politics are such factors. Culture is another factor that is regularly mentioned in the comparative branch of the stockholder-stakeholder debate. Yet societal-level analysis is an aspect about which current economic theory faces significant challenges.

⁶Erik Berglöf & Ernst-Ludwig von Thadden, *The Changing Corporate Governance Paradigm : Implications for Transition and Developing Countries*, in ANNUAL WORLD BANK CONFERENCE ON DEVELOPMENT ECONOMICS 135 (1999).

⁷*Id.* Berglöf and von Thadden further note, in the wake of the financial crises in Asia and Latin America, that protecting foreign investors has its limits, as international portfolio investment is a highly volatile source of funds and cannot be the centerpiece of a development program.

Every theory of corporate governance is at heart a theory of power. In this view, the corporation is a nexus of power relationships more than a nexus of contracts. The corporate setting is rife with agency relationships in which certain parties have the ability (power) unilaterally to affect the interests of other parties notwithstanding preexisting contractual arrangements. In the present context, corporate fiduciaries are entrusted with the power to weigh and prefer the interests of certain constituencies to the interests of others (beyond their own self-interest). Given the current limitations of economic theory, progress in the analysis of the maximands of corporate governance may be achieved by drawing on additional sources of knowledge. This paper points to certain branches of psychology as such sources.

The psychological study of reasoning by policy- and decision-makers in the presence of conflicting considerations, or interests, reveals that such reasoning varies systematically. Prominent factors found to be relevant in this regard are people's cognitive style (i.e., their typical modes of handling information) and in particular, people's relative need for cognitive closure—to wit, their desire to put an end to deliberation and reach an answer, *any* answer.⁸ These factors in turn correlate with people's political views. Meanwhile, another branch of psychology has established that people from different cultures also differ in their cognitive styles—among other things, in their treatment of contradiction and their modes of assigning responsibility. Finally, in yet another field of psychology, universal models of values at the individual and cultural levels have been advanced and validated. These advances seem to be taking place independently from one another. An integrative view of these issues has not been explicated.

⁸ See below section II.B.1.

The theoretical framework developed in this paper is based on an integration of the insights suggested by these psychological studies. The psychological analysis thus complements the standard economic analysis of the maximands of corporate governance. The present theory yields specific, testable hypotheses in regards with both the micro level (individual persons or corporations) as well as the macro level (national and international). At the micro level, effective corporate governance requires corporate fiduciaries first, to overcome their self-interest and second, constantly to coordinate the interests of several constituencies. Especially in pressing times—e.g., during economic downturns or in the face of a hostile takeover bid—some managers may prove better than others in performing this task. These managers will exhibit a lesser need to reach cognitive closure; they will tend to be of a liberal more than conservative or libertarian persuasion;⁹ their individual values would emphasize openness to change more than conservation and self-transcendence more than self-enhancement.¹⁰ Other managers would exhibit the opposite qualities more. A continuum of management styles exists between these two extremes. It must be stressed from the outset that these hypotheses do not imply that the former type of managers would do a better managerial job than the latter. The opposite probably would be true in many cases. The point is that certain management styles would vary systematically in accordance with managers' personal characteristics.

⁹These titles of political inclinations have special meanings in American politics and may connote different meaning in other countries. They are used here for presentation convenience only. Moreover, as will be made clear below, it may be problematic to use only a single dimension—e.g., left vs. right—to classify ideological positions. *See* below note 44 and accompanying text.

¹⁰ The concepts mentioned in the text are terms of art. For definitions and theoretical analysis, *see* below Section II.B.1.

Further insights on these issues may be gained by conducting a comparative analysis of national corporate governance regimes. In contemplating which line of action to choose, corporate decision makers in the U.S. may consider what the law says and also how the media and public opinion would respond to their action. In the main, they are likely to prefer steps that are publicly palatable. When faced with a similar situation, however, German or Korean managers may take different lines of action in light of differences in the social environment in which they operate. Assuming the latter managers are equally attentive to the tastes of the public palate, the German and Korean styles of corporate governance may give greater weight to non-shareholder constituencies compared with the typical American style.

Stated more generally, managerial action will be affected by what is considered right, legitimate, or desirable in the society. This type of analysis is related to but is conceptually different than the above reference to managers' own individual values. In this context, issues are analyzed at the general societal level. Social scientists refer to what is considered good, right, or desirable in the society as culture. It follows that managers in similar situations may reach different decisions depending on the culture in which they operate. At a more fundamental level, the law, social norms, and public views are likely to reflect each country's general culture.

While some readers at this point might consider the propositions made above as intuitive and self-evident, it should be stressed that this is entirely not the case. This paper in fact challenges common wisdom at a number of levels. To begin, the above propositions reconcile and integrate conflicting theories in current corporate governance research. More generally, these assertions expand the boundaries of the emerging strand of behavioral law and economics and its application to corporate governance. These propositions are presented

here as testable hypotheses that can be confirmed or refuted empirically. The theory advanced in this paper thus suggests a new framework for the assessment of foreign corporate governance systems. This theory also lends itself to the design and implementation of corporate governance reforms by countries and international bodies alike.

This paper proceeds as follows. Part II lays the foundations for the present theory. After reviewing basic concepts in the theories of values and cognitive styles, this Part integrates them relying on the notion of “value complexity.” It then applies the integrated framework to the problem of corporate governance maximands. Part III revisits the American stockholder-stakeholder debate. This new reading of the debate highlights the implementation problem that has bedeviled all proponents of multiple constituencies as maximands from Dodd to contemporary scholars. Part IV seeks to generalize the scope of discussion by looking into the field of management studies – a discipline that has been largely ignored by most legal commentators. In comparison to legal scholarship, writers in this field have made progress that deserves attention and analysis in light of the present theory. Part V further extends the analysis by providing a comparative perspective on the maximands problem. This Part critically reviews recent trends of convergence and harmonization in corporate governance reform and points out their failure to meaningfully address the maximands problem. Part VI concludes.

II. FOUNDATIONS FOR A NEW THEORY

A. *Foreword*

Many corporate governance scholars contend that corporate decision makers cannot systematically implement the task of advancing the interests of non-shareholder

constituencies in parallel with shareholders' interests.¹¹ To some, the lack of clearly defined implementation methods implies that managers should focus only on shareholder value maximization. Others are seemingly unfazed by this implementation problem. Proponents of both extreme views, however, put their heads in the sand. The needs and claims of non-shareholder constituencies must be addressed if the firm is to continue functioning, and managers and policy makers can use better advice than simply to deal with problems on an *ad hoc* basis.¹² The need to better understand the mechanisms underlying the maximands of corporate governance becomes more pressing with the globalization of financial markets. Firms and countries alike, both developed and developing, are urged to improve their corporate governance. But today, this injunction is narrowly construed as a call for improving public/minority shareholder protection from the opportunism of managers and controlling shareholders.

The goal of this Part is to advance a systematic framework for the analysis of the maximands of corporate governance. The foundations of this framework are drawn from psychological theories that bear on the central controversies in the stockholder-stakeholder debate – primarily the problem of dealing with competing claims and the managerial confusion they could entail. Using psychology as the underlying discipline of the present theory has the advantage of allowing one to address these issues at both the individual and societal level and to identify factors that operate at both levels. This framework lends itself to deriving testable hypotheses and, where available, empirical evidence will be presented.

¹¹ For a detailed exposition of this claim, *see* below Part III.

¹² *See* below Section III.E.3.

Section B reviews dimensional theories of values at the individual and societal levels. Section C reviews recent advances in the study of cognitive styles within and across cultures with a special focus on the need for cognitive closure. I then offer a new integrative framework for discussing these issues. Section D implements this framework to the subject of corporate governance maximands. Section E points out supportive evidence.

*B. The Value Dimension Framework*¹³

The core concept in the present discussion is values. Values are defined as conceptions of the desirable that guide the way social actors (e.g., organizational leaders, policy makers, individual persons) select actions, evaluate people and events, and explain or justify their actions and evaluations.¹⁴ In this view, values are trans-situational criteria or goals (e.g. security, wealth, justice), ordered by importance as guiding principles in life. Values are not objective, cold ideas. Rather, when values are activated, they become infused with feeling. The trans-situational nature of values means that values transcend specific actions and contexts. Obedience, for example, is relevant at work or in school, in sports or in business, with family, friends or strangers.

The ways that societal institutions (e.g., the family, education, economic, political, religious systems) function, their goals and their modes of operation, express cultural value

¹³ This Section draws on Peter B. Smith & Shalom H. Schwartz, *Values*, in 3 HANDBOOK OF CROSS-CULTURAL PSYCHOLOGY 70 (2nd ed., J.W. Berry *et al.*, eds 1997) and Shalom H. Schwartz, *Cultural Value Differences: Some Implications for Work*, 48 APPL'D PSYCHOL. INT'L REV. 23 (1999). Because the current study employs the framework developed by Schwartz only this model is described in detail. For a review of theories that draw on the individualism/collectivism dimension developed by Geert Hofstede and Harry Triandis, *see* Smith & Schwartz, *id.*, at 88-91. This dimension, however, was first formulated in a cultural-level context.

¹⁴ *See*, generally, Clyde Kluckhohn, *Value and Value Orientations in the Theory of Action*, in TOWARD A GENERAL THEORY OF ACTION 383 (Talcott Parsons & Edward A. Shils, eds. 1951); MILTON ROKEACH, THE NATURE OF HUMAN VALUES (1973); Shalom H. Schwartz, *Universals in the Content and Structure of Values:*

priorities. Because cultural value priorities are shared, role incumbents in social institutions (e.g., leaders in governments, teachers in schools, executive officers of corporations) can draw upon them to select socially appropriate behavior and to justify their behavioral choices to others (e.g., to go to war, to punish a child, to fire employees). The explicit and implicit value emphases that characterize a culture are imparted to societal members through everyday exposure to customs, laws, norms, scripts, and organizational practices that are shaped by and express the prevailing values.¹⁵

Values thus feature at two distinct levels of analysis: individual and societal (or cultural). Let us consider them in turn.

1. The Individual Level

A theory-driven analysis of values begins with identifying the fundamental issues facing people that define the human condition. Milton Rokeach provided a clear definition of values as guiding principles in life and proposed a list of values that was supposed to be universal, comprehensive, and exhaustive.¹⁶ Shalom Schwartz and Wolfgang Bilsky analyzed cross-national data based on a survey instrument developed by Rokeach and confirmed the existence of certain value types in each country.¹⁷ Later on, Schwartz advanced a comprehensive model of individual-level values that represent universal requirements of

Theoretical Advances and Empirical Tests in 20 Countries, in *ADVANCES IN EXPERIMENTAL SOCIAL PSYCHOLOGY 1* (M. Zanna ed. 1992).

¹⁵ See PIERRE BOURDIEU, *OUTLINE OF A THEORY OF PRACTICE* (1972); Hazel R. Markus & Shinobu Kitayama, *A Collective Fear of the Collective: Implications for Selves and Theories of Selves*, 20 *PERSONALITY & SOC'L PSYCHOL. BULL.* 568 (1994).

¹⁶ ROKEACH, *supra* note 14.

¹⁷ See Shalom H. Schwartz & Wolfgang Bilsky, *Towards a Universal Psychological Structure of Human Values*, 53 *J. PERSONALITY & SOC'L PSYCHOL.* 550 (1987); Shalom H. Schwartz & Wolfgang Bilsky,

human existence (biological needs, coordination of social interaction, group functioning) as motivational goals. Schwartz extended the Rokeach value inventory with values drawn from other cultures, including Asian and African ones. Out of fifty-six values items included in this inventory, forty-five have been shown to have equivalent content meaning across cultures.¹⁸ Table 1 provides definitions of the ten values types distinguished by Schwartz and the value items that reflect them.

[Table 1 about here]

An interesting feature of Schwartz's individual-level model is the structural interrelations among value types. These value types can be drawn as segments of a circle. Figure 1 depicts this spatial arrangement. Adjacent value types are conceptually close to one another whereas opposing value types express conceptually diametrical goals in life. Thus, individual persons that put a high emphasis on values of universalism (social justice, equality) would also tend to emphasize benevolence values (helpful, honest, etc.). Respectively, people that emphasize universalism and benevolence would tend to de-emphasize values that belong to opposing value types (e.g., achievement versus benevolence).

[Figure 1 about here]

Towards a Theory of Universal Content and Structure of Values, 58 J. PERSONALITY & SOC'L PSYCHOL. 878 (1990).

¹⁸ For instance, "curiosity" has an equivalent meaning across cultures even if people from various cultures differ in the importance they ascribe to it as a guiding principle. See Shalom H. Schwartz, *Universals in the content and structure of values: Theoretical advances and empirical tests in 20 countries*, in 25 ADVANCES IN EXPERIMENTAL SOCIAL PSYCHOLOGY 1 (M. Zanna Ed. 1992); Shalom H. Schwartz, *Are There Universal Aspects in the Content and Structure of Values?* 50 J. SOC'L ISSUES 19 (1994). For this survey Schwartz also created versions of this inventory in other languages using procedures that ensured their language-equivalence.

Multidimensional scaling analysis¹⁹ has revealed that the values of the ten value types distinguished by Schwartz are organized along two bipolar orthogonal dimensions. These dimensions reflect a higher level of conceptual commonality among value types. One dimension, entitled Self-enhancement versus Self-transcendence, opposes power and achievement values to universalism and benevolence values.²⁰ The dimension of Openness to change versus Conservation opposes self-direction and stimulation to security, conformity, and tradition values. Hedonism values share elements of both Openness to change and Self-enhancement.²¹ In sum, the Schwartz model provides a nearly universal description of the content and structural relations of human values at the individual level.²²

2. The Cultural Level

Cross-cultural psychologists have made considerable progress over the last two decades toward developing a universal analytical framework for comparing cultures.²³ Defined in subjective terms, culture is the values, orientations, and underlying assumptions

¹⁹ For more detail on the empirical methods used in cross-cultural psychological research, see Amir N. Licht, *The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems*, 26 DELAWARE J. CORP. L. 147, 173-75 (2001).

²⁰ The names of value dimensions are capitalized throughout to notify that these are terms of art whose definitional meaning might differ from the common usage of these words.

²¹ See Smith & Schwartz, *supra* note 13, at 87-88.

²² There is now substantial supportive evidence that the Schwartz model indeed reflects a universal structure of human values. See Shalom H. Schwartz et al., *Extending the Cross-Cultural Validity of the Theory of Basic Human Values with a Different Method of Measurement*, 32 J. CROSS-CULTURAL PSYCHOL. 519 (2001); Wolfgang Bilsky & Mareike Koch, *On the Content and Structure of Values: Universals or Methodological Artefacts?*, in SOCIAL SCIENCE METHODOLOGY IN THE NEW MILLENNIUM (Jörg Blasius et al. Eds. 2002).

²³ The text only summarizes the core features of the two leading models in this field. For a general accessible introduction to cross-cultural psychology and additional sources, see Licht, *supra* note 19. For further detail, see Schwartz, *supra* note 13.

that are prevalent among the members of a society.²⁴ A common postulate in cross-cultural psychology is that all societies confront similar basic issues or problems when they come to regulate human activity. The cultural responses to the basic problems that societies face are reflected, among other things, in prevailing value emphases of individuals.²⁵ Because values vary in importance, it is possible to characterize societies by the relative importance attributed to these values in the society using dimensional models. This yields unique cultural profiles for societies or countries.²⁶

One cannot overstate the importance of the distinction between the individual and the societal levels of analysis. At the individual level, what is analyzed is the relative importance of values for the individual person given the general challenges that he or she faces in conducting their life. At the societal level of analysis what is sought are the societal responses to challenges that societies face. Although societies do not make conscious decisions or choices they do struggle with the need to ensure subsistence, establish social order, etc. – some societies more successfully than others. To illustrate the distinction, it may be noted that giving high priority to both authority and humility would be incompatible at the individual level: one cannot conduct one’s life simultaneously seeking authority and trying to be humble in the same

²⁴ This definition is similar to that adopted in studies of the effects of societal development, e.g., *CULTURE MATTERS: HOW VALUES SHAPE HUMAN PROGRESS* (Lawrence E. Harrison & Samuel P. Huntington, eds., 2000), and widespread in cross-cultural psychology, e.g., *HANDBOOK OF CROSS-CULTURAL PSYCHOLOGY* (J.W. Berry, M.H. Segall & C. Kagitcibasi, Eds. 2nd ed. 1997).

²⁵ See, for instance, ROKEACH, *supra* note 14; FLORENCE R. KLUCKHOHN & FRED L. STRODTBECK, *VARIATIONS IN VALUE ORIENTATIONS* (1961).

²⁶ In this paper I use “cultural” and “societal” interchangeably because the present focus is on national societies. However, it is possible to implement the value dimension framework to study sub-national groups. See Heather M. Coon & Markus Kemmelmeier, *Cultural Orientations in the United States: (Re-)examining Differences Among Ethnic Groups* 32 *J. CROSS-CULTURAL PSYCHOL.* 348 (2001).

situation.²⁷ At the cultural level, however, these values are compatible. “The societal system will run more smoothly if people accept authority as a desirable basis for organizing human relations *and* humility as the appropriate response toward those with greater authority.”²⁸

Thus, the “players” at the two levels of analysis are different, as are the problems they face and the answers they give to these problems. In comparing cultures, cross-cultural psychologists take advantage of the fact that general societal orientations—namely, culture—are reflected in value preferences of individual persons and compare differences in *average* value preferences across societies.²⁹

In the wake of his joint work with Bilsky, Schwartz developed a cultural level theory during the 1990s and validated it in survey data that covered some 55,000 respondents in 67 nations.³⁰ Schwartz derives three bipolar cultural value dimensions from three basic issues he identifies as confronting all societies: Embeddedness/Autonomy, Hierarchy/Egalitarianism, and Mastery/Harmony. In coping with these issues, societies exhibit greater or lesser emphasis on the values at one or the other pole of each dimension. Seven value orientations on which cultures can be compared derive from the analysis of the bipolar dimensions. The theory also specifies the structure of relations among these types of values. Table 2 provides definitions of the cultural value dimensions distinguished by Schwartz. Figure 2 presents graphically the relations among the value dimensions and orientations.

²⁷ Smith & Schwartz, *supra* note 13, at 82-83.

²⁸ *Id.*, at 83.

²⁹ See PETER B. SMITH & MICHAEL H. BOND, *SOCIAL PSYCHOLOGY ACROSS CULTURES: A ANALYSIS AND PERSPECTIVES* 48-49 (2nd ed. 1998).

³⁰ See Schwartz, *supra* note 13.

[Table 2 about here]

[Figure 2 about here]

Another pioneering and still influential dimensional framework for characterizing cultures was advanced by Geert Hofstede.³¹ His framework is widely used today in studies on management and accounting.³² Hofstede identified four—and later, five—value dimensions: Individualism/Collectivism, Power Distance, Uncertainty Avoidance, Masculinity/Femininity,³³ and Long-term Orientation.³⁴ Table 3 provides definitions of the cultural value dimensions distinguished by Hofstede.

[Table 3 about here]

³¹ See GEERT H. HOFSTEDE, *CULTURE'S CONSEQUENCES: INTERNATIONAL DIFFERENCES IN WORK-RELATED VALUES* (1980) (hereinafter "CULTURE'S CONSEQUENCES 1980"); GEERT HOFSTEDE, *CULTURE'S CONSEQUENCES: COMPARING VALUES, BEHAVIORS, INSTITUTIONS, AND ORGANIZATIONS ACROSS NATIONS* (2d ed. 2001) (hereinafter "CULTURE'S CONSEQUENCES"); GEERT H. HOFSTEDE, *CULTURES AND ORGANIZATIONS: SOFTWARE OF THE MIND* (1991) (hereinafter "SOFTWARE OF THE MIND").

³² See Peter B. Smith, *The End of the Beginning?*, 1 INT'L J. CROSS-CULTURAL MGMT. 21 (2001). See also STEPHEN P. ROBBINS & MARY COULTER, *MANAGEMENT* 125-29 (6th ed 1999) (arguing that "[t]he most valuable framework to help managers better understand differences between national cultures was developed by Geert Hofstede."); RICHARD MEAD, *INTERNATIONAL MANAGEMENT: CROSS-CULTURAL DIMENSIONS* (2nd ed. 1998) (drawing on Hofstede's theory); Greame Harrison & Jill L. McKinnon, *Cross-Cultural Research in Management Control System Design: A Review of the Current State*, 24 ACTG ORG. & SOC. 483 (1998) (same). Hofstede's work has also stirred objections on various grounds over the years. For a review and discussion of common objections, see HOFSTEDE, *CULTURE'S CONSEQUENCES*, *id.*, at 73; see also Ulrich Schimmack, Shigehiro Oishi, & Ed Diener, *Individualism: A Valid and Important Dimension of Cultural Differences* (Working paper 2002), available at <http://www.erin.utoronto.ca/~w3psyuli/msIndividualism.pdf>.

³³ This label has elicited negative responses. Writing originally in 1980, Hofstede was well aware of the problematic of attributing certain qualities to particular genders. He nonetheless kept this dimension, arguing that it reflects a positive reality that is independent of its normative undesirability. HOFSTEDE, *CULTURE'S CONSEQUENCES* 1980, *supra* note 31, at 189-90. In the 2001 edition, Hofstede follows the modern distinction between *sex* and *gender* and uses the latter term when referring to social function. HOFSTEDE, *CULTURE'S CONSEQUENCES*, *supra* note 31, at 280. For further discussions, see GEERT H. HOFSTEDE & WILLEM A. ARRINDELL, *MASCULINITY AND FEMININITY: THE TABOO DIMENSION OF NATIONAL CULTURES* (1998).

³⁴ This value dimension was not included in Hofstede's original study. It was added later, in HOFSTEDE *SOFTWARE OF THE MIND*, *supra* note 31, in light of a study led by Michael Bond. There, it was named "Confucian work dynamism." See Chinese Cultural Connection, *Chinese Values and the Search for Culture-Free Dimensions of Culture*, 18 J. CROSS-CULTURAL PSYCHOL. 143 (1987). Notwithstanding its apparent link to

Based on their value priorities, countries can further be classified into cultural regions. Hofstede's analysis yielded the following regions: Anglo, Germanic, Nordic, two Latin regions, two Asian regions (one consisting only of Japan), and Near Eastern.³⁵ Schwartz identified six cultural groups of nations: English-speaking, West European, East European, Far Eastern, Latin American, and African.³⁶ A broader, more recent sample suggests that the Far Eastern cultural region comprises two sub-regions: South Asian and Confucian.³⁷

C. *Cognitive Styles, Complexity, and Values*

1. **The Need for Cognitive Closure and Complexity**

One of the basic tasks that people constantly face is to acquire and construct knowledge. The cognitive processes of knowledge acquisition are the subject of an ever-growing psychological literature. Among the factors that influence these processes is the need for cognitive closure, defined by Arie Kruglanski as “the desire for a definite answer on some topic, *any* answer as opposed to confusion and ambiguity.”³⁸ The need for cognitive closure is primarily motivational. That is, “need” denotes “a motivational tendency or proclivity rather than a tissue deficit.”³⁹ Cognitive closure is a goal that can bias individuals' choices

Asian cultures it is arguably a universal dimension. Data for this dimension cover a smaller set of countries and it is not commonly used in the literature.

³⁵ HOFSTEDE, *CULTURE'S CONSEQUENCES* 1980, *supra* note 31, at 333-36. Note that the classification into more and less economically developed cultural regions dates from 1980.

³⁶ Schwartz, *supra* note 13, at 35-39.

³⁷ Shalom H. Schwartz, *Relations of Culture to Social Structure, Demography and Policy in the Study of Nations*, invited lecture delivered at the 25th International Congress of Applied Psychology, Singapore, July 2002 (on file with author). The Confucian region consists of China, Hong Kong, Taiwan, South Korea, Singapore, and Japan—though Japan differs some from the others.

³⁸ ARIE W. KRUGLANSKI, *LAY EPISTEMICS AND HUMAN KNOWLEDGE: COGNITIVE AND MOTIVATIONAL BASES* 14 (1989) (emphasis in the original).

³⁹ Arie W. Kruglanski & Donna M. Webster, *Motivated Closing of the Mind: "Seizing" and "Freezing"*, 103 *PSYCHOL. REV.* 263, 264 (1996).

when they are faced with the need to acquire new knowledge (including updating existing knowledge) in order to make decisions. This is because cognitive processes are costly: they take time and entail mental effort. Achieving cognitive closure is thus accompanied by positive affective reaction, and vice versa when the attainment of closure is threatened.⁴⁰

The need for cognitive closure concept is close to similar constructs advanced earlier by psychologists such as closed mindedness,⁴¹ certainty vs. uncertainty orientation, and need for cognition.⁴² These constructs have been strongly associated with political conservatism—defined as general resistance to change and endorsement of inequality—in light of a wide array of psychological theories that relate political conservatism with “a generalized susceptibility to experiencing threat or anxiety in the face of uncertainty.”^{43 44} The need for

⁴⁰ Lucia Mannetti et al., *A Cross Cultural Study of the Need for Cognitive Closure Scale: Comparing Its Structure in Croatia, Italy, the USA and the Netherlands*, 41 BRIT. J. SOC’L PSYCHOL 139, 140 (2002).

⁴¹ See MILTON ROKEACH THE OPEN AND THE CLOSED MIND (1960).

⁴² Kruglanski & Webster, *supra* note 39, at 264. Sorrentino and Roney trace the possible roots of certainty/uncertainty orientation to people’s early childhood development. RICHARD M. SORRENTINO & CHRISTOPHER J.R. RONEY, THE UNCERTAIN MIND: INDIVIDUAL DIFFERENCES IN FACING THE UNKNOWN 7 (2000) (“From a psychodynamic approach, the [certainty-oriented person] likely did not make it through the oral, anal, and phallic stages of development very successfully. Consequently, this person developed a basic mistrust in the world, a lack of sense of autonomy, and a desire to adhere to predictable and familiar worlds.”); see also Richard M. Sorrentino & J.A.C. Short, *Uncertainty Orientation, Motivation, and Cognition*, in THE HANDBOOK OF MOTIVATION AND COGNITION: FOUNDATIONS OF SOCIAL BEHAVIOR 379, 400 (Richard M. Sorrentino & E. Tory Higgins Eds. 1986)) (same, but without reference to the phallic stage). Sorrentino and Roney note that even without reliance on “the excessive baggage of Freudian and Eriksonian thought that many find unpalatable today,” early childhood development probably accounts for certainty versus uncertainly orientation. These authors further speculate that these orientations might be related to inborn dispositions. Under either theory, such orientation would be difficult to alter in adult age. SORRENTINO & RONEY, *id.*, at 157-58.

⁴³ John T. Jost et al., *Political Conservatism as Motivated Social Cognition*, 129 PSYCHOL. BULL 339, 347 (2003) (hereinafter *Political Conservatism*) (citing Glenn D. Wilson, *A Dynamic Theory of Conservatism*, in THE PSYCHOLOGY OF CONSERVATISM 257, 259 (Glenn D. Wilson Ed. 1973)). For a critique on this general thesis and a forceful rejoinder, see, respectively, Jeff Greenberg & Eva Jonas, *Psychological Motives and Political Orientation—The Left, the Right, and the Rigid: Comment on Jost et al. (2003)*, 129 PSYCHOL BULL. 376 (2003); John T. Jost et al., *Exceptions That Prove the Rule—Using a Theory of Motivated Social Cognition to Account for Ideological Incongruities and Political Anomalies: Reply to Greenberg and Jonas (2003)*, 129 PSYCHOL BULL 383 (2003). Notwithstanding the fact that it summarizes research of several decades, Jost et al.’s article raised vocal objections from right-wing groups shortly after its publication in the summer of 2003. See, e.g., Vicki Haddock, *The Right Stuff: Getting in Touch with the Mussolini Inside: A Trip Inside the Conservative Mind is a Perilous Journey Indeed*, THE SAN FRANCISCO CHRONICLE, Aug. 3, 2003, at D2; Byron

cognitive closure involves tendencies to “seize” and “freeze” upon information that is readily accessible (simply stated: stick to what first comes to mind). Notwithstanding its motivational nature, this phenomenon is therefore also referred to as a cognitive style because it relates to modes of handling information.⁴⁵ Individuals differ from one another in their stable degree of preference for closure and they differ across situations in the extent to which they are open to novel information and are willing to invest the cognitive effort required for adjusting their knowledge base.⁴⁶

Kruglanski, Webster, and Klem have developed and validated a scale (survey questionnaire) for measuring the degree of individual need for cognitive closure. Statistical analysis revealed that the scale items point to five factors representing this concept: preference for order and structure, preference for predictability, decisiveness of judgment and

York, *The “Conservatives Are Crazy” Study: Paid For by Taxpayers*, THE NATIONAL REVIEW ONLINE Aug. 1, 2003, available at <http://www.nationalreview.com/york/york080103.asp>; David Fein, *Psychological Study Links Hitler to Reagan*, Limbaugh, available at <http://www.crosswalk.com/news/1211434.html> (visited Aug. 19, 2003).

⁴⁴ A thorny issue, which the various authors, *supra* notes 50-43, abstract from, and this paper will therefore follow suit, is the validity of classifying political ideologies and orientations along a uni-dimensional left-right or conservative-liberal continuum. Philip Tetlock advances the proposition that “it is impossible to create a psychometrically defensible one-dimensional measure of ideology.” Tetlock empirically derives two such dimensions: high/low traditional conservatism and high/low market libertarianism. Philip E. Tetlock, *Cognitive Biases and Organizational Correctives: Do Both Disease and Cure Depend on the Ideological Beholder?*, 45 ADMIN. SCI. Q. 293 (2001) (citing HERBERT MCCLOSKEY & ALIDA BRILL, *THE DIMENSIONS OF TOLERANCE: WHAT AMERICANS BELIEVE ABOUT CIVIL LIBERTIES* (1983); Donald R. Kinder, *Opinion and Action in the Realm of Politics*, in 2 HANDBOOK OF SOCIAL PSYCHOLOGY 778 (D. Gilbert et al. Eds. 4th ed. 1998)). Shalom Schwartz similarly notes that “students of politics have identified two major dimensions of political ideology on which parties in various countries are differentiated.” One is concerned with civil liberties and law and order; the other with economic issues. Shalom H. Schwartz, *Value Priorities and Behavior: Applying a Theory of Integrated Value Systems*, in ONTARIO SYMPOSIUM ON SOCIAL AND PERSONALITY PSYCHOLOGY: VALUES 1, 10 (Clive Seligman, James M. Olson, & Mark P. Zanna Eds., 1996).

⁴⁵ See Kruglanski & Webster, *supra* note 39, at 267; see also John T. Jost, Arie W. Kruglanski, & Linda Simon, *Effects of Epistemic Motivation on Conservatism, Intolerance, and Other System-Justifying Attitudes*, in SHARED COGNITION IN ORGANIZATIONS: THE MANAGEMENT OF KNOWLEDGE 91, 93 (L. Thompson, J. M. Levine, & D. M. Messick Eds. 1999).

⁴⁶ See Kruglanski & Webster, *supra* note 39, at 264.

choices, discomfort with ambiguity, and closed-mindedness.⁴⁷ Recent research shows that the need for cognitive closure as captured by the Kruglanski and Webster scale exhibits a similar dimensional structure in samples from the United States, Croatia, Italy, and The Netherlands,⁴⁸ and, separately, among Hong Kong Chinese.⁴⁹ Using this scale, Kruglanski, Webster, and colleagues have demonstrated that the need for cognitive closure produces similar consequences whether this need was evoked situationally (e.g., by time pressure or by ambient noise) or as an individual personality characteristic.⁵⁰

Thus, the evidence shows that the need for cognitive closure is a universal trait but that its actual manifestations vary among individuals and across situations. Research in another field of psychology, judgment and decision making, may be helpful in identifying the factors that influence this variation. The pivotal observation here is that cognitive processes are taxing for individuals. This is strongly evidenced by the phenomenon of cognitive heuristics, that allow for fast and frugal reasoning albeit at the price of systematic errors.⁵¹

⁴⁷ Arie W. Kruglanski, Donna M. Webster, & Adena Klem, *Motivated Resistance and Openness to Persuasion in the Presence or Absence of Prior Information*, 65 J. PERSONALITY & SOC'L PSYCHOL. 861 (1993); Donna M. Webster & Arie W. Kruglanski, *Individual Differences in Need for Cognitive Closure*, 67 J. PERSONALITY & SOC'L PSYCHOL. 1049 (1994).

⁴⁸ Mannetti et al., *supra* note 40. Note that as this analysis was conducted at the individual level, its findings do not indicate that people from different cultures exhibit similar levels of need for closure – only that the need for cognitive closure is a construct that could be applied cross-culturally. Mannetti et al. argue, however, that the scale items that reflect the decisiveness subdimension are probably susceptible to Western cultural bias that values quick decision making. *Id.*, at 152-53. For an application of the need for closure scale in Germany without reporting on subdimensional structure, see Markus Kimmelmeier, *Political Orientation and Need for Cognitive Closure in German University Students*, 137 J. SOC'L PSYCHOL. 787 (1997).

⁴⁹ See Chi-yue Chiu, Michael W. Morris, Ying-yi Hong, & Tanya Menon, *Motivated Cultural Cognition: The Impact of Implicit Theories on Dispositional Attribution Varies as a Function of Need for Closure*, 78 J. PERSONALITY & SOC'L PSYCHOL. 247 (2000).

⁵⁰ For further discussion and concentration of references, see Jost et al., *Political Conservatism*, *supra* note 43, at 348.

⁵¹ See GERD GIGERENZER, PETER M. TODD, & THE ABC RESEARCH GROUP, *SIMPLE HEURISTICS THAT MAKE US SMART* (2000) (a collection of studies demonstrating how heuristics (“cognitive biases”) can enable

Human decision strategies change depending on a number of factors, including the decision's perceived importance, motivation, time pressure, and the complexity of the decision. Payne, Bettman and Johnson have emphasized the role of minimizing the cognitive effort involved in decision making. They have argued that complex decisions involving many alternatives are more taxing and lead people to adopt simplifying heuristics.⁵²

In the economic literature, Sonsino and colleagues have documented “complexity-aversion”, or “negative complexity effects in choice with uncertainty.” In particular, they show that more complex alternatives are less likely to be chosen, and that noise in the choice process increases with complexity.⁵³ Cognitive complexity was studied earlier in connection with individuals' political ideology. As defined by Tetlock, individuals' integrative complexity refers to the extent of differentiation among multiple perspectives or dimensions and the higher order integration or synthesis of these differentiated components.⁵⁴ In political decision making of voters, cognitive heuristics are at times employed by almost all voters, and that they are particularly likely to be used when the choice situation facing voters is complex.⁵⁵

both living organisms and artificial systems to make smart choices, judgments, and predictions by employing bounded rationality).

⁵² JOHN W. PAYNE, JAMES R. BETTMAN, & ERIC J. JOHNSON, THE ADAPTIVE DECISION MAKER 29-41 (1993); see also James R. Bettman, Eric J. Johnson, & John W. Payne, *A Componential Analysis of Cognitive Effort in Choice*, 45 ORG. BEHAVIOR & HUMAN DECISION PROCESSES 111 (1990).

⁵³ See Doron Sonsino, Uri Benzion, Galit Mador, *The Complexity Effects on Choice with Uncertainty – Experimental Evidence*, 112 ECON. J. 936, 937 (2002); see also Doron Sonsino & Marvin Mandelbaum, *On Preference for flexibility and Complexity Aversion – Experimental Evidence*, 51 EXPERIMENTAL EVIDENCE, THEORY AND DECISION 197 (2001) (showing that increasing the number of options produces a negative complexity effect).

⁵⁴ See Philip E. Tetlock, *Cognitive Style and Political Ideology*, 45 J. PERSONALITY & SOC'L PSYCHOL. 118 (1983); Philip E. Tetlock, *Cognitive Style and Political Belief Systems in the British House of Commons*, 46 J. PERSONALITY & SOC'L PSYCHOL. 365 (1984).

⁵⁵ See Richard Lau & David Redlawsk, *Advantages and Disadvantages of Cognitive Heuristics in Political Decision Making*, 45 AM. J. POL. SC. 951 (2001)

Taken together, this evidence points to the likely connection between complexity and the need for cognitive closure—namely, more complex tasks entail greater cognitive effort, which more strongly invokes the need for cognitive closure. Research in cultural psychology supports this proposition in demonstrating that when the level of need for cognitive closure rises, people are more likely to fall back on “standard solutions” to problems suggested by their culture. In ambiguous, complex social interactions, culture provides easily accessible heuristics for reaching satisfactory solutions. These solutions differ systematically with people’s culture, however.⁵⁶

Examination of the content of the need for closure construct suggests that it is closely related to the Conservation versus Openness to change dimension (see Table 1). The subscales that are captured in Kruglanski and Webster’s scale and the items that reflect them overlap conceptually with the values of security, tradition, and conformity in Schwartz’s model on the one hand versus self-direction and stimulation values on the other hand. The emphasis on preserving the status quo—whether real or an imaginary ideal thereof (consider “preserving family values”)—is especially clear in such value items as respect for tradition, honoring parents and elders, and social order. The preference for certainty over ambiguity and change is also reflected in seemingly innocuous value items like cleanliness that convey a sense of clarity.⁵⁷

⁵⁶ See Ho-Ying Fu & Michael W. Morris, Which Romans Do “as Romans Do”? Individual Differences in Conformity to Cultural Conflict Resolution Scripts, (Working paper 2002), available at http://gobi.stanford.edu/researchpapers/detail1.asp?Paper_No=1660 (showing that both American and Chinese subjects with higher levels of need for cognitive closure tended to rely more on their cultures’ (different) standard scripts for dispute resolution); Chiu et al., *supra* note 49, at 256 (“What cultural knowledge provides to the individual is a set of highly accessible cognitive tools that can be applied to a problem to reach a quick interpretation and articulation of one’s answer.”) Note that these findings also corroborate the evidence that individuals’ behavior tends to comply with their values. *See supra* note 59 and accompanying text.

⁵⁷ Cf. Jost et al., *Political Conservatism*, *supra* note 43, at 346.

The need for closure may also be related to the Self-enhancement versus Self-transcendence dimension. Self-transcendence, reflected in values of benevolence and universalism, calls for considering multiple others in addition to considering oneself. To the extent that values participate significantly in affecting behavioral choices, people who see merit in multiple considerations would exhibit lesser need to reach cognitive closure, and vice versa for individuals who are higher on power and achievement values. Studies done by Philip Tetlock and colleagues indirectly support these hypotheses and the association of higher need for cognitive closure with political conservatism.⁵⁸ Studies by Schwartz and colleagues demonstrate relations of value priorities to behavior, some of it directly relevant to the liberal-conservative distinction.⁵⁹ Further research of this subject is clearly warranted.

The above findings and observations suggest that the need for cognitive closure can be more systematically related to Schwartz's universal model of individual value dimensions. I propose that the notion of complexity may be a helpful organizing element for this purpose.

⁵⁸ See, e.g., Tetlock, *supra* note 44; Philip E. Tetlock, *The Impact of Accountability on Judgment and Choice: Toward a Social Contingency Model*, in 25 ADVANCES IN EXPERIMENTAL SOCIAL PSYCHOLOGY 331 (Mark P. Zanna, Ed. 1992); Philip E. Tetlock, L. Skitka, & R. Boettger, *Social and Cognitive Strategies for Coping with Accountability: Conformity, Complexity, and Bolstering*, 57 J. PERSONALITY & SOC'L PSYCHOL. 632 (1989). For further discussion, see Philip E. Tetlock & Jennifer S. Lerner, *The Social Contingency Model: Identifying Empirical and Normative Boundary Conditions on the Error-and-Bias Portrait of Human Nature*, in DUAL PROCESS THEORIES IN SOCIAL PSYCHOLOGY 571 (Shelly Chaiken & Yaacov Trope, Eds. 1999); Jennifer S. Lerner & Philip E. Tetlock, *Accountability and Social Cognition*, in ENCYCLOPEDIA OF HUMAN BEHAVIOR (1994).

⁵⁹ See Schwartz, *supra* note 44; Marina Barnea & Shalom H. Schwartz, *Values and Voting*, 19 POLITICAL PSYCHOL. 17 (1998); Anat Bardi & Shalom H. Schwartz, *Values and Behavior: Strength and Structure of Relations*, PERSONALITY & SOC'L PSYCHOL. BULL (forthcoming 2003). To be sure, the path from values to behavior is complicated and involves several mediating factors. One would be misguided to expect a unique deterministic link between values and behavior—in the least, because many values that belong to opposing value types are viewed positively by many people (see Table 1), such that conflicting values may be activated as a matter of course. Cf. C. M., Kristiansen, & A. M. Hotte, *Morality and the Self: Implications for When and How of Value-Attitude-Behavior Relations*, in ONTARIO SYMPOSIUM ON SOCIAL AND PERSONALITY PSYCHOLOGY: VALUES 77 (Clive Seligman, James M. Olson, & Mark P. Zanna Eds., 1996) (questioning the causal relations between values and behavior); Kwok Leung, Michael Harris Bond, & Shalom H. Schwartz, *How to Explain Cross-Cultural Differences: Values, Valences, and Expectancies?*, 1 ASIAN J. PSYCHOL. 70 (1995) (discussing mediating factors).

In line with research on complexity and cognitive effort, greater complexity is associated with a greater number of relevant elements worthy of consideration and higher uncertainty and ambiguity. Values therefore may differ in the level of complexity they feature. Values whose subject is multifaceted or involves multiple issues (persons, entities, etc.) or is more ambiguous may be deemed more complex, and vice versa. In this view, Openness to change and Self-transcendence may be considered more complex than Conservation and Self-enhancement, respectively.

It follows that adhering to values of the former two dimensional poles entails greater cognitive complexity than adhering to values of the latter poles. Hence, compliance with higher-complexity values would be more likely to induce a need for cognitive closure in individuals. After all, if the need for cognitive closure can vary as a function of internal individual traits and external environmental circumstances, one may be justified in expecting similar variance as a function of the object of behavior—specifically, as a function of the complexity of values that underlie such behavior.

2. Cognitive Styles Across Cultures

For several decades, most psychologists have assumed that basic cognitive processes are universal: Every human being is equipped with the same set of attentional, memorial, learning, and inferential procedures.⁶⁰ Cognitive scientists' endorsement of the universalistic

⁶⁰ This is only one basic assumption out of several. The literature on culture and cognition is outpouring. For sample reviews, on which the following paragraphs draw liberally, see Richard E. Nisbett & Ara Norenzayan, *Culture and Cognition*, in STEVENS' HANDBOOK OF EXPERIMENTAL PSYCHOLOGY: COGNITION 561 (D. L. Medin Ed. 3d Ed. 2001); Richard E. Nisbett et al., *Cultures as Systems of Thought: Holistic versus Analytic Cognition*, 108 PSYCHOL. REV. 291 (2001); Kaiping Peng, Daniel R. Ames, & Eric Knowles, *Culture and Human Inference*, in HANDBOOK OF CULTURE AND PSYCHOLOGY 245 (D. Matsumoto Ed. 2001); Alan P.

position was encouraged by the analogy between the human mind and the computer: brain = hardware, cognitive procedures = operating principles and factory-installed software.⁶¹ The heuristics and biases movement started by Daniel Kahneman and Amos Tversky encouraged the view that procedures such as judgment of probability by the representativeness heuristic and judgment of frequency by the availability heuristic, were primary, universal, and difficult to alter.⁶²

Evidence that has accumulated mostly since the late 1990s now casts doubt on the universality assumption about cognitive processes. Among other things, studies indicate that cognitive styles differ markedly across cultures. That is, people from different cultures perceive, understand, and judge the world in systematically different ways. Cultural differences in cognitive processes are further tied to cultural differences in basic assumptions about the nature of the world. Cultural practices encourage and sustain certain kinds of cognitive processes, which then perpetuate these cultural practices.⁶³

The vast majority of empirical studies compared Western subjects (mostly American) with East Asian subjects (mostly Chinese and Korean). For instance, Americans were more inclined to assign causality and responsibility to individual group members in agency

Fiske et al., *The Cultural Matrix of Social Psychology*, in HANDBOOK OF SOCIAL PSYCHOLOGY 915 (D. T. Gilbert, S. T. Fiske, & G. Lindzey Eds., 4th ed. 1998).

⁶¹ Nisbett & Norenzayan, *id.*, at 561 (citing N. Block, *The Mind as the Software of the Brain*, in THINKING AN INVITATION TO THE COGNITIVE SCIENCE 377 (E. E. Smith & D. N. Osherson Eds. 1995)). Note, anecdotally, that Hofstede considered culture to be the software of the mind. HOFSTEDE, SOFTWARE OF THE MIND, *supra* note 31.

⁶² Nisbett & Norenzayan, *supra* note 61, at 561. For a law-oriented discussion, see Donald C. Langevoort, *Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review*, 51 VAND. L. REV. 1499 (1998); Justin D. Levinson & Kaiping Peng, *Different Torts for Different Cohorts: A Cultural Psychological Critique of Tort Law's Actual Cause and Foreseeability Inquiries*, 13 S. CAL. INTERDISC. L.J. 195 (2004). See also Christine Jolls, Cass R. Sunstein, & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998).

situations, while the Asians were more inclined to assign causality to attributes of the group as a whole.⁶⁴ In explaining causes of behavior, Asians more than Americans placed credence on situational and interactional factors.⁶⁵ Asians were also better able than Americans to recognize the influence of situational constraints on individual behavior: Americans were more susceptible to the fundamental attribution error.⁶⁶ On the other hand, Asians were more susceptible to the hindsight bias, believing that they could have predicted outcomes that in fact one could not have predicted.⁶⁷ This finding may stem from the fact that in analyzing a situation, Asians consider more factors as relevant than Americans do.⁶⁸

To conceptualize the differences between subjects' cultures, cultural psychologists draw on the distinction between conceptions of the self as independent versus interdependent, suggested by Hazel Markus and Shinobu Kitayama.⁶⁹ In this view, the Western construal of the self is characterized by a sense of autonomy and distinctiveness from others. In the East

⁶³ Nisbett & Norenzayan, *supra* note 61, at 561-62.

⁶⁴ Tanya Menon et al., *Culture and the Construal of Agency: Attribution to Individual versus Group Dispositions*, 76 J. PERSONALITY & SOC'L PSYCHOL. 701 (1999).

⁶⁵ Ara Norenzayan, Incheol Choi, & Richard E. Nisbett, *Cultural Similarities and Differences in Social Inference: Evidence from Behavioral Predictions and Lay Theories of Behavior*, 28 PERSONALITY & SOC'L PSYCHOL. BUL. 109 (2002).

⁶⁶ Incheol Choi & Richard E. Nisbett, *Situational Salience and Cultural Difference in the Correspondence Bias and Actor-Observer Bias*, 24 PERSONALITY & SOC'L PSYCHOL. BUL. 949 (1998). Originally thought to be a universal phenomenon, the fundamental attribution error, also known as the correspondence bias, is people's tendency to consistently ignore external situational explanations in favor of internal dispositional explanations. This means that people are more likely to conclude that something about the person caused her behavior rather than something about the situation, even when the situation already provides an adequate explanation. See Lee Ross, *The Intuitive Psychologist and His Short-comings: Distortions in the Attribution Process*, in 10 ADVANCES IN EXPERIMENTAL SOCIAL PSYCHOLOGY 184 (Leonard Berkowitz ed. 1977).

⁶⁷ Incheol Choi & Richard E. Nisbett, *The Cultural Psychology of Surprise: Holistic Theories and Recognition of Contradiction*, 79 J. PERSONALITY & SOC'L PSYCHOL. 890 (2000).

⁶⁸ Incheol Choi, R. Dalal, C. Kim-Prieto, & Hyekyong Park, *Culture and Judgment of Causal Relevance*, 84 J. PERSONALITY & SOC'L PSYCHOL. 46 (2003).

Asian construal of the self, one's identity is diffused socially across significant others in one's in-group.⁷⁰ These polar views are close to the polar orientations on Schwartz's Autonomy/Embeddedness dimension. They are also reminiscent of, but not identical to Hofstede's and Harry Triandis' Individualism/Collectivism distinction.⁷¹ Explanations for these and many other striking cultural differences in cognitive styles call upon differences in reasoning traditions that go back to ancient times – possibly to the era of Confucius and Aristotle.⁷²

Compared with other aspects of cognition, relatively less attention so far has been paid to the need for cognitive closure across cultures. It is now assumed that in addition to individual characteristics and environmental factors, culture may also affect the level of people's need for cognitive closure. This hypothesis is inspired by Hofstede's Uncertainty Avoidance dimension.⁷³ It should be emphasized, however, that the need for cognitive closure construct applies at the individual level, not the societal level. Societies do not perform cognitive processes and they cannot experience a need for cognitive closure in the sense defined by Kruglanski as “a desire for a definite answer... *any* answer.”

Preliminary evidence suggests that people in different cultures vary in their typical level of need for cognitive closure. Chiu et al. administered the Kruglanski and Webster scale to Hong Kong Chinese and to non-Asian Americans. They found that compared to the

⁶⁹ Hazel R. Markus & Shinobu Kitayama, *Culture and the Self: Implication for Cognition, Emotion, and Motivation*, 98 *PYSCHOL. REV.* 224 (1991).

⁷⁰ Peng et al., *supra* note 60, at 248.

⁷¹ See HARRY C. TRIANDIS, *INDIVIDUALISM AND COLLECTIVISM* (1995).

⁷² See Fiske et al., *supra* note 60, at 322-24.

⁷³ See Jost et al., *Political Conservatism*, *supra* note 43, at 348 (citing Hofstede).

Chinese participants, Americans participants scored lower on the subscales that reflect preference for predictability, discomfort with ambiguity, and closed-mindedness. Americans scored higher on the subscale of decisiveness; they had a greater preference for a quick and confident decision on one best solution to a problem.⁷⁴ This finding, the authors argue, is in line with broader views in the cultural psychology literature on cognitive styles.⁷⁵

Compared with Western systems of thought, the East Asian systems of thought (as these are conceptualized in this literature) are more holistic. According to Nisbett et al., the holistic approach, as opposed to the Western analytic thought, puts ‘an emphasis on change, a recognition of contradiction and of the need for multiple perspectives, and a search for the "Middle Way" between opposing propositions.’⁷⁶ East Asian subjects have been found to be more tolerant to apparent contradictions and in fact exhibit a clear preference for contradicting, dialectical statements.⁷⁷ The metaphor of cultures as “systems of thought” vividly captures this pattern.⁷⁸

3. Cultural Orientations, Complexity, and Need for Closure

The aforementioned evidence raises the question whether we should expect a systematic relationship to exist between cultural orientations and societal stances toward cognitive closure? In line with the proposition regarding the individual level, I propose that

⁷⁴ Chiu et al., *supra* note 49, at 252. On the relations between these subscales *see supra* note 48.

⁷⁵ *See* Chiu et al., *supra* note 49, at 252-53.

⁷⁶ Nisbett et al., *supra* note 60, at 11.

⁷⁷ *See* Kaiping Peng & Richard E. Nisbett, *Culture, Dialectics, and Reasoning about Contradiction*, 54 AM. PSYCHOLOGIST 741 (1999).

such relationships are to be expected, and argue that these relationships may be better understood in light of the notion of complexity. At the societal level, cultural orientations too may be considered more complex if adherence to their values necessitates consideration of a greater number of relevant factors or should be more nuanced. Let us thus examine which cultural orientations may be considered more cognitively demanding to comply with.

In this analysis, Embeddedness and Egalitarianism imply greater complexity. Social appropriateness in high Embeddedness societies depends on preserving relationships with numerous others, the Confucian ideal of social structure that rests on the “Five Relationships” being a prime example.⁷⁹ In contrast, the focus of Autonomy is primarily on the thoughts and feeling of the individual. The thoughts and feelings of others are of secondary importance. Stated otherwise, an East Asian likely has many more “significant others” than a Western person. The literature on the Asian holistic, multifaceted system of thought extends this pattern to non-human contexts as well. Conducting one’s life in an ideal-type Confucian society thus may be more cognitively demanding.

Egalitarianism similarly implies greater complexity than Hierarchy. Egalitarianism emphasizes the moral equality of people such that numerous societal members or groups are seen as relevant factors for decision. An egalitarian cultural orientation therefore appears more cognitively demanding as it invites deliberation over pros and cons and weighing of multiple claims. Speedy attainment of cognitive closure may be detrimental to this process and may therefore be discouraged in egalitarian cultures. In contrast, Hierarchy connotes a

⁷⁸ See Nisbett et al., *supra* note 60.

clear social order in which people know their place relative to one another and can more easily ascertain whose judgment should prevail in social interactions. Hierarchy simplifies things considerably by legitimizing what comes from above.

The Harmony/Mastery dimension may be more ambiguous in what regards its complexity. Harmony appears to entail greater complexity than Mastery in that Harmony expresses an integrative view of the natural and social world. People in societies high on Harmony are encouraged to internalize this view and subject their desires to some general order that they need to comprehend. In contrast, Mastery calls on people to change things at their own initiative, thus implying less consideration for others. The latter orientation, however, entails greater uncertainty that people are expected to adjust to.

Societies whose cultural orientations are more complex should develop means for accommodating the greater cognitive load that these orientations impose on societal members. As cultures evolve over generations, they may adopt strategies for allowing societal members to optimize the cognitive effort required for complying with their values.⁸⁰ One strategy for facilitating optimization of cognitive effort bears on the payoffs from engaging in it by individuals. Along this line, cultures may develop social norms that encourage or discourage speedy attainment of cognitive closure. Thus, people who live in societies characterized by high-complexity cultural orientations would be socially rewarded for their ability to withstand the enhanced need for cognitive closure (and vice versa). This

⁷⁹ Formulated by classical Chinese philosophers, this concept states that there should be affection between father and son, righteousness between ruler and minister, attention to their separate functions between husband and wife, proper order between old and young, and faithfulness between friends.

⁸⁰ The text anthropomorphizes cultures but it should be obvious that cultures do not consciously choose strategies. This usage is common shorthand for non-human players, however.

social esteem would compensate people for the potential disutility of the extended cognitive process.⁸¹ Because multifacetedness and ambiguity are inherent to the promotion of societal values, it may not be surprising if satisfying the desire for cognitive closure would be perceived as immature in these cultures.

An alternative strategy for dealing with greater complexity is, simply put, to lower the pressure. When a particular culture puts greater emphasis on values, whose promotion typically entails greater cognitive effort, societal members may develop a cognitive style that, on average, gives lesser importance to reaching cognitive closure. By contrast, societies whose values generally call for narrowing the focus of attention will also socialize their members to be intolerant to lengthy and convoluted reasoning.

Finally, cultures could develop institutions that reduce the uncertainty and ambiguity perceived by societal members (perhaps irrespectively to the complexity of cultural orientations). This is the thrust of Hofstede's Uncertainty Avoidance dimension. Such mechanisms can take on various forms, from inhibiting multiple choices to setting fixed scripts to encouraging deference to seniors and so forth. Schwartz's model of cultural value dimensions does not feature a close parallel to Uncertainty Avoidance although low Harmony is somewhat close to low Uncertainty Avoidance.⁸²

⁸¹ See, generally, Richard H. McAdams, *The Origin, Development, and Regulation of Norms*, 96 MICH L. REV. 338 (1997) (proposing a model of social norms based on costless social esteem and opprobrium).

⁸² Schwartz notes that "Harmony might seem to overlap conceptually with uncertainty avoidance, since both idealize an harmonious order. However, harmony stresses that people and nature should exist comfortably together without assertion of control. In contrast, uncertainty avoidance emphasizes controlling ambiguity and unpredictability through institutions and beliefs that provide certainty. Harmony and uncertainty avoidance share about 6% of their variance." Shalom H. Schwartz, *Mapping and Interpreting Cultural Differences around the World*, in *COMPARING CULTURES* (Henk Vinken, Joseph Soeters & Peter Ester Eds. forthcoming 2003).

The strategies postulated above operate in opposite directions. The upshot is that greater complexity of a society's cultural orientations does not necessarily entail that its members will on average exhibit higher levels of need for cognitive closure. Every society may have a normal distribution of individuals with high and low need for cognitive closure and average levels could vary in accordance with different cultural profiles.⁸³ Yet the extant evidence from Chui et al. remains suggestive at this stage. Although we have a fair picture of the working of the need for closure within cultures, more cross-cultural analysis that employs careful standardization is warranted.⁸⁴

D. Values, Cognitive Styles, and Corporate Governance

Corporate governance is the framework that defines the division of power in the corporation. This division of power in turn determines the division of wealth created by the corporation. Oftentimes, the regulation of power in the corporation—either of managers or controlling shareholders—is subsumed under the rubric of “accountability.” For instance, the OECD Principles of Corporate Governance define the role of the board in terms of accountability to the company and the shareholders.⁸⁵ In the context of the maximands of corporate governance the debate is framed as accountability only to shareholders versus

⁸³ It is implicitly assumed here that genetic differences that may affect the average level of need for cognitive closure do not exist among societies. Relaxing this assumption does not alter the analysis although it is relevant for actual average levels, of course.

⁸⁴ On the potential importance of standardization in cross-cultural research *see* Ulrich Schimmack, Shigehiro Oishi, & Ed Diener, *Individualism: A Valid and Important Dimension of Cultural Differences* (Working paper 2002), available at <http://www.erin.utoronto.ca/~w3psyuli/msIndividualism.pdf>.

⁸⁵ ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, *OECD PRINCIPLES OF CORPORATE GOVERNANCE* (2004), available on-line at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> (hereinafter *OECD 2004 PRINCIPLES*), Principle VI (“The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders.”) The original 1999 version of the *OECD Principles* used identical language. *See* AD HOC TASK FORCE ON CORPORATE GOVERNANCE, *OECD PRINCIPLES OF CORPORATE*

accountability to multiple constituencies or stakeholders. The latter may be called “accountees.” In addition to identifying the parties who owe and who are owed accountability, a full description of accountability relationships also must specify the content of the duties it entails.

In social psychology, “[a]ccountability refers to the implicit or explicit expectation of decision makers that they may be called upon to justify their beliefs, feelings, and actions to others... [It is] a universal feature of social life that inevitably arises from the norm-enforcement needs of groups and organizations.”⁸⁶ Societies establish accountability systems in order to cope with common problems in group life. Accountability practices are crucial for establishing social order in that they serve as a feedback mechanism between parties to power relationships in rule and norm enforcement. In other words, accountability is the “social psychological link between individual decision makers on the one hand and social systems on the other.”⁸⁷ The concept of accountability has deep roots in English traditions.⁸⁸ Nevertheless, it is now commonly being used as a general term to describe who should bear responsibility to whom.⁸⁹

GOVERNANCE, DOCUMENT SG/CG (99) 5, 9 (1999) (hereinafter OECD 1999 PRINCIPLES), Principle V. For a critical analysis of the OECD Principles, *see* below, text to note 322 *et seq.*

⁸⁶ Jennifer S. Lerner & Philip E. Tetlock, *Accountability and Social Cognition*, in 1 *ENCYCLOPEDIA OF HUMAN BEHAVIOR* 1, 1 (1994).

⁸⁷ G. R. SEMIN & A.S.R. M ANSTEAD, *THE ACCOUNTABILITY OF CONDUCT: A SOCIAL PSYCHOLOGICAL ANALYSIS* (1983), cited by Lerner & Tetlock, *supra* note 86, at 1-2.

⁸⁸ *See* Amir N. Licht, *Accountability and Corporate Governance*, (working paper 2002), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=328401; Melvin Dubnick, *Clarifying Accountability*, in *PUBLIC SECTOR ETHICS: FINDING AND IMPLEMENTING VALUES* 68, 69 (Charles Samford et al., ed. 1998).

⁸⁹ *See* Licht, *id.* For a representative description of public sector accountability in the United States, *see* Barbara S. Romzek & Melvin J. Dubnick, *Accountability*, in 1 *INTERNATIONAL ENCYCLOPEDIA OF PUBLIC POLICY AND ADMINISTRATION* 6 (Jay M. Shafritz, ed. 1998) (“A relationship in which an individual or agency is held to answer for performance that involves some delegation of authority to act... [which performance is] expected by some significant “other”... accountability is a generic form of social relationship found in a variety

In the Anglo-American legal and political tradition accountability entails promoting the accountee's interests, transparency and reporting, and liability to make amends for misdeeds.⁹⁰ American courts thus have used strong language to describe their loathing of people in fiduciary relationships who derive private benefits from their power position without making full disclosure to their accountees.⁹¹ The precise scope of the accountability duties owed by corporate fiduciaries may differ from those of other actors in fiduciary relationships, but the deep suspicion towards transactions that involve conflict of interest is a dominant feature of American corporate law.⁹² As part III demonstrates, the entire stockholder-stakeholder debate revolves around the permissible use of power in the relations of corporate constituencies. This debate is less about the need to overcome fiduciaries' self-interest (over which there is consensus) than about reconciling the conflicting interests of several constituencies by corporate fiduciaries.

The current theoretical framework highlights the strength with which these basic issues are tied to psychological and cultural elements. Accountability regimes that define the division of power and wealth in corporations are determined by a host of factors ranging from legal rules to court decisions to social norms. Individual corporate decision makers eventually

of contexts... [A]ccountability does not necessarily imply the existence of democracy; rather, it suggests any form of governance conducted through some delegation of authority.")

⁹⁰ See Licht, *id.*

⁹¹ Consider Judge Cardozo's famous admonition in *Meinhard v. Salmon*, 164 N.E. 545, 546 (N.Y. 1928)

"Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions... Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd."

decide situations that are not directly and exhaustively governed by these social institutions. None of these factors can sensibly be assumed to be immune to the impact of politics and culture and, more fundamentally, the psych of the people involved. The aforementioned theory and evidence suggest that people tend to behave in consonance with their values. Pressure to reach decisions rises in tandem with the need for cognitive closure. The pressure also rises when the situation is vague, when several options need to be weighed against one another, and when decision makers expect to be held accountable for their decisions. When under increased pressure to reach a decision, people resort to their shared implicit cultural knowledge.

The upshot of this reasoning is that accountability mechanisms may look and function in fundamentally different ways according to the personal characteristics of the people involved and the to the social environment (country) in which they interact. To get a flavor of this contextuality, briefly consider the typical Anglo-American version of accountability in corporate settings, which is explored in more detail below. Through its focus on conflicts of interest, this accountability style strongly resonates with the Autonomy orientation that perceives individuals as socially alienated from one another. The Anglo-American accountability also echoes with Hierarchy in that it presupposes power relationships between the accountable and the accoutee.⁹³ Hence its legitimation of certain economic outcomes of

⁹² For a through review, *see* ROBERT C. CLARK, CORPORATE LAW 160-80 (1986).

⁹³ As originally noted by Ronald Coase, *The Nature of The Firm*, 4 *ECONOMICA* 386 (1937); reprinted in 4 *J. L. ECON. & ORG.* 3 (1988), and later elaborated on by OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* (1985), hierarchy is the constitutive feature of the firm as opposed to market-based transactions. Although hierarchy in firms (and other organizations) is inevitable, societal stances may vary in what regards the desirability of its outcomes (e.g., economic inequality). The Schwartz cultural-level dimension of Hierarchy-Egalitarianism refers to such differences in societal emphases.

power differences in the corporation and by curbing others. By narrowing its focus to a single accountee, this governance norm facilitates the functioning of corporate fiduciaries with higher levels of need for cognitive closure.

It follows, however, that managers with lower need for cognitive closure and with individual value emphases that give greater weight to complex values may feel overly restrained by such a norm. At the societal level, public opinion in societies that score higher on Embeddedness or Egalitarianism may consider Anglo-American accountability as anti-social because the latter expresses different views on the proper place of individuals in society and on proper social structures. Thus, the very notion of “conflict of interest” takes on a different meaning in a high Embeddedness society, in which the individual self is perceived as an interdependent entity in a large array of other social members. As a result, basic institutions from the standard American corporate governance toolkit—e.g., the independent director—may be incompatible with East Asian corporate governance systems, or at least produce different outcomes.⁹⁴ These differences also may have far-reaching implications on corporate decisions, because managers appear to be very attentive to public opinion.⁹⁵

Granted, economic incentives to individuals and nations alike also participate in determining the structure of corporate governance. For instance, financial markets exert pressure on corporations and decision makers generally to protect the interests of investors of

In this view, the dividing line between the market and the firm is delineated according to the relative transaction costs entailed by performing a task in each of the former.

⁹⁴ See Amir N. Licht, *Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform*, 22 BERKELEY J. INT’L L. 159 (2004).

⁹⁵ See I.J. Alexander Dyck & Luigi Zingales, *The Corporate Governance Role of the Media* (CRSP Working Paper No. 543 2002), available at http://papers.ssrn.com/paper.taf?abstract_id=335602 (providing

capital, namely, shareholders and creditors. It would be a mistake, however, to consider market forces as exogenous. Economic forces and the signals they convey to corporate and political decision makers through market prices are endogenous to corporate governance. Nevertheless, subject to these restraints, there is ample room for decision makers to take different actions as long as they can reasonably justify them to themselves and to their surrounding social environment.

1. Testable Hypotheses

We are now in a position to generate testable hypotheses about the relations between values, need for cognitive closure, and corporate governance. Specifically, the foregoing theoretical discussion suggests several hypotheses concerning the maximands of corporate governance and the endorsement of shareholder value versus multiple constituency interests as the maximand. The reasoning behind these hypotheses is simple and follows closely from the discussion above. Few and relatively straightforward as these hypotheses may be, the subsequent parts will show that their implications have been hotly debated for decades without showing signs of reaching resolution.

- The first main hypothesis concerns the individual level. In this context, people in decision-making positions in corporations or involved in policy making are expected to be more receptive to multiple-constituency corporate governance the more they emphasize the values of Openness to change versus

evidence that media affect companies' policy toward the environment and the amount of corporate resources that are diverted to the sole advantage of controlling shareholders).

Conservation and, perhaps more weakly, values of Self-transcendence versus Self-enhancement. Vice versa for shareholder value maximization.

- A corollary hypothesis is that people's endorsement of multiple-constituency corporate governance would decrease the higher is their typical level of need for cognitive closure.
- Another corollary hypothesis predicts that endorsement of multiple-constituency corporate governance would correlate positively with liberal political persuasion whereas endorsement of shareholder-oriented corporate governance would correlate positively with political conservatism.
- The second main hypothesis concerns the societal level. Here it is expected that societies that put greater emphasis on Embeddedness and Egalitarianism will have corporate governance systems that are more stakeholder-oriented. The same may be true for societies high on Harmony. In contrast, societal emphases on Autonomy, Hierarchy, and Mastery would be accompanied by stronger endorsement of shareholder value maximization.

E. Some Evidence

Empirical evidence that bears directly on the issues raised here, albeit limited at this stage, is consistent with the above hypotheses. In this Section, I concentrate the available evidence. Together with additional evidence, it will be put in more detailed context in subsequent parts.

Let us again begin at the individual level. A study by Tetlock investigated the relations between American managers' political positions and need for cognitive closure on

the one hand and their views on a variety of organizational problems on the other hand.⁹⁶ Among other things, subjects were presented with scenarios that confronted shareholders' versus multiple stakeholders' interests as the goal of corporations. Traditional conservatives and modern libertarians ranked high on the need for cognitive closure scale and were also more favorable to management that endorsed accountability to shareholders only. Lower scorers on these scales praised management that endorsed the pluralistic regime of accountability to stakeholders. Follow-up in-depth interviews with participants provided further support to the quantitative statistical results.⁹⁷

Analysis at the societal level is based on comparative studies. A well-known survey by Charles Hampden-Turner and Fons Tropicenaars has found suggestive evidence for significant relations between culture and stakeholder issues. These researchers surveyed international managers from several countries and asked them about their attitudes toward corporate profit. Specifically, managers were asked to choose one of the following as an accurate statement of the proper goal of a company: "(a) The only real goal of a company is making profit. (b) A company, besides making profit, has a goal of attaining the well-being of

⁹⁶ Tetlock, *supra* note 44.

⁹⁷ Tetlock, *id.*, vividly summarizes these interviews: "Conservatives understood stakeholder concerns and the necessity of taking them into account as a means to the end of profit maximization. But they feared that egalitarian efforts to promote the stakeholder vision rested on a fundamental misunderstanding of both human nature and of capitalism that would impair long-term growth by enmeshing corporate executives in ever more elaborate webs of communitarian regulations ("You can't do anything until the local politicians, labor unions, environmentalists, minority-rights activists, and other assorted opportunists have all had their palms crossed with silver") and by creating an inextinguishable source of excuses for poorly performing managers to put off long-suffering shareholders (as one freshly minted MBA pontificated, "the stakeholder model aggravates the principal-agent problem at the heart of corporate capitalism— it gives agents too much wiggle room to evade their responsibility to promote the principal's interest")."

various stakeholders, such as employees, customers, etc.”⁹⁸ Four English-speaking countries ranked highest in endorsing profit-only goal (i.e., shareholder value) among the twelve countries represented in this study, with the United States ranking at the top of the list. In contrast, Germany, France, Singapore, and Japan ranked lowest.⁹⁹

Lilach Sagiv and Shalom Schwartz have reanalyzed data compiled by Hampden-Turner and Trompenaars on managers’ preferences about solving social dilemmas in organizations. Specifically, managers who “analyze phenomena into parts (i.e., items, tasks, numbers, units, points, specifics)” were differentiated from those who “integrate and configure such details into whole patterns, relationships and wider contexts.”¹⁰⁰ As hypothesized by Sagiv and Schwartz and in line with the above hypothesis on complexity, managers in nations with cultures that emphasize Harmony tended to choose the integrating option over the analyzing option for solving social dilemmas.

III. THE AMERICAN DEBATE REVISITED

The most puzzling feature of the stockholder-stakeholder debate is its longevity. American courts adjudicated the core issue—namely, the supremacy of shareholders’ interest in the corporation—during the 1910s. The scholarly debate between corporate law giants Adolf Berle and Merrick Dodd is often said to have been “settled” during the 1930s, arguably

⁹⁸ CHARLES HAMPDEN-TURNER & ALFONS TROMPENAARS, *THE SEVEN CULTURES OF CAPITALISM* 32 (1993). This question essentially replicates the famous “Friedman Doctrine” which stated that “the social responsibility of business is to increase its profits.” See below note 162 and accompanying text.

⁹⁹ Ranking in the middle were Italy, Sweden, the Netherlands, and Belgium. *Id.*, *id.* Unfortunately, a more recent version of this study does not report results for this question. See FONS TROMPENAARS AND CHARLES HAMPDEN-TURNER, *RIDING THE WAVES OF CULTURE: UNDERSTANDING THE CULTURAL DIVERSITY IN BUSINESS* (1997).

¹⁰⁰ Lilach Sagiv & Shalom H. Schwartz, *A New Look at National Culture: Illustrative Applications to Role Stress and Managerial Behavior*, in *HANDBOOK OF ORGANIZATIONAL CULTURE AND CLIMATE* 417 (Neal

in favor of Dodd's view. The discord over this issue resurfaced repeatedly, however, as scholars, courts and legislators continued to address it. At the beginning of the new century, exchanges between holders of the two views continue unabated, indeed with greater intensity than ever before.

This Part provides a new reading of the debate over the maximands of corporate governance. By critically reviewing the intellectual history of the central positions made in this debate, this Part will identify the issues over which there is wide consensus and, more importantly, which issues remain unresolved. This Part will then demonstrate how the theoretical framework put forward in Part II improves our understanding of this controversy. Following an analysis of the landmark decision in *Dodge v. Ford* in Section A, Section B derives new insights from the details of the Berle-Dodd dialogue. Sections C and D briefly review the (non)development of the stockholder-stakeholder debate from the 1950s through the 1990s. Section E takes a more theory-oriented perspective and reviews the development of analyses from traditional economic ones, to progressive views, to recent hierarchical models of the corporation. Section F connects the debate to the theoretical framework in the preceding Part.

A. *Dodge v. Ford*

In the summer of 1915, the board of directors of the Ford Motor Company approved a plan to expand the company's production capacity to 1,000,000 cars annually. The plan also called for a reduction in the price per Model T car from \$440 to \$360 although the market apparently could sustain the higher price even if for a lower volume. It was further decided

M. Ashkanasy, Celeste P.M. Wilderom, & Mark F. Peterson Eds. 2000) (referring to HAMPDEN-TURNER &

not to distribute as dividends rather huge funds that the company had earned and to invest them back in the business.¹⁰¹ Mr. Henry Ford, the founder, controlling shareholder, and dominant figure in the company, declared that his ambition was “to spread the benefits of this industrial system to the greatest possible number, to help [people] build up their lives and homes.”¹⁰² In 1919, the Supreme Court of Michigan, in a suit brought by the Dodge brothers as minority shareholders, clarified that it had “no doubt that certain sentiments, philanthropic and altruistic, credible to Mr. Ford, had large influence in determining the policy to be pursued by the Ford Motor Company...”¹⁰³

The *Dodge* court was not impressed by these sentiments, however. In what has become a definitive exposition of shareholders’ status in the corporation for years to come the court said:

“A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself, to the reduction of profits or to the nondistribution of profits among stockholders in order to devote them to other purposes.”¹⁰⁴

TROMPENAARS, *supra* note 98, at 10-11).

¹⁰¹ *Dodge v. Ford Motor Co.* 170 N.W. 668, 683 (Mich. 1919) (hereinafter *Dodge*).

¹⁰² *Id.*, *id.*

¹⁰³ *Id.*, at 684.

¹⁰⁴ *Dodge*, *supra* note 101, at 684. The court held that it was the directors’ duty to distribute a very large sum of money to stockholders. It therefore affirmed the lower court’s decree to fix and determine a specific amount to be distributed to stockholders. *Id.*, at 685. The company had to pay about \$19 million in dividends. In response to the court decision Mr. Ford bought out the holdings of all minority shareholders, including the Dodges. For further historical details about the early years of the Ford Motor Company and Henry Ford’s problematic personality, see *Henry Ford And The Model T* in DANIEL GROSS, FORBES® GREATEST BUSINESS STORIES OF ALL TIME (1996), also available on-line at <http://www.wiley.com/legacy/products/subject/business/forbes/ford.html>.

The proposition, that shareholders are the primary beneficiaries of the corporation and that, hence, fiduciary duties run to them, in conjunction with the corporation, is now widely accepted. This proposition is traditionally interpreted as calling on corporate fiduciaries to maximize shareholder value.¹⁰⁵ It is often referred to by shorthand as the “shareholder primacy norm” or the “shareholder wealth maximization norm.” While being widely cited and compelling in its rhetoric, the ruling in *Dodge* only marks the beginning of the discussion. It does not reflect current legal doctrines in the U.S. nor does it fully comport with subsequent theoretical analyses.

Strictly speaking, in terms of the black-letter law concerning the maximands of corporate governance, only a few courts have read *Dodge* as saying what countless law review articles have cited it as saying. In Delaware, both the Supreme Court and the Court of Chancery cited this case as demonstrating a possible relief to minority shareholders who are oppressed by the controlling shareholder or management through withholding of dividends.¹⁰⁶ The courts of Michigan, where *Dodge* originated, also consider *Dodge* a

¹⁰⁵ See, e.g., Michael P. Dooley, FUNDAMENTALS OF CORPORATION LAW 97 (1995) (Corporate law scholars “generally agree... that management's principal fiduciary duty is to maximize the return to the common shareholders....”); D. Gordon Smith, *The Shareholder Primacy Norm*, 32 IOWA J. CORP. L. 277, 278 (1998) (“Corporate directors have a fiduciary duty to make decisions that are in the best interests of the shareholders.”)

¹⁰⁶ See *Hall v. John S. Isaacs & Sons Farms, Inc.*, 163 A.2d 288, 295 (Del. 1960) (Delaware Supreme Court; citing *Dodge* for the proposition that “[i]f the plaintiffs are able to establish as the fact that money is available in the corporations which should be paid out in dividends, and that the management willfully refuses to do so in order to freeze out the minority interest, then upon such a showing the extraordinary relief of a direction to management to declare and pay a dividend might become available to them.”); *Blackwell v. Nixon*, 1991 Del. Ch. LEXIS 150 (“[I]f this were merely a dividend case, they would have to establish that the directors set dividends at an amount so low as to be oppressive, a gross abuse of discretion, or the product of bad faith. Few, if any, cases have involved a set of facts egregious enough to meet that standard. Cf. [*Dodge*]”).

standard case of management discretion.¹⁰⁷ One Michigan court in fact noted that *Dodge* was *not* a case of action against shareholders' interests.¹⁰⁸

Doubtless, reading *Dodge* as a minority rights case would be correct. In a thorough discussion of *Dodge*, D. Gordon Smith maintains that this is how the case should be understood.¹⁰⁹ Smith correctly notes that the *Dodge* court emphasized Henry Ford's position as a controlling stockholder in the sentence immediately preceding its statement of the shareholder primacy norm.¹¹⁰ Yet such reading clearly would also be partial – obscuring more than revealing. If *Dodge* had been merely a case of majority-minority relationships in the corporation it would not have gained the pride of place it has among the seminal authorities on U.S. corporate law.¹¹¹

The strength of the ruling in *Dodge* and the explanation for its longevity both lie in its being paradigmatic of *bona fide* conflicts of interest among several corporate constituencies. There have been a number of more recent episodes in which interests of non-shareholder

¹⁰⁷ See *Lytle v. Malady*, 566 N.W.2d 582, 593 (Mich. 1997) (citing *Dodge* for the proposition that courts should be reluctant to second-guess management in its day-to-day operations, e.g., with regard to payment of dividends).

¹⁰⁸ See *Miller v. Magline, Inc.*, 256 N.W.2d 761, 772 (Mich. 1977) (“Moreover, in the *Dodge* case the Court assumed that the expansion policy was in the best interest of the company and its shareholders, but concluded that it did not justify a withholding of dividends.”)

¹⁰⁹ D. Gordon Smith, *The Shareholder Primacy Norm*, 23 IOWA J. CORP. L. 277, 279 (1998) (“the shareholder primacy norm was first used by courts to resolve disputes among majority and minority shareholders in closely held corporations. Over time this use of the shareholder primacy norm has evolved into the modern doctrine of minority oppression. This application of the shareholder primacy norm seems incongruous today because minority oppression cases involve conflicts among shareholders, not conflicts between shareholders and nonshareholders.”)

¹¹⁰ *Id.*, at 319.

¹¹¹ It should be noted that in order to be considered a “seminal authority on U.S. corporate law”, as I claim that *Dodge* is, a case need not be uncontroversial nor does it have to reflect common legal practice. Quite the contrary. To become a seminal precedent a case has to address a core problem in a systematic way while being coherent with the general legal body to which it belongs. Prominent examples include the decisions in

constituencies were invoked, e.g., with regard to anti-takeover statutes and court rulings on anti-takeover defense tactics.¹¹² Yet none of these contexts exhibits the type of dilemma that *Dodge* poses with comparable clarity. In the former cases there often exists an overriding concern about insiders' self-interest – a lingering suspicion that stakeholders only serve as a pretext or camouflage for incumbent managements that want to entrench themselves to the detriment of public shareholders. *Dodge*, in contrast, is free of this concern. The court believed that Henry Ford, in his capacity as the company's dominant decision maker, was genuinely motivated by a desire to distribute the fruits of the company's success to non-shareholder constituencies.

B. The Berle-Dodd Dialogue

Dodge was a legal reflection of its political and economic era. Within a decade, America would slump into the Great Depression. The level of new car sales that was reached in the 1920s would be regained only in the late 1950s, after the New Deal and the Second World War. In the meanwhile, a seminal scholarly exchange had unfolded between two law professors, Adolf A. Berle of Columbia Law School and E. Merrick Dodd of Harvard Law School. Like the court's statements in *Dodge*, the positions that were articulated in this dialogue remain definitive and continue to dominate current discussions. Understanding the original positions in this exchange is key to understanding contemporary positions as well. The following paragraphs therefore revisit Berle and Dodd with a view to identifying the historical intellectual roots of the maximands of corporate governance.

Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (directors' duty of care) and Perlmann v. Feldman, 219 F.2d 173 (1955) (sharing of control premium upon sale of control).

¹¹² For a discussion, *see* below Section II.D.

Berle fired the opening shot in a 1931 article titled *Corporate Powers as Powers in Trust*.¹¹³ “It is the thesis of this essay,” Berle stated, “that all powers granted to a corporation or to the management of a corporation... are necessarily and at all times exercisable only for the ratable benefit of all the shareholders as their interest appears.”¹¹⁴ At first blush, Berle’s claim reads like a restatement of *Dodge*. Yet it isn’t. Noting that “through the very nature of the corporate entity, responsibility goes with power,”¹¹⁵ Berle conducted a survey of powers granted under contemporary law either to corporations or to corporate officers and showed that all of them are governed by equitable fiduciary duties akin to those that are owed by trustees toward a *cestui que trust*.

The central insight and the recurring theme in Berle’s article pertain to the content and legal nature of the fiduciary duties – not to the identity of the beneficiaries thereof (i.e., the accountees in the accountability relationship). To be sure, Berle did cite *Dodge*. But this decision is brought as supporting authority only to the proposition that the “power to declare or withhold dividends must be so used as to tend to the benefit not only of the corporation as a whole but also of all of its shareholders to the extent that this is possible.”¹¹⁶ In other words, the issue at bar was the relationship between majority and minority shareholders rather than between shareholders and other constituencies as competing accountees.¹¹⁷

¹¹³ Adolf A. Berle, Jr., *Corporate Powers as Powers in Trust* 44 HARV. L. REV. 1049 (1931) (hereinafter *Powers in Trust*).

¹¹⁴ *Id.*, at 1049.

¹¹⁵ *Id.*, at 1050.

¹¹⁶ *Id.*, at 1060.

¹¹⁷ When Berle mentions the “general good of the community”, *id.*, at 1961, he does so to indicate Henry Ford’s personal whims as a controlling shareholder. In a similar vein, Berle, *id.*, *id.*, cites *Channon v. Channon Co.*, 218 Ill. App. 397 (1920) as an example of a case where a majority shareholder was directed to

It was actually Dodd who defined the debate over the maximands of corporate governance as we know it. In his 1932 article *For Whom Are Corporate Managers Trustees?*,¹¹⁸ Dodd turned the limelight on the beneficiaries of managers' duties and away from the legal nature of these duties, agreeing with Berle on the latter issue, namely, that the trusteeship principle should apply to such duties.¹¹⁹ Citing *Dodge*, Dodd acknowledged that legal doctrine of his time considered the sole function of the corporation to be the making of profit for its stockholders such that they are the beneficiaries of the business and the people who carry it on.¹²⁰ Dodd nevertheless believed that this situation was undesirable. Writing in the midst of great economic and social upheaval in America, Dodd appears to have been deeply moved by the Depression and the budding New Deal.¹²¹ In the reformed economy, he prophesied, there would be "modifications of the maximum-profit-for-the-stockholders-of-the-individual-company formula."¹²²

A close reading of Dodd makes it abundantly clear that his prediction, that managers will come to consider the interests of employees, consumers, and the general public in addition to stockholder's interests, was never more than wishful thinking. Support for Dodd's belief that the American society was heading in this direction is found in opinions made by a

declare dividends after he, as the father of the family, withheld them because he thought that other shareholders who were members of the family needed discipline.

¹¹⁸ E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932).

¹¹⁹ Dodd writes: "The present author is thoroughly in sympathy with Mr. Berle's efforts to establish a legal control which will more effectively prevent corporate managers for diverting profit into their own pockets from those of stockholders, and agrees with many of the specific rules which latter deduces from his trusteeship principle." *Id.*, at 1147.

¹²⁰ *Id.*, at 1146. However, Dodd stresses that neither the language of the opinion nor the relief granted necessarily involves an unqualified acceptance of the maximum-profit-for-stockholders formula. *Id.*, at 1158n31.

¹²¹ Dodd makes references to "the present time," "recent economic events," "contemporary discussion of the need for planned economic order," and so forth. *See*, respectively, *id.*, at 1148, 1151, 1152.

few prominent figures in the business community of the time.¹²³ Dodd interpreted these sporadic statements as harbingers of an emerging, more general trend in American society toward greater concern for non-stockholder constituencies.

Yet beside Dodd's unmistakable enthusiasm about these statements, he was quite inconsistent as to *why* such trend would likely succeed. Dodd cites the view that taking employees and consumers into account will increase stockholders' long-run profits (namely, efficiency concerns); but he also asserts that managers who have power over the lives of others will "come to feel as strong a community of interest with their fellow workers as with a group of investors" (namely, ethical concerns).¹²⁴ At bottom, the justification for taking other constituencies into account depends on the recognition of corporations as public entities, rather than private property of their stockholders. At the same time, such recognition is a necessary condition for including other constituencies in managers' considerations.

Just as Dodd never challenged Berle's original argument, so did Berle, in his response to Dodd's article,¹²⁵ not really dispute the latter's theoretical position.¹²⁶ Nevertheless, Berle literally lashed out at Dodd for making a fallacious move from the normative to the descriptive. Desirable as it may be as a matter of theory, social responsibility was not in fact pursued by corporations and corporate insiders. Nor could it be pursued. This implementation

¹²² *Id.*, at 1151.

¹²³ Dodd cites extensively from an address by Owen D. Young, an executive officer of the General Electric Company (GE) and formerly a practicing lawyer, from GE's President Swope, and from Dean Donham of the Harvard Graduate School of Business Administration. *Id.*, at 1154-56.

¹²⁴ *Id.*, at 1156-57.

¹²⁵ Adolf A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932) (hereinafter *Note*).

problem, Berle believed, is insurmountable, as there is no mechanism that could enforce social responsibility on corporations.¹²⁷

The conclusion, averred Berle, is grim but inevitable:

“Now I submit that you can not [sic] abandon emphasis on ‘the view that business corporations exist for the sole purpose of making profits for their shareholders’ until such time as are to be prepared to offer a clear and reasonably enforceable scheme of responsibilities to someone else.”¹²⁸

When Berle was exchanging with Dodd, he was already engulfed in his collaborative study with Gardiner Means that would yield their seminal book *The Modern Corporation and Private Property*.¹²⁹ In this book, Berle and Means empirically documented the actual separation between American shareholders’ ownership of corporate stocks on the one hand and control over Corporate America on the other hand. The result was effective control residing in the hands of managers, who used it to benefit themselves and controlling shareholders. Berle and Means called for conceiving corporations as public again. They wrote that “by surrendering control and responsibility over the active property, [shareholders] have surrendered the right that the corporation be operated in their sole interest. . . . They have

¹²⁶ *Id.*, at 1366 (“As a matter of economics and social theory, Professor Dodd’s argument is not only sound but familiar”).

¹²⁷ *Id.*, *id.* (“This is the real justification for Professor Dodd’s argument. But it is theory, not practice. The industrial “control” does *not* now think of himself as a prince; he does *not* now assume responsibilities to the community; his bankers do *not* now undertake to recognize social claims; his lawyers do *not* advise him in terms of social responsibility. Nor is there any mechanism now in sight enforcing accomplishments of [Dodd’s] theoretical function.”)

¹²⁸ *Id.*, at 1367.

¹²⁹ ADOLPH A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (rev. ed. 1932).

placed the community in a position to demand that the modern corporation serve not alone the owners or the control but all society.”¹³⁰

Berle and Means’ position looks strikingly similar to Dodd’s position, which Berle so forcefully criticized in his note of the same year. Several commentators have thus been puzzled by Berle’s position. William Bratton, in an appraisal of *The Modern Corporation and Private Property* at the turn of the millenium, points out this apparent inconsistency and writes that “Berle appears to have been of two minds on the matter.”¹³¹ Several decades earlier, Joseph Weiner also argued that Berle was offering contradictory resolutions of the corporate governance problem and was in fact changing positions on managerial accountability to shareholders or community.¹³²

Although Bratton is willing to forgive Berle for this inconsistency,¹³³ I would argue that no such forgiveness is called for, as there is no incoherence in Berle’s writings.¹³⁴ In writing his note on Dodd and his book with Means, Berle was fully aware of the need to protect both stockholders and stakeholders from those in positions of power over their interests – the constituency that Berle and Means dubbed “control.” The bulk of Berle and

¹³⁰ BERLE & MEANS, *supra* note 129 at 355-56.

¹³¹ William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 IOWA J. CORP. L. 737, 761 (2001).

¹³² Joseph L. Weiner, *The Berle-Dodd Dialogue on the Concept of the Corporation*, 64 COLUM. L. REV. 1458 (1964); see also Wilber G. Katz, *Responsibility and the Modern Corporation*, 3 J. L. & ECON. 75 (1960).

¹³³ Bratton, *supra* note 131, at 761-762 (“Berle also can be forgiven this inconsistency. His indecision reflects the ambivalence displayed in corporate law commentary ever since. The public-regarding approach persists as a minority view. Each generation raises anew the same questions about corporate accountability because corporations continue to bear importantly on our social and political lives, and external regulation can never bring corporate results and perceived social goals into congruence. At the same time, no advocate of enhanced responsibility has ever successfully confronted and disposed of the counterargument Berle made in the debate with Dodd.”) (footnotes omitted).

Means' opus is dedicated to a positive analysis of the separation between ownership and control in American corporations. Their normative analysis is mostly confined to a small number of pages in the closing chapter.¹³⁵ More than seventy years after its publication, this chapter's policy analysis remains as fresh and compelling as ever.

Having established the factual separation of ownership from control and the concomitant concentration of power in the hands of "control," Berle and Means set out to outline different ways in which this power could be regulated in capitalist countries in the future.¹³⁶ Two possible ways are the more traditional ones: The first way is to provide legal protection to public shareholders through the trusteeship model.¹³⁷ The second way is to give the groups in control powers which are absolute and not limited by any implied obligation with respect to their use.¹³⁸ Of these two alternatives, the former is said to be the lesser of two evils.¹³⁹ Berle and Means did not stop there, however. They point out a third possibility – the one cited above, under which the "control groups have, rather, cleared the way for the claims of a groups far wider than either the owners or the control," to wit, all society.¹⁴⁰ Should this "third way" be implemented, Berle and Means claimed, in contrast to the ruling

¹³⁴ As a technical matter, one may note that *The Modern Corporation and Private Property* is repeatedly cited in Berle's article. See Berle, *Note*, *supra* note 125, at 1366n4, 1367n7, 1369n9.

¹³⁵ BERLE & MEANS, *supra* note 129 at 352-57. The very limited scope dedicated to normative analysis may be explained by the fact that the writing of *The Modern Corporation and Private Property* was commissioned and financed by grant from the Social Science Research Council of America. For a historiography of this project, see Bratton, *supra* note 131.

¹³⁶ BERLE & MEANS, *supra* note 129 at 353-54 ("How will this demand [for regulation of power in corporations] be made effective? To answer this question would be to foresee the history of the next century.")

¹³⁷ *Id.*, at 354. This strategy is described in more detail in an earlier chapter titled *Corporate Powers as Powers in Trust*, *id.*, at 247-276, which draws on Berle's article of the same title. Berle, *Powers in Trust*, *supra* note 113.

¹³⁸ BERLE & MEANS, *supra* note 129, at 354.

¹³⁹ *Id.*, at 355.

in *Dodge*, courts would approve of managerial programs that benefited employees and communities at the expense of shareholders and bondholders.¹⁴¹

In contrast with *Dodd*, however, Berle (writing both alone and with Means) was fully aware that such a social arrangement would entail formidable implementation problems. Berle and Means do not hide their preference for this “third way.” Yet they are very careful to note that it would require specifying the claims of the community “with clarity and force.” Only “[w]hen a convincing system of community obligations is worked out and is generally accepted, the passive property rights of today must yield before the larger interests of society.”¹⁴² Until such system is devised, and since effective legal protection of all stakeholders is infeasible (at least at the time) the law should concentrate on protecting stockholders through the accountability mechanism of trusteeship.¹⁴³ The interests of non-stockholder constituencies may receive protection through other means.¹⁴⁴

¹⁴⁰ *Id.*, at 355-56.

¹⁴¹ BERLE & MEANS, *supra* note 129 at 355 (“Should the corporate leaders, for example, set forth a program comprising fair wages, security to employees, reasonable service to their public, and stabilization of business, all of which would divert a portion of the profits from the owners of passive property, and should the community generally accept such a scheme as a logical and human solution of industrial difficulties, the interests of passive property owners would have to give way. Courts would almost of necessity be forced to recognize the result, justifying it by whatever of the many legal theories they might choose.”)

¹⁴² *Id.*, at 356.

¹⁴³ *See id.*, *id.* (“Choice between strengthening the rights of passive property owners, or leaving a set of uncurbed powers in the hands of control therefore resolves itself into a purely realistic evaluation of different results. We might elect the relative certainty and safety of a trust relationship in favor of a particular group within the corporation, accompanied by a possible diminution of enterprise. Or, we may grant the controlling group free rein, with the corresponding danger of a corporate oligarchy coupled with the probability of an era of corporate plundering.”); Berle, *supra* note 125, at 1371-72 (“The shareholder who now has a primary property over residual income after expenses are met, may ultimately be conceived as having an equal participation with a number of other claimants...But it is one thing to say that the law must allow for such developments. It is quite another to grant uncontrolled power to corporate managers in the hope that they will produce that development... Meanwhile, as lawyers, we had best be protecting the interests we know, being no less swift to provide for the new interests as they successively appear.”)

¹⁴⁴ Increased government regulation could serve such purpose. Whether regulation can be relied on to deliver effective protection to stakeholders is beyond the scope of this study. *See* Amir N. Licht, *International*

The dialogue between Berle and Dodd largely subsided after 1932 but did not fully end. In a review of *The Modern Corporation and Private Property*, Dodd conceded that regulation of management conduct would require strong legal measures.¹⁴⁵ However, in another lesser-known article,¹⁴⁶ Dodd seems to have tried to deflect Berle's arguments using reasoning somewhat similar to Berle's. Dodd too noted that the major problem for social regulation of corporate managements had to do with implementation. Legal enforcement alone, he argued, cannot ensure managements' loyalty to stockholders if the legal rules are not in congruence with their professional ethics and, more generally, with socially-approved goals.¹⁴⁷ In this respect, advancing the interests of employees, consumers, and the general community appeared to Dodd to be "less abnormal" than shareholder value maximization.¹⁴⁸ Dodd, however, failed to furnish any new evidence that could support his belief, that trusteeship for absentee investors "is an ideal that is losing ground in the community generally."¹⁴⁹

Diversity in Securities Regulation: Roadblocks on the Way to Convergence, 20 CARDOZO L. REV. 227, 159 (1998) (arguing that the Securities Acts of 1933 and 1934 defused the debate over the nature of the corporation as a public or private entity). Whatever position one may hold about the role of regulation, it cannot affect the insight that establishing legal fiduciary duties to several constituencies faces serious implementation problems.

¹⁴⁵ E. Merrick Dodd, *The Modern Corporation and Private Property*, 81 U. PA. L. REV. 782, 785 (1933) ("If corporations generally are to be conducted in such manner as to give due regard to the interests of all classes in society, including wage earners and consumers as well as investors and management, it is primarily through legislation that the change can be brought about.")

¹⁴⁶ E. Merrick Dodd, *Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?*, 2 U. CHI. L. REV. 194 (1934).

¹⁴⁷ *Id.*, at 199, 202 ("the endeavor to write that ideal [of stockholder profit maximization] into law [gives] much reason to fear that the law will have to depend for its effectiveness primarily upon external compulsion rather than upon the internal harmony between the legal rules and the natural impulses of the group which is expected to govern its conduct thereby.") Dodd may thus be considered an early precursor of the social norms scholarship on corporate governance. *See, generally*, Symposium, *Norms and Corporate Law*, 149 U. PA. L. REV. (2001).

¹⁴⁸ *Id.*, at 203 ("Service to one's fellow workers, to those who have need of one's products, or the social and political community of which one is a member would seem a less abnormal aim than vicarious profit-seeking.")

¹⁴⁹ *Id.*, at 207. Dodd, *id.*, at 206, only repeats the references made in Dodd, *supra* note 118.

Oddly, twenty years after their dialogue unfolded, Berle stated that events had settled the argument in Dodd's favor.

“Twenty years ago, the writer had a controversy with the late Professor E. Merrick Dodd, of Harvard Law School, the writer holding that corporate powers were powers in trust for shareholders while Professor Dodd argued that these powers were held in trust for the entire community. The argument has been settled (at least for the time being) squarely in favor of Professor Dodd's contention.”¹⁵⁰

The immediate reason that led Berle to concede defeat was the ruling in *A.P. Smith Manufacturing Co. v. Barlow*,¹⁵¹ in which a corporate donation to Princeton University was upheld. However, Berle later clarified that he did not intend to indicate that Dodd was “right all along.”¹⁵² Bearing in mind that the *Barlow* court cited long-term business interests among the justifications for the donation to Princeton¹⁵³—a consideration that is fully in line with shareholders' interest—it would seem that Berle was too modest. Berle's late writings from the 1950s reflect a conviction that corporations should, as a normative matter, be engaged in

¹⁵⁰ ADOLF A. BERLE, *THE 20TH CENTURY CAPITALIST REVOLUTION* 169 (1954), cited in A.A. Sommer, Jr., *Whom Should the Corporation Serve? The Berle-Dodd Debate Revisited Sixty Years Later*, 16 DEL. J. CORP. L. 33, 37n14 (1991); see also Adolf A. Berle, Jr., *Corporate Decision-Making and Social Control*, 24 BUS. LAW. 149, 150 (1968) (“Pragmatically, Professor Dodd won the debate. I was not convinced as a matter of doctrine that social responsibility should not be left to government but there was no doubt that the event conformed rather to his prediction than to mine.”)

¹⁵¹ 98 A.2d 581 (N.J. 1953).

¹⁵² Adolf A. Berle, Jr., *Foreword* to *THE CORPORATION IN MODERN SOCIETY* xii (E. Mason ed. 1959), cited in Sommer, *supra* note 150, *id.* (“It is one thing to agree that this is how social fact and judicial decisions turned out. It is another to admit this was the 'right' disposition; I am not convinced it was.”)

¹⁵³ 98 A.2d at 590 (“[the donation] was voluntarily made in the reasonable belief that it would aid the public welfare and advance the interests of the plaintiff as a private corporation and as part of the community in which it operates.”)

promoting the interests of multiple constituencies.¹⁵⁴ At the same time—much like Dodd of the 1930s—Berle provided no practical details as to how exactly managers could bring about this utopian vision. Perhaps he never believed they could.¹⁵⁵

Be it as it may, by the mid-1930s, legal doctrine and scholarship in the United States had developed a sophisticated account of the issues pertaining to the maximands of corporate governance. The most important achievement of these analyses is their pointing out the core problem, which is the absence of a coherent system with which the competing interests of corporate constituencies could be furthered—or at least reconciled—by corporate agents. This problem continues to haunt corporate governance analysis to this day.

C. From the 1950s to the 1970s

The period from the 1950 through the 1970s witnessed America undergoing several cycles of renewed interest in corporate social responsibility—the term that was coined to express promotion of interests of non-shareholder constituencies. These episodes are of lesser import for the purposes of the present study.¹⁵⁶ After World War II and the Korean War, the United States was the single, unchallenged economic superpower in the world. Large American corporations were without equal foreign competitors in many markets. This sheer economic power—concentrated more than ever before in a small number of giant corporations—has drawn the attention of American commentators. During the 1950s,

¹⁵⁴ BERLE, *supra* note 150, at 56 (“the modern American corporation understands well enough that it has a ‘constituency’ to deal with. If its constituents—notably its buyers—are unsatisfied, they will go to the political state for solution.”)

¹⁵⁵ Tellingly, Berle titled the fifth chapter of his joint book, *supra* note 150, *Corporate Capitalism and the City of God*.

journalists, academics, and other critics (including Berle) were musing on the ways to harness corporate power to socially desirable goals.¹⁵⁷ Contemporary contributors identified the corporation as a problem, yet were unable to propose specific mechanisms to curb its power or direct it in socially beneficial directions.¹⁵⁸ A critical voice came from Yale Law School Dean Eugene V. Rostow. In what reads like an early version of Jensen's argument brought in the beginning of this article, Rostow said:

“The economist has demonstrated with all the apparent precision of plane geometry and the calculus that the quest for maximum revenue in a competitive market leads to a system of prices, and an allocation of resources and rewards, superior to any alternative, in its contribution to the economic welfare of the community as a whole.”¹⁵⁹

The 1960s and 1970s brought new reasons for concern with corporate social responsibility. Attention was paid to a variety of social and political issues, at home and abroad, including the Vietnam War, civil rights and apartheid, consumer protection, and environmental issues. With giant corporations perceived as significant players in these issues (if not outright evil-doers), campaigns were consequently waged for shareholder proposal reform, public interest directors, and federal corporate chartering.¹⁶⁰ These campaigns mostly

¹⁵⁶ These episodes are described in detail in a recent, skillful account by C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-first Century*, 51 KAN. L. REV. 77 (2002), on which the following paragraphs draw.

¹⁵⁷ See Wells, *id.*, at 99-110.

¹⁵⁸ *Id.*, at 108.

¹⁵⁹ Eugene V. Rostow, *To Whom and for What Ends Is Corporate Management Responsible?*, in *THE CORPORATION IN MODERN SOCIETY* 63 (Edward S. Mason ed., 1961), cited in Wells, *id.*, at 109.

¹⁶⁰ Under a proposal advanced by Ralph Nader, Mark Green, and Joel Seligman in *RALPH NADER ET AL., TAMING THE GIANT CORPORATION* 125 (1976), the board would be composed entirely of outside “professional” directors, working full-time and provided with an independent staff to oversee the firm. Large corporations would be run by a board answerable simultaneously to shareholders, other constituencies, and the general public, with one director specially responsible for employee welfare, another for consumer protection,

failed or had a negligible lasting effect.¹⁶¹ Indeed, the most memorable voice from that period is probably Milton Friedman's in his article *The Social Responsibility of Business Is to Increase Its Profits*.¹⁶² In this article, Friedman argued against using corporate resources to promote social goals or moral values in ways not required by law or ethical custom.¹⁶³ Friedman remained silent about the content and scope of that "ethical custom" which would legitimate diversion of resources away from maximizing profits. Yet it is clear that such ethical considerations would be extremely narrow.¹⁶⁴

In terms of positive law too, little changed in the direction of eroding shareholder primacy. *Barlow* exemplifies a general trend of state legislators to allow corporations to make charitable contributions but did not seriously challenge shareholder primacy. The famous 1968 decision in *Shlensky v. Wrigley*,¹⁶⁵ upholding the directors' decision not to install lights in Wrigley Field despite the loss of potential profits, similarly noted that "the *long run*

another for community relations, and so on. As Wells pointedly notes, *id.*, at 122-23, how exactly a director was supposed to fulfill simultaneous legal responsibilities to shareholders, the general public, and another constituency as well was not made clear.

For additional calls in a similar spirit see, generally, ROBERT A. DAHL, *AFTER THE REVOLUTION? AUTHORITY IN A GOOD SOCIETY* (Rev. ed. 1990); CHRISTOPHER D. STONE, *WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR* (1975).

¹⁶¹ See Wells, *id.*, at 111-23.

¹⁶² Milton Friedman, *A Friedman Doctrine - The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, 6 (Magazine), at 32 (hereinafter *Social Responsibility*).

¹⁶³ *Id.*, at 33 ("[A] corporate executive.... has direct responsibility to his employers.... That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom."). See also MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* 133-36 (1962) (presenting similar views).

¹⁶⁴ According to Friedman, *Social Responsibility*, *supra* note 162, at 33, "social goals" that do *not* warrant departure from profit maximization include providing employment, eliminating discrimination, reducing pollution, preventing inflation, and fighting poverty.

¹⁶⁵ 237 N.E.2d 776 (Ill. 1968).

interests of the corporation in its property value at Wrigley Field might demand all efforts to keep the neighborhood from deteriorating.”¹⁶⁶

D. *Other-Constituency Statutes*

The controversy over the appropriate maximands of corporate governance erupted in earnest again during the 1980s. This was largely in consequence to the tidal wave of hostile takeovers and states’ response in the form of “other constituency statutes.” The title “other constituency statutes” subsumes a variety of state legislative measures intended to expand the scope of discretion of public corporations’ managements such that it would include the interests of non-shareholder constituencies.¹⁶⁷ These statutes have engendered numerous legal commentaries,¹⁶⁸ but, fortunately, this sizeable literature need not engage us here for too long.

¹⁶⁶ 237 N.E.2d 780 (emphasis added). *See also* Theodora Holding Corp. v. Henderson, 257 A.2d 398 (Del. Ch. 1969) (using corporate assets for charitable and other non-profit purposes should be in the best long-range interest of the corporation or the best long-range interest of the shareholders); for a contemporary review, *see* David S. Ruder, *Public Obligations of Private Corporations*, 114 U. PA. L. REV. 209 (1965). Later decisions reaching similar holdings include *Universal Leaf Tobacco Co. v. Congoleum Corp.*, 554 F.2d 1283 (4th Cir. 1977); *Herald Co. v. Seawall*, 472 F.2d 1081 (10th Cir. 1972); *Boyertown Burial Casket Co. v. Amedco*, 407 F. Supp. 811 (E.D. Pa. 1976); *Elco Corp. v. Microdot Inc.*, 360 F. Supp. 741 (D. Del. 1973); *Abramson v. Nytronics, Inc.*, 312 F. Supp. 519 (S.D.N.Y. 1970).

¹⁶⁷ *See* Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH L. REV. 14, 26-27 (1992).

¹⁶⁸ Scholarly treatments of other constituency statutes alone are too numerous to cover fully. For concentrated discussions of this issue in the general context of corporate stakeholders, *see* Symposium, *Defining the Corporate Constituency*, 59 U. CIN. L. REV. 319 (1990); Symposium, *Corporate Malaise – Stakeholder Statutes: Cause or Cure?*, 21 STETSON L. REV. 279 (1991) (hereinafter *Stetson Symposium*); Symposium, *The Corporate Stakeholder Debate: The Classical Theory and its Critics*, 43 U. TORONTO L.J. 297 (1993); Symposium, *New Directions in Corporate Law*, 50 WASH & LEE L. REV. 1373 (1993). A partial list of individual contributions that pay special attention to constituency statutes would include William J. Carney, *Does Defining Constituencies Matter?*, 59 U. CIN. L. REV. 385 (1990); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579 (1991); Marleen A. O’Connor, *Restructuring the Corporation’s Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C.L. REV. 1189 (1991); Morey W. McDaniel, *Stockholders and Stakeholders*, 21 STETSON L. REV. 121 (1991); Steven M.H. Wallman, *The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties*, 21 STETSON L. REV. 163 (1991); Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971 (1992); Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH L. REV. 14 (1992); Ronn S.

In the late 1970s and early 1980s, corporate charter amendments were adopted by a few corporations allowing directors, should their corporation become subject to a change of control, to consider the social and economic effects of the acquisition on the target's employees, suppliers, customers, and others.¹⁶⁹ The paradigmatic takeover that ostensibly dominated public perception at the time was the hostile "bust-up" takeover, in which the new controlling shareholder not only ousts the incumbent management but actually liquidates the firm's assets, fires most or all of its employees, and severely disrupts the way of life of small communities, especially in one-factory towns.¹⁷⁰

In 1983, Pennsylvania adopted the first other-constituency statute.¹⁷¹ This statute served as a model for several other states.¹⁷² Today, twenty-nine states have statutes that permit, or in one instance requires, the directors and officers of corporations chartered within their states to consider the interests of the standard other constituencies beyond the corporations' shareholders, at least in certain situations (particularly in connection with a

Davids, *Constituency Statutes: An Appropriate Vehicle for Addressing Transition Costs?*, 28 COLUM. J.L. & SOC. PROBS. 145 (1995); Lynda J. Oswald, *Shareholders v. Stakeholders: Evaluating Corporate Constituency Statutes Under the Takings Clause*, 24 IOWA J. CORP. L. 1 (1998).

¹⁶⁹ Orts, *supra* note 167, at 20.

¹⁷⁰ This public image was intensified with the development of a colorful jargon to describe takeover activity – a jargon that referred to raiders, white knights, poison pills, shark repellants, greenmail, etc. For a glimpse into that period's atmosphere, see, e.g., Anne B. Fisher, *Oops! My Company is on the Block*, FORTUNE, July 23, 1984, at p. 16; *Who Can Stop the Raiders of Corporate America?*, ECONOMIST, April 7, 1984, Vol. 291, at 77.

¹⁷¹ The statute provided that

In discharging the duties of their respective positions, the board of directors, committees of the board, individual directors and individual officers may, in considering the best interests of the corporation, consider the effects of any action upon employees, suppliers and customers of the corporation, communities in which offices or other establishments of the corporation are located, and all other pertinent factors.

Act of Dec. 23, 1983, No. 1983-92, § 1(B), 1983 Pa. Laws 395, cited in Orts, *supra* note 167, at 27.

¹⁷² Orts, *supra* note 167, at 27. For a list of states with other constituency statutes, see Wai Shun Wilson Leung, *The Inadequacy of Shareholder Primacy: A Proposed Corporate Regime that Recognizes Non-*

change of control).¹⁷³ Delaware never adopted a constituency statute of this type. The Delaware Supreme Court, in its 1985 decision in *Unocal Corp. v. Mesa Petroleum Co.*, nevertheless stated that in analyzing the effect of an imminent takeover on the “corporate enterprise”, the directors may consider its “impact on constituencies other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)...”¹⁷⁴ Courts in other jurisdictions followed suit and approved of considering the interests of other constituencies.¹⁷⁵ The courts did that while emphasizing that such consideration cannot be made unless benefits to shareholders can be identified, thus echoing earlier decisions mentioned above.¹⁷⁶ In summary, the other constituency statutes are generally interpreted as having made hardly any change in American corporate law.¹⁷⁷

Shareholder Interests, 30 COLUM. J.L. & SOC. PROBS. 587, 613, 620 (1997). For the relevant text of most of the statutes, see *Stetson Symposium*, *supra* note 168, at 279-93.

¹⁷³ See Lynda J. Oswald, *Shareholders v. Stakeholders: Evaluating Corporate Constituency Statutes Under the Takings Clause*, 24 IOWA J. CORP. L. 1, 4-6 (1998) (providing a survey of current statutes). The Connecticut statute applies in change-of-control situations, and provides that the directors “shall consider, in determining what he reasonably believes to be in the best interests of the corporation,... the interests of the corporation’s employees, customers, creditors, and suppliers,” as well as “community and societal considerations.” Conn. Gen. Stat. 33-756(d) (2003).

¹⁷⁴ *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985).

¹⁷⁵ See *GAF Corp. v. Union Carbide Corp.*, 624 F. Supp. 1016, 1019-20 (S.D.N.Y. 1985) (“protection of loyal employees, including managers, of the organization is not anathema... legitimate concerns for their past conduct of the enterprise and its requirements need not be left to the goodwill of an unfriendly acquirer of corporate control in the jungle warfare involving attempted takeovers”); *Amanda Acquisition Corp. v. Universal Foods Corp.*, 708 F. Supp. 984, 1009, 1015 (E.D. Wis. 1989), *aff’d*, 877 F.2d 496 (7th Cir. 1989) (same).

¹⁷⁶ See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (the “board may have regard for various constituencies in discharging its responsibilities, *provided that there are rationally related benefits accruing to the stockholders.*”); *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1282, 1285 (Del. 1989) (respectively, the board may consider “the impact of both the bid and the potential acquisition on other constituencies, provided that it bears some reasonable relationship to general shareholder interests.”; “an offer [can] be rebuffed, given...the alternatives available and their effect on the various constituencies, particularly the stockholders.”); see also E. Norman Veasey, *Should Corporation Law Inform Aspirations for Good Corporate Governance Practices - or Vice Versa?*, 149 U. PA. L. REV. 2179, 2184 (2001) (“Delaware’s jurisprudence holds that the interests of stockholders are primary and may not be trumped by that of other constituencies, although those interests may be considered if congruent with the interests of the stockholders.”).

¹⁷⁷ In 1990, the Committee on Corporate Laws of the Section of Business Law of the American Bar Association (“ALFABA”), as part of the preparation of the Revised Model Business Corporation Act (the

It has been noted that these statutes have received only cursory attention from the courts,¹⁷⁸ and have played a negligible part, if any, in litigation over directors' decisions.¹⁷⁹ The reason, I argue, is twofold. First, advancing the interests of non-shareholder constituencies probably never was the primary reason for the enactment of the other constituency statutes. These statutes should be assessed in light of their typical legislative history, according to which they were enacted in response to hostile takeovers and were lobbied for mostly by managements of potential target firms.¹⁸⁰ Seen in this light, these statutes belong to a larger arsenal of anti-takeover defenses that were developed and deployed to help incumbent managements entrench themselves.¹⁸¹ The legal technology for thwarting management-unfriendly takeovers has progressed since the mid-1980s such that today it relies on other means.¹⁸² Moreover, once the consideration of other constituencies' interest

"Model Act"), reviewed the other constituency statutes. The Committee has concluded that the Model Act should not be amended in light of these statutes. The Committee opined, however, that other constituency statutes may create "opportunities for misunderstanding and thus pose potential for mischief unless the courts carefully construe them consistently with existing law." See ABA Committee on Corporate Laws, *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253, 2254-55, 2257-61 (1990).

¹⁷⁸ See Orts, *supra* note 167, at 23-35 (analyzing court opinions); Oswald, *supra* note 173, at 7n37 (same).

¹⁷⁹ See Oswald, *supra* note 173, at 7 ("Judicial interpretation of the constituency statutes to date has been sparse and uninformative, invariably referring to the constituency statutes in only a fleeting and tangential manner. No court has yet provided an analysis of the legality or constitutionality of constituency statutes, or even an explanation of how they should be implemented in specific contexts.")

¹⁸⁰ Orts, *supra* note 167, at 24. For instance, the Pennsylvania statute was enacted at the behest of the state Chamber of Commerce at a time when two local companies, Scott Paper Company and Gulf Oil, were facing control battles. Orts, *id.* Orts notes, however, that a few statutes were also backed by labor unions – a fact that underscores their consistency with employees' interest. This point should distract one from the argument made in the text. The language of these statutes – in principle and perhaps also in practice – benefits employees. Yet the motivation for their enactment came from managements.

¹⁸¹ See Thomas W. Dunfee, *Challenges to Corporate Governance: Corporate Governance in a Market with Morality*, 62 LAW & CONTEMP. PROB. 129, 136 (1999) (arguing that this heritage of other constituency statutes taints their status as legitimizing a multi-stakeholder approach to corporate governance.)

¹⁸² A general discussion of anti-takeover techniques is beyond the scope of the present study. For a review and analysis, see, e.g., John C. Coates IV, *Explaining Variation in Takeover Defenses: Blame the Lawyers*, 89 CALIF. L. REV. 1301 (2001); see also Lucian Arye Bebchuk, John C. Coates IV, & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN.

was brought within the ambit of legitimate managerial discretion—namely, within the ambit of the business judgment rule—chances became slim that parties would litigate over such consideration, similar to other “just say no” anti-takeover defenses.¹⁸³

The second explanation for the low impact that the other constituency statutes have had on American corporate law brings us back to the subject of this paper. Beyond merely mentioning the interests of the regular constituencies—often with the reservation that they should be in line with long-term shareholder interests—these statutes did not provide much guidance as to *how* these apparently conflicting interests should be reconciled. When could employees’ interests take precedence over shareholders’ interests? Must the benefit accruing to employees be larger than the loss visited on shareholders? How should this calculus be done – per constituency, per capita, per relative investment? Stated otherwise, these statutes raised the very implementation problem that Berle was so keenly aware of – the problem that caused him to abandon his City-of-God principle¹⁸⁴ of managers’ trusteeship to multiple stakeholder for a second-best duty to shareholders. To use Berle and Means’ words, what was (and remains) lacking is a “convincing system of community obligations” that is framed

L. REV. 887 (2002); Lucian Arye Bebchuk, John C. Coates IV, & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Further Findings and a Reply to Symposium Participants*, 55 STAN. L. REV. 885 (2002).

¹⁸³ For a retrospective review of the take-over wave and anti-takeover defenses (particularly the poison pill), see Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 U. CHI. L. REV. 871, 873-88 (2002); see also Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973, 1021-26 (2002).

¹⁸⁴ See *supra* note 155.

“with clarity and force.”¹⁸⁵ Neither the courts nor academic commentators have succeeded in devising such a system.¹⁸⁶

E. Contemporary Analyses and Their Limits

The debate over other constituency statutes in the late 1980s and early 1990s also rekindled the more general discussion on the maximands of corporate governance and the appropriate beneficiaries of managers’ fiduciary duties. This Section maps these approaches and identifies their relative strengths and weaknesses.

1. Traditional Economic Analysis

The traditional law and economics approach to the maximands issue holds, simply, that the shareholder-value-maximization rule is (1) efficient and (2) workable. Respectively, a multiple-constituency rule is said to be inefficient and unworkable. This line of analysis is represented in its the purest form by Frank Easterbrook and Daniel Fischel’s 1991 book summarizing their work on corporate law.¹⁸⁷ In line with their general contractual view of the

¹⁸⁵ See *supra* text to note 142.

¹⁸⁶ The final version of the ALI’s Principles of Corporate Governance similarly reflects the vague rule that directors are allowed to consider the interests of non-shareholder constituencies. The general rule provides that “a corporation...should have as its objective the conduct of business activities with a view to enhancing corporate profit and shareholder gain.” AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(a) (1994). Nevertheless, corporations may pursue non-profit-enhancing objectives in three conditions: (1) such action is required for staying within the boundaries of the law; (2) such action is taken in light of ethical considerations appropriate to responsible conduct of business; (3) a reasonable amount of resources may be dedicated to charitable causes. *Id.* § 2.01(b). The Principles also include a rule covering the specific context of corporate behavior in the face of a hostile takeover bid, *id.*, at § 6.02, which reflects the case law described above. That these Principles are vague and leave ample room for reaching different decisions can hardly be denied. Section 2.01(b)(2) in particular imports into corporate decision-making processes a host of potential considerations that are *bound* to be controversial and subject to political inclinations.

¹⁸⁷ EASTERBROOK & FISCHEL, *supra* note 4.

corporation,¹⁸⁸ Easterbrook and Fischel also address the issue of the maximands of corporate governance. The pivotal element in this analysis is the notion of “residual claimant,” namely, the party (constituency) who is entitled to derive benefits from an enterprise only after all other claims have been satisfied. Easterbrook and Fischel equate this constituency with shareholders. Shareholders are the only constituency whose interest is risky and is determined *ex post factum*. All other constituencies—including creditors and employees—have fixed claims whose value is known in advance, at least in expectancy, or no (valid) claim at all.¹⁸⁹

Under this analysis, shareholder wealth maximization is the desirable rule because it takes advantage of the firm’s strength due to its tendency to maximize wealth in general. Easterbrook and Fischel set aside other social goals such as addressing pollution, bribery, and plant closing, for two reasons:

“One reason is obvious: a manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither... Agency costs rise and social wealth falls.

¹⁸⁸ The view of the corporation as a contractual arrangement—or a “nexus of contracts”—raises prickly questions that are beside the goal of this paper. The nexus metaphor is attributed to Michael C. Jensen & William H. Meckling, *Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976) and Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972). For a critical analysis, see Melvin A. Eisenberg, *The Conception that the Corporation is a Nexus of Contracts*, 24 IOWA J. CORP. L. 819 (1999); see also Jeffrey Nesteruk, *Persons, Property, and the Corporation*, 39 DEPAUL L. REV. 543 (1990); William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261 (1992).

¹⁸⁹ EASTERBROOK & FISCHEL, *supra* note 4, at 36 (“For most firms the expectation is that the residual risk bearers have contracted for a promise to maximize long-run profits of the firm, which in turn maximizes the value of their stock. Other participants contract for fixed payouts—monthly interest, salaries, pensions, severance payments, and the like... Risk bearers get a residual claim to profit; those who do not bear risk on the margin get fixed terms of trade.”)

Another reason is no less important but more often missed: maximizing profits for equity investors assists the other “constituencies” automatically... In a market economy each party to a transaction is better off.”¹⁹⁰

Thus, the justifications for determining shareholders’ interest as the single maximand of corporate governance are both theoretical and practical. The shareholder-wealth-maximization rule arguably increases social wealth and is therefore efficient in comparison to the alternative rule that decreases wealth. This is the traditional argument of the rising-tide-lifts-all-boats type—an alleged “win-win situation.”¹⁹¹ It explicitly ignores other social issues. Indeed, Easterbrook and Fischel deny that such issues have to do with corporate governance.¹⁹² Other scholars have joined Easterbrook and Fischel’s camp of those endorsing shareholder value as the proper maximand relying on a variety of arguments.¹⁹³ What is

¹⁹⁰ *Id.*, at 38.

¹⁹¹ For similar articulations of this argument see Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001) (“The utilitarian justification [for the shareholder wealth maximization norm] is that... in the long run, the argument goes, employees and other stakeholders are overall better off with fluid and efficient capital markets, managers need a simple metric to follow, and both wealth and, in the end, fairness are maximized by shareholders being the corporation’s residual beneficiary, with the other claimants getting what they want via contract with the corporation.”); Allen, *supra* note 188, at 269-70 (same).

¹⁹² *Id.*, at 39 (“To view pollution, or investment in South Africa, or other difficult moral and social questions as *governance* is to miss the point”) (emphasis in the original). Many commentators may object to this classification of issues as related or unrelated to corporate governance. Scholars from the progressive corporate law movement, mentioned in the text below, surely would make such objections. However, writers not identified with this group also include a broader set of issues in “corporate governance.” See, e.g., Dyck & Zingales, *supra* note 95 (discussing the role of the media in pressuring corporate managers and directors to behave in ways that are “socially acceptable”, mostly with regard to environmental issues, and sometimes not in line with shareholders’ value maximization.)

¹⁹³ See, e.g., Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923 (1984); Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23 (1991); Jonathan R. Macey & Geoffrey P. Miller, *Corporate Stakeholders: A Contractual Perspective*, 43 U. TORONTO L.J. 401 (1993); Stephen M. Bainbridge, *In Defense of Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423 (1993); Mark E. Van Der Weide, *Against Fiduciary Duties to Corporate Stakeholders*, 21 DEL. J. CORP. L. 27 (1996); Lynda J. Oswald, *Shareholders v. Stakeholders: Evaluating Corporate Constituency Statutes Under the Takings Clause*, 24 IOWA J. CORP. L. 1 (1998); Alan J. Meese, *The Team Production Theory Of Corporate Law: A Critical Assessment*, 43 WILLIAM & MARY L. REV. 1629 (2002).

common to this group is the assumption that shareholder primacy leads to efficient outcomes because it requires corporate decision makers to maximize the corporate residual claim and, consequently, the entire corporate pie and general social welfare.

The practical reason for preferring shareholder value as a unique maximand is that this is a workable rule, or, more accurately, that the alternative multiple-constituency rule would be unworkable. As economist Oliver Hart has put it, calling on management to take the interests of all constituencies into account “is essentially vacuous, because it allows management to justify almost any action on the grounds that it benefits some group.”¹⁹⁴

2. Incomplete Contracts and Power

The traditional economic analysis case for shareholder primacy as it is described above is susceptible to a number of criticisms. These criticisms challenge different aspects of the traditional case but on the whole they tend to undermine the claim that shareholder primacy is an efficient rule. The central critique of this claim attacks the pivotal distinction between fixed and residual claims on the corporation. Consider the corporation’s creditors. In theory, no claim on the firm can be more fixed than those stipulated in a loan agreement, a debenture, and the like. Courts have indeed underscored the fact, that bondholder protection is determined only by the language of the indenture. Bondholders were thus denied any further vague and open-ended protection under a duty of loyalty paradigm.¹⁹⁵ In light of this

¹⁹⁴ Oliver Hart, *An Economist's View of Fiduciary Duties*, 43 U. TORONTO. L.J. 299, 303 (1993).

¹⁹⁵ See *Simons v. Cogan* 542 A. 2d 785, 785-791 (1987) (hereinafter *Simons*); see also William B. Bratton, *The Economics and Jurisprudence of Convertible Bonds*, 1984 WISC. L. REV. 667, 668 (1984) (“Courts traditionally have directed bondholders to protect themselves against... self-interested issuer action with explicit contractual provisions. Holders of senior securities, such as bonds, are outside the legal model of the firm for protective purposes: a heavy black-letter line bars the extension of corporate fiduciary protections to them.”)

legal situation it is no wonder that the legal profession has perfected the art of indenture drafting and developed a comprehensive set of contractual covenants intended to protect creditors in various contingencies.¹⁹⁶

This seeming perfectness is misleading, however. Developments in the economic theory of contracts especially since the late 1980s have highlighted the problem of incomplete contracts.¹⁹⁷ In contrast to what some scholars and courts may have believed in the past, commercial relationships between corporations and their creditors can never be “exhaustively documented” in a contract.¹⁹⁸ The complete contingent contract—namely, the contract that defines the parties’ rights and entitlements in every future contingency—is impossible to achieve.

In reality, parties are unable to foresee all future states of the world such that surprises are bound to occur. Even if all future contingencies were foreseeable the cost of spelling them out, negotiating for an agreed outcome, and putting down the agreement in writing would be prohibitive. At times, a party may even wish to exploit an informational advantage it has over the other party if it would not be actionable in court and abstain from pointing out certain

¹⁹⁶ The *Simons* court, at 542 A. 2d 791, thus referred to the “highly negotiated and exhaustively documented commercial relationship between an issuer of convertible securities and the holders of such securities”. For a classic survey, see Clifford W. Smith & Jerold B. Warner, *On Financial Contracting: An Analysis of Bond Covenants* 17 J. FIN. ECON. 117 (1979).

¹⁹⁷ See, generally, OLIVER HART, *CONTRACTS AND FINANCIAL STRUCTURE* (1995); for further economic analyses, see Sharon Gifford, *Limited Attention and the Optimal Incompleteness of Contracts*, 15 J. L. ECON. & ORG. 468 (1999); Kathryn E. Spier, *Incomplete Contracts and Signaling*, 23 RAND J. ECON. 432 (1992); Jonathan Thomas & Tim Worrall, *Income Fluctuations and Asymmetric Information*, 51 J. ECON. THEORY 367 (1991); Douglas B. Bernheim & Michael Whinston, *Incomplete Contracts and Strategic Ambiguity*, 88 AM. ECON. REV. 432 (1998); Oliver Hart & John Moore, *Incomplete Contracts and Renegotiation*, 56 ECONOMETRICA 755 (1988); Oliver Hart, *Incomplete Contracts and the Theory of the Firm*, 4 J. L. ECON. & ORG. 119 (1988); Gur Huberman & Charles M. Kahn, *Limited Contract Enforcement and Strategic Renegotiation*, 78 AM. ECON. REV. 471 (1988).

¹⁹⁸ Cf. the court’s statement in *Simons*, *supra* note 196.

contingencies. Parties may fail to contract on certain contingencies if such contracting would be futile. Such will be the case when it is impossible or prohibitively costly to monitor the other party (the problem of unobservability); or, even when a breach could be detected, the injured party would be unable to prove it to a third party, e.g., a judge (the problem of unverifiability).

These aspects of incomplete contracts link the issue of corporate governance maximands to the agency problem. The myriad reasons for impossibility of complete contingent contracts suggest that in many cases, the rights and entitlements of the parties will be indeterminate. Situations in which one party (the agent) has the ability unilaterally to affect the interest of the other party (the principal) are likely to be ubiquitous. In these situations, the former has power over the latter.¹⁹⁹

Let us now return to the corporation's creditors. The logic behind the *Simons* doctrine, under which creditors are protected only by contractual covenants, holds when the firm is solvent and the parties can assess, and price, the likelihood of default. As the firm nears financial distress, shareholders—as the beneficiaries of corporate officers' fiduciary duties—have an interest that the firm will take excessive risk. Should the contingency of business

¹⁹⁹ The RESTATEMENT (SECOND) AGENCY, § 6 defines “power” as follows: “A power is an ability on the part of a person to produce a change in a given legal relation by doing or not doing a given act.” The Restatement definition comports with the Hohfeldian meaning of this term. In the 1910s, Wesley Hohfeld advanced an elegant diagrammatic model of dyadic relationships between legal statuses that included a dyadic relationship between power and liability. Wesley N. Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 23 YALE L.J. 16 (1913) (hereinafter Hohfeld 1913); Wesley N. Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 26 YALE L.J. 710 (1917). According to Hohfeld, “[the] person (or persons) whose volitional control is paramount may be said to have the (legal) power to affect the particular change of legal relations that is involved in the problem.” Hohfeld 1913, *id.*, at 44. Liability is simply a correlative concept of power, denoting the status of the other party as subject to the first party's power. Hohfeld later consolidated his model in WESLEY N. HOHFELD, *FUNDAMENTAL LEGAL CONCEPTIONS AS APPLIED IN JUDICIAL REASONING*, (W.W. Cook, ed. 1919; reprint 1964). For a general analysis of Hohfeld's framework, see ANDREW HALPIN, *RIGHTS AND LAW: ANALYSIS AND THEORY* (1997).

failure materialize the loss will be visited on the creditors; but shareholders will reap all the gains (net of financing costs) should the firm succeed. One can therefore say that in such cases, shareholders have power vis-à-vis creditors.

Acknowledging the nature of this relationship as one of power, the courts of Delaware voiced guarded willingness to recognize an exception to the *Simons* doctrine. In *Credit Lyonnais*,²⁰⁰ Chancellor Allen stated in an *obiter dictum* that when a corporation is in severe financial distress, corporate fiduciaries owe their fiduciary obligation to the “corporate enterprise” rather than to shareholders or any single constituency. “At least where a corporation is operating in the vicinity of insolvency, a board of directors is not merely the agent of the residue [sic] risk bearers, but owes its duty to the corporate enterprise.”²⁰¹ In a situation like this, management may need to harm shareholder value by accepting fire-sale prices for corporate assets.²⁰² This is because the “board or its executive committee [has] an obligation to the community of interest that sustained the corporation.”²⁰³

Credit Lyonnais and its progeny²⁰⁴ thus go explicitly against the traditional economic analysis injunction, that shareholder value, as it reflects the residual claim on the corporation,

²⁰⁰ *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, No. CIV.A.12150, 1991 WL 277613, at 34 (Del. Ch. Dec. 30, 1991); reprinted in William Allen, *Unreported Case: Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, 17 DEL. J. CORP. L. 1099 (1992).

²⁰¹ *Credit Lyonnais*, 1991 WL 277613 at 33.

²⁰² *Id.*

²⁰³ *Id.*

²⁰⁴ In a later decision Chancellor Allen clarified the ruling in *Credit Lyonnais* while repeating the reference to multiple constituencies. See *Equity-Linked Investors, L.P. v. Adams*, 705 A.2d 1040, 1042 n. 2 (Del. Ch. 1997) (“where foreseeable financial effects of a board decision may importantly fall upon creditors as well as holders of common stock, as where [the] corporation is in the vicinity of insolvency, an independent board may consider impacts upon all corporate constituencies in exercising its good faith business judgment for the benefit of the ‘corporation.’”); see also Official Comm. of Unsecured Creditors of Buckhead Am. Corp. v. Reliance Capital Group, Inc. (*in re: Buckhead Am. Corp.*) 178 B.R. 956, 968 (D. Del. 1994) (board of directors

should be the single appropriate maximand. When the indeterminacy of entitlements in the firm cannot be avoided, e.g., during severe financial distress, corporate decision makers²⁰⁵ are called to consider the interest of a nebulous “corporate enterprise” and give regard to its multiple constituencies.²⁰⁶

Like earlier calls for multiple-constituency fiduciary duties, the *Credit Lyonnais* doctrine is susceptible to the critique that it is unworkable as it immediately raises the implementation problem identified by Berle. Once the residual-claim yardstick is rejected, corporate decision makers are left with no clear beacon with which they can navigate corporate affairs. Echoing Easterbrook and Fischel, Victor Brudney thus criticizes this line of court rulings, because the current board structure makes “the same persons arbiters for conflicting interests with accountability to none.”²⁰⁷ Brudney indeed opines that “it is hard to

of corporations operating in vicinity of insolvency owes duty to corporate enterprise); *Miramar Resources, Inc. v. Schultz* (*In re Schultz*), 208 B.R. 723, 729 (Bankr. M.D. Fla. 1997) (same; applying the *Credit Lyonnais* decision).

²⁰⁵ One may note anecdotally that somewhat like the situation in *Dodge*, in *Credit Lyonnais* these decision makers included both the majority shareholder and the board of directors.

²⁰⁶ The “corporate enterprise” thus denotes something different, and arguably broader, than the firm itself as a legal personality. Readers should therefore not be misled by the fact that corporate fiduciaries are commonly said to owe their duties to the corporation. See, e.g., *Guth v. Loft, Inc.*, Del. Supr., 23 Del. Ch. 255, 5 A.2d 503, 510 (1939). The real issue is which maximand fiduciaries should choose in fulfilling their obligations toward the corporation.

²⁰⁷ Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C. L. REV 595, 645-46 (1997). Brudney, *id.*, thus proposes a reformed governance structure for properly considering the conflicting interests of all the constituencies involved:

“[I]t may be necessary and appropriate for the corporate decision-making body (the board and management) to reconcile the interests of the competing claims of stockholders and creditors (and other stakeholders) in maximizing the enterprise's value. If so, that body should by law (1) be so instructed, and furnished with appropriate criteria for decision, and (2) be constituted of appropriately weighted representatives of each class of claimants.”

Note the similarity between Brudney's requirement (1) and Berle's requirement for “a system of community obligations” that is framed “with clarity and force.”

see why directors should become [creditors'] fiduciaries, and it is impossible to see how directors can at one time be fiduciaries for both (or all) constituencies."²⁰⁸ ²⁰⁹

The conflict of interest between shareholders and creditors is only a specific case that exemplifies the multiple constituency problem. In fact, the constituencies of shareholders and creditors have more in common with one another than most other constituencies since both of them provide capital to the firm. As a result, the relationships between these constituencies are less likely to invoke more general political controversies. The foregoing discussion therefore provides a good example for the general problem.

²⁰⁸ *Id.*, at 645 n. 128.

²⁰⁹ The situation may change materially when the firm is no longer "in the vicinity of insolvency" but is actually insolvent, even if formal bankruptcy proceedings were not initiated. At that point, creditors legally are the residual claimholders such that fiduciary duties should run to them. *See, e.g.,* Federal Deposit Ins. Corp. v. Sea Pines Co., 692 F.2d 973, 976 (4th Cir. 1982); *Geyer v. Ingersoll Publications Co.*, 621 A.2d 784, 787-90 (Del. Ch. 1992) (acknowledging fiduciary duties to creditors); *Brandt v. Hicks, Muse & Co. (In re Healthco Int'l, Inc.)*, 208 B.R. 288, 300 (Bankr. D. Mass. 1997) (directors owe fiduciary duties to creditors when a transaction leaves the corporation insolvent or with unreasonably small capital); *Odyssey Partners v. Fleming Cos.*, 735 A.2d 386, 420 (Del. Ch. 1999) (the board of an insolvent corporation was under a duty to balance the effect of corporate action on "shareholders, creditors and other corporate constituencies").

Note, however, that even insolvent corporations, who are in bankruptcy proceedings, may face the problem of multiple constituencies. There, the amalgam of constituencies that constitutes the corporate enterprise under *Credit Lyonnais* is replaced with a similar amalgam, which is the estate. *See* LaSalle Nat'l Bank v. Perelman, 82 F. Supp. 2d 279, 292 (D. Del. 2000) (officers and directors of an insolvent corporation have a "fiduciary duty to act in the best interests of the estate as a whole, including its creditors, equity interest holders and other parties in interest"). For an analysis, *see* Lynn M. Lopucki, *The Nature of the Bankrupt Firm: A Reply to Baird and Rasmussen's 'The End of Bankruptcy'*, 56 STAN. L. REV. (forthcoming 2003) (arguing that no single class of residual owners exists in most bankrupt firms); Jesse M. Fried & Alon Chaver, *Managers' Fiduciary Duty Upon the Firm's Insolvency: Accounting for Performance Creditors*, 55 VAND. L. REV. 1813 (2002) (arguing that an insolvent firm is likely to have two types of creditors such the duty to maximize the value of only one category may be inefficient); Jonathan Lipson, *Directors' Duties to Creditors: Volition, Cognition, Exit and the Financially Distressed Corporation*, 50 UCLA L. REV. (forthcoming 2003) (arguing that fiduciary duties of distressed corporations should shift only toward relatively weaker creditors, who lack volition, cognition, and exit). For additional analyses of the relationships between shareholders and creditors as corporate constituencies, *see* Ann E. Conway Stilson, *Reexamining the Fiduciary Paradigm at Corporate Insolvency and Dissolution: Defining Directors' Duties to Creditors*, 20 DEL. J. CORP. L. 1 (1995); Laura Lin, *Shift of Fiduciary Duty Upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors*, 46 VAND. L. REV. 1485 (1993); Gregory V. Varallo & Jesse A. Finkelstein, *Fiduciary Obligations of Directors of the Financially Troubled Company*, 48 BUS. LAW. 239 (1992); Zipora Cohen, *Directors' Negligence Liability to Creditors: A Comparative and Critical View*, 26 IOWA J. CORP. L. 351 (2001).

Similar problems can be found between shareholders and other constituencies.²¹⁰

Employees in particular have been said to suffer from setting shareholder value as the unique corporate governance maximand. Many (though not all) employees make considerable investment in firm-specific human capital—namely, skills and knowledge that cannot easily be utilized if the worker moved to a different employer or were left without a job. Workers may not be fully compensated for this investment through their salaries or wages before some unforeseen contingency materializes that threatens their employment.²¹¹ In other words, employees are exposed to the power of corporate decision makers and, in consequence, to the power of shareholders.

3. The Progressive View

As noted above, American legislators and courts, primarily in the context of other constituency statutes,²¹² have opened the door for considering the interest of employees by corporate decision makers. Yet they provided no guidance as to how such consideration could be implemented. Similarly, legal scholars have called for recognizing fiduciary duties to corporate employees especially during financial distress.²¹³ Many of these calls are part of the

²¹⁰ Cf. Fried & Chaver, *supra* note 209, at 1817 n. 9 (“We assume that the only parties affected by managers' decisions upon a firm's insolvency are those holding financial and performance claims against the firm. To the extent that other parties - such as potential tort victims - are affected by managers' decisions, our approach would need to be modified to require managers to account for the interests of these other parties.”)

²¹¹ This view thus contrasts with the view of Easterbrook and Fischel and their followers, that employees are similar to other creditors in that they can assess the likelihood of their employer's failure (either directly or by relying on market prices) and can negotiate for a compensation for this expected loss.

²¹² See *supra* text to note 174 *et seq.*

²¹³ See Marleen A. O'Connor, *Restructuring the Corporation's Nexus of Contracts: Recognizing a Fiduciary Duty to Protect Displaced Workers*, 69 N.C. L. REV. 1189 (1991) (arguing that directors should owe employees a fiduciary duty to alleviate employee displacement caused by corporate restructuring); Katherine Van Wezel Stone, *Employees as Stakeholders Under State Nonshareholder Constituency Statutes*, 21 STETSON L. REV. 45 (1991) (advocating the creation of fiduciary duties on behalf of employees); see also Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. REV. 283 (1998); Joseph William Singer, *Jobs*

Progressive Corporate Law movement whose members advocate using and, to the extent necessary, also reforming corporate law in order to promote the interests of non-shareholder constituencies: employees, local communities, the environment.²¹⁴

The Progressive Corporate Law movement is ideologically associated with the communitarian movement headed by Amitai Etzioni and can roughly be characterized as of left-of-center persuasion.²¹⁵ The communitarian view argues for the ability to choose different rules for different situations in corporate law²¹⁶ and for discharging fiduciary duties toward various constituencies on a case-by-case, situation-specific basis.²¹⁷ That this would create uncertainty is readily admitted by these scholars and is actually seen as an advantage.²¹⁸ The progressive left-wing political characterization of this group contrasts advocates of multiple-constituency corporate governance with some prominent advocates of adhering to shareholder value as a unique maximand, who self-label as political

and Justice: Rethinking the Stakeholder Debate, 43 U. TORONTO L.J. 475 (1993); Alan Hyde, *Ownership, Contract, and Politics in the Protection of Employees against Risk*, 43 U. TORONTO L. J. 721 (1993).

²¹⁴ For general background, see PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed., 1995); see also Lawrence E. Mitchell, *A Critical Look at Corporate Governance*, 45 VAND. L. REV. 1263 (1992); Ronald M. Green, *Shareholders as Stakeholders: Changing Metaphors of Corporate Governance*, 50 WASH. & LEE L. REV. 1409 (1993); Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865 (1990); Lyman Johnson, *Individual and Collective Sovereignty in the Corporate Enterprise*, 92 COLUM. L. REV. 2215 (1992); David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223 (1991); David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201 (1990); Eric W. Orts, *The Complexity and Legitimacy of Corporate Law*, 50 WASH. & LEE L. REV. 1565 (1993). For a recent symposium see Symposium, *Corporate Irresponsibility: America's Newest Export?*, 70 GEO. WASH. L. REV. 890 (2002) (discussing LAWRENCE E. MITCHELL, *CORPORATE IRRESPONSIBILITY: AMERICA'S NEWEST EXPORT* (2001)).

²¹⁵ See, e.g., Michael Bradley, Cindy A. Schipani, Anant K. Sundaram, and James P. Walsh, *The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads*, 62 LAW & CONTEMP. PROB. 9 41-44 (1999). See, generally, AMITAI ETZIONI, *THE SPIRIT OF COMMUNITY: THE REINVENTION OF AMERICAN SOCIETY* (1993); AMITAI ETZIONI, *THE MORAL DIMENSION: TOWARD A NEW ECONOMICS* (1988).

²¹⁶ Orts, *supra* note 214, at 1581.

²¹⁷ O'Connor, *supra* note 213, at 1259.

²¹⁸ *Id.*, *id.*

conservatives.²¹⁹ To the latter, as we have seen, the need to address multiple interests under uncertainty renders multiple-constituency corporate governance unworkable.²²⁰

4. Hierarchical Models

The journey through the intellectual history of the stockholder-stakeholder debate in the United States would not be complete without noting two interesting recent contributions. Margaret Blair and Lynn Stout have offered a new view on the role of directors in public corporations.²²¹ Blair and Stout propose to adopt a view of the corporation as a team to which different constituencies—shareholder, creditors, employees, managers, and communities—contribute and from which they expect certain returns. Because contracting among constituencies cannot be complete constituencies constantly have competing claims and each constituency may be exposed to the opportunistic power of other constituencies.²²² The public corporation, it is argued, is better viewed as a “mediating hierarchy” in which the directors are the “mediating hierarchs.” The board enjoys ultimate decisionmaking authority

²¹⁹ See Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856 (1997).

²²⁰ See Stephen Mark Bainbridge, *The Bishops and the Corporate Stakeholder Debate*, VILLANOVA J. L. INVESTMENT MGMT. (forthcoming 2003) (hereinafter *The Bishops*), available at http://papers.ssrn.com/paper.taf?abstract_id=308604 (arguing that requiring directors to make trade-offs between shareholder and stakeholder interests would prove unworkable).

²²¹ Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA L. REV. 247 (1999) (hereinafter *Team Production*); Lynn A. Stout & Margaret M. Blair, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1737 (2001) (hereinafter *Behavioral Foundations*); see also Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403 (2001) (hereinafter *Director Accountability*); Lynn A. Stout, *Bad and Not-So-Bad Arguments For Shareholder Primacy*, 75 SO. CAL. L. REV. 1189 (2002); Lynn A. Stout, *On the Proper Motives of Corporate Directors (Or, Why You Don't Want to Invite Homo Economicus to Join Your Board)* (Working paper 2003), available at http://papers.ssrn.com/paper.taf?abstract_id=389407.

²²² *Id.*, at 276-87.

to determine the use of corporate assets and to reconcile all the conflicting interests and disputes that may arise among corporate constituencies.²²³

Like any other theory of corporate governance, the mediating hierarch model needs to address two different questions: first, what prevents such powerful hierarchs from using their power to their own personal benefit, and second, how should these hierarchs exercise their power to reconcile conflicts of interest among constituencies. Blair and Stout propose an answer to the first question but eschew the second question altogether.

In regards with the problem of curbing managerial opportunism (which is largely beside the focus of this study) Blair and Stout marshal a large body of behavioral research that has looked at people's behavior in social dilemma games. In such games subjects have to weigh their self-interest, usually expressed in some monetary payoff, against the interest of other players. It is now well established that in seeming contradiction to predictions of neoclassical economic theory, subjects quite often behave in ways that appear altruistic: They would sacrifice self-reward to achieve an outcome that benefits others, or in ways that appear compatible with an abstract ethical principle (e.g., fairness).^{224 225}

²²³ *Id.*, at 276-77. Blair and Stout's team production model draws on Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972); their mediating hierarch view is influenced by Raghuram G. Rajan & Luigi Zingales, *Power in the Theory of a Firm*, 113 Q.J. ECON. 387 (1998). Blair & Stout, *id.*, at 265, 271.

²²⁴ As noted in the text, this is the subject of a huge literature. Blair and Stout review some of this literature and apply its major findings to their mediating hierarch model in Blair & Stout, *Behavioral Foundations*, *supra* note 221. For a review see, e.g., Ernst Fehr & Urs Fischbacher, *Why Social Preferences Matter - The Impact of Non-Selfish Motives on Competition, Cooperation and Incentives*, 112 ECON. J. C1 (2002); see also Robyn M. Dawes & Richard H. Thaler, *Cooperation*, 2 J. ECON. PERSP. 187 (1988); David Sally, *Conversation and Cooperation in Social Dilemmas: A Meta-Analysis of Experiments from 1958 to 1992*, 7 RATIONALITY & SOC'Y 58 (1995).

²²⁵ Blair and Stout also argue generally, that managers derive utility from keeping their job in which they serve their corporate constituents well and that corporate law limits managers' ability to enrich themselves at the expense of other corporate constituents. Blair & Stout, *Team Production*, *supra* note 221, at 315. Whether

Compelling as it may be, the evidence from behavioral economics is unhelpful in resolving the problem of multiple constituencies' interests. This body of evidence may be relevant primarily to situations that involve conflict of interest between managers and the corporation or beneficiaries of the corporation. In other words, this evidence may shed light on the type of agency problem that is relatively less controversial. To the extent that the experimental results carry over to real-life situations, they may mitigate concerns about managerial opportunism. With regard to the conflict of interest among constituencies, Blair and Stout's approach suggests that directors should not be under direct control of either shareholders or other stakeholders, although they believe that shareholders would benefit from granting directors discretion to favor other constituencies.²²⁶

Stephen Bainbridge has advanced a "director primacy" theory that shares major features with Blair and Stout's mediating hierarch model.²²⁷ Drawing on early work by Kenneth Arrow on governance in institutions, Bainbridge argues that authority rather than consensus should be the governance mechanism in corporations and that the directors are the

these factors are sufficient for preventing managerial opportunism in extreme settings like a hostile takeover bid is controversial. See Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973, 1023 n.133 (2002) (questioning the validity of Blair and Stout's argument in the takeover context). For a general critique of the mediating hierarch model, see Meese, *supra* note 193.

²²⁶ Blair & Stout, *Team Production*, *supra* note 221, at 255, 304; Blair and Stout, *Director Accountability*, *supra* note 221, at 424. Blair and Stout therefore distance themselves from progressive commentators who have argued that corporate law ought to be reformed to make directors more accountable to stakeholders. *Team Production*, *id.*, at 255.

²²⁷ Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003) (hereinafter *Means and Ends*); Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791 (2002) (hereinafter: *Preliminary Reflections*); Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1 (2002) (hereinafter: *Nexus of Contracts*); Stephen M. Bainbridge, *Director v. Shareholder Primacy in the Convergence Debate*, 16 TRANSNAT'L LAW. 45 (2002). On the similarity between Bainbridge's model and Blair and Stout's model, see Bainbridge, *Preliminary Reflections*, *id.*, at 795 n. 21 ("As a positive description of corporate governance, director primacy bears some resemblance to Margaret Blair and Lynn Stout's team production model, especially in that both models assume that control over the corporation and its "assets is exercised by an internal hierarchy,

proper locus of authority.²²⁸ The board of directors is portrayed not as an agent for the shareholders but rather as “a sort of Platonic guardian serving as the nexus of the various contracts that make up the corporation.”²²⁹ Unlike Blair and Stout, Bainbridge holds to the view that shareholder value should be the sole maximand of corporate governance.²³⁰ Similar to the claim in traditional economic analysis, the fear is that requiring directors to make trade-offs between shareholder and stakeholder interests would prove unworkable.²³¹

F. *A New Look at the Old Debate*

The standard reading of the stockholder-stakeholder debate used to be couched in terms of desirability—that is, whether corporate fiduciaries *should* be accountable to non-shareholder constituencies. As we have seen, modern economic theory teaches that simple economic analysis cannot resolve this question. This Part has shown that below the surface of the question of desirability there lies a more fundamental problem of feasibility – whether corporate fiduciaries can, systematically, be held accountable to multiple non-shareholder constituencies. Berle was the first to identify this problem as the factor that should determine legal policy. Berle strongly believed that accountability to multiple constituencies is desirable

“at the apex of which sits” a board of directors whose authority over the use of corporate assets is virtually absolute.”) (citing Blair & Stout, *Team Production*, *supra* note 221, at 251).

²²⁸ Bainbridge, *Nexus of Contracts*, *id.*, at 20 (citing KENNETH J. ARROW, *THE LIMITS OF ORGANIZATION* 69-70 (1974)).

²²⁹ Bainbridge, *Preliminary Reflections*, *supra* note 227, at 795.

²³⁰ Bainbridge, *Means and Ends*, *supra* note 227, at 549 (“[D]irector primacy claims that shareholders are the appropriate beneficiaries of director fiduciary duties. Hence, director accountability for maximizing shareholder wealth remains an important component of director primacy.”) This view has been advanced by Bainbridge well before he put forward the director primacy model. *See* Bainbridge, *supra* note 193, at 1446 (“How would I feel about living in a world governed by the moral rules implicit in the shareholder wealth maximization norm? Frankly, my answer is: ‘pretty good.’... That rule has helped produce an economy that is dominated by public corporations, which in turn has produced the highest standard of living of any society in the history of the world.”)

but could not think of a way to implement it. He therefore advocated accountability only to shareholders as a distant second best in order to at least mitigate the adverse effects of insiders' self-interest.

Modern economic theory vindicates Berle's position. This theory also highlights the gravity of the implementation problem in formalizing the notion that the corporation is not a nexus of contracts but rather a nexus of power relationships governed only partially by the law. The interests of various corporate constituencies are inherently indeterminate and, consequently, may be inherently conflicting. The recent contributions by Blair and Stout and by Bainbridge continue the old divide between stakeholderists and stockholderists. These authors explicate the fact that corporate decision makers have both the duty and power to reconcile conflicting interests on a constant basis. Notwithstanding the similarity of their basic frameworks, these authors, like many before them, disagree on whether American managers can be trusted to successfully deal with situations that involve multiple considerations, ambiguity and uncertainty.

The theory of values and cognitive style put forward in Part II casts the stockholder-stakeholder debate in a new light that exposes its roots. The polar views in this debate reflect different assumptions about the psychology of American managers and the American culture. The position that shareholder value should be the only maximand of corporate governance reflects a belief that, on average, American managers would find it difficult to function under a multiple constituency accountability regime and are likely to take advantage of the situation

²³¹ Bainbridge, *The Bishops*, *supra* note 220, at 6. Bainbridge does not elaborate on the problem of unworkability although this position is compatible with traditional economic analyses that reject recognizing multiple maximands for this reason.

to benefit themselves. Proponents of multiple constituency accountability appear to believe that the personal qualities of the average American manager enable her to manage complex situations to the benefit of all corporate constituencies even without a clear roadmap.

The present theory allows one to move from general assertions of the sort just made to a more rigorous framework that allows for empirical testing. Thus, the debate should be analyzed as a controversy over the values and need for cognitive closure of American managers and other decision makers. The single shareholder-value-maximand position is consistent with the view that managers emphasize values of Conservation and Self-enhancement more than values of Openness to change and Self-transcendence. In accordance with the emphasis on Conservation, the single maximand position also implies that managers' average level of need for cognitive closure may be too high to enable them simultaneously to consider the interests of multiple constituencies and cope with the confusion they entail. The opposite holds for the multiple maximands position: Emphasis on Openness to change and Self-transcendence and low need for cognitive closure that accommodates handling multiple considerations under uncertainty on an ad hoc basis.

As we have seen, Tetlock's study of American managers provides evidence in support of this analysis.²³² Tetlock uses political positions to conceptualize and operationalize values at the individual level. In this analysis, political conservatism and libertarianism are contrasted with liberalism in supporting a single versus multiple maximands corporate governance, respectively. The Schwartz model of individual values offers a superior

²³² Tetlock, *supra* note 44.

analytical framework for discussing value -related issues, especially in comparative contexts, and should yield equivalent results.

The value dimension framework also allows for identifying gaps in existing theoretical accounts. In the main, most theorists have focused on managerial self-interest. This aspect is related primarily to the Self-enhancement/Self-transcendence dimension. Little elaboration if any has been offered in regards to the reconciliation of conflicting interests of third parties by managers. Scholars either assume that this task is feasible or that it is not, without elaborating on factors that may affect managers' ability to cope with this implementation problem. By relating this aspect to the Openness to change/Conservation dimension, this paper points to the direction in which further research should continue.²³³

The foregoing analysis leads to an interesting conclusion about the future of the stockholder-stakeholder debate. It also provides an important lesson for policy makers. In brief, this debate is unlikely ever to be resolved. People's positions in this debate appear to be rooted deep in their individual value preferences and cognitive style. The American society, like every other society, has a wide distribution of individual traits, including value preferences and cognitive styles. The insight that multiple considerations and ambiguity are inherent to managing corporate affairs entails that people will always differ on how best to cope with this task.

²³³ Even the more sophisticated accounts, such as Blair and Stout's theory of the board a mediating hierarchy, fail to account for the latter aspect in postulating the mechanisms that affect directors' behavior. Blair and Stout, *Behavioral Foundations*, *supra* note 221, point to evidence on other-regarding behavior by (largely Western) subjects. Unfortunately, this evidence has not yet been connected to psychological theories of values, but its underlying theme suggests a relation mostly with the Self-enhancement/Self-transcendence dimension identified by Schwartz. As far as I am aware, behavioral economics thus far has neglected factors that relate to the Openness to change/Conservation dimension and to the need for cognitive closure. As this paper argues, the latter two factors may play a significant role in determining the maximands of corporate governance.

Do these insights imply the desirability of legal reform in the United States (specifically, a reform in the direction advocated by stakeholderists)? It appears not. Since the board of directors is the ultimate holder and arbiter of power in the corporation, the question essentially boils down to the one debated by Berle and Dodd, to wit, “To whom are corporate directors trustees?” Once the American jurisprudence had defined the relations between corporate officers and corporate constituencies (and the corporation itself) as relations that rest on power differences, an accountability-based legal regime was the natural response given the legal roots of American corporate law in common law and equity principles. Such a regime precludes loyalty to multiple beneficiaries almost by definition, irrespective of the danger of managerial opportunism. A legal reform that required directors to discharge their fiduciary duties simultaneously to multiple constituencies thus would resemble trying to fit a square peg into a round hole. It would not matter, for that purpose, whether one classified such multiple-beneficiary duties in the duty of loyalty or the duty of care rubrics.

By uncovering the psychological roots of the stockholder-stakeholder debate, this article implies that legal reform—no matter how well intentioned it may be—is unlikely to eradicate the consequences of the balance struck by American legislators and courts, that focuses primarily on shareholders’ interests. The current legal environment apparently is one in which more managers can function given their level of need for cognitive closure. A legal regime that imposes a lower cognitive load allows a wider range of managers to discharge their duties effectively, as it accommodates those managers who are higher on the need for closure. Managers with a lower need for closure can still function under a single-maximand regime. Yet by not equally catering to the interests of non-shareholder constituencies, the current regime may be leading to sub-optimal management of firms, as several management

scholars argue.²³⁴ What may look to some as unnecessary social waste, however, may actually be a social optimum once the constraint of cognitive style is taken into account.

If the present hypotheses are correct—namely, that a higher level of need for cognitive closure is accompanied by individual emphases on certain values (Conservation and Self-enhancement)—then the current U.S. legal regime also reflects a political balance. Hence, the political overtones of the stockholder-stakeholder debate are simply manifestations of its underlying psychological foundations. No amount of economic analysis is likely to be decisive in the eyes of people who disagree on what's important in life. Tetlock's study demonstrates that these differences cut across many issues unrelated to corporate governance. As for corporate governance, Berle has identified the second-best solution. Subsequent developments in the American society apparently have not yet changed its values to an extent that would cause it to reject the shareholder-primacy norm.

Finally, two general points deserve noting about conclusions that the present analysis does *not* entail. First, the present theory improves our understanding of the mechanisms that underlie the choice of maximands for corporate governance. This analysis does not imply, however, that one version of corporate governance is universally better than the other. The fact that some managers (or people in general) have a strong need for cognitive closure, that they prefer security and conformity more than self-direction, etc., does not mean that they would be worse managers. Indeed, the contrary may be true. These managers may also be more decisive, better able to see through the details, and so on. In the same vein, higher

²³⁴ For a development of this theme, *see* below Part III.

Openness to change and lower need for cognitive closure may lead to procrastination – a bad quality for managers.²³⁵

Second, it may be a mistake to attribute the value preferences and cognitive style associated with either the stockholder or the stakeholder view to proponents of these views. Thus, it would be wrong to assume that advocates of the single shareholder-value-maximand position are all right-wing conservatives with low tolerance for ambiguity and nuance whose early childhood development was somehow impaired.²³⁶ When the discussion revolves on law- and policy-making, the crucial consideration is which policy would better fit the general, average case. One can be of strong liberal persuasion and bent on dialectical reasoning yet hold the view that American corporations had better be managed under a single-maximand accountability regime. Adolf Berle is a shining example of the ability to draw the line between one's own values and optimal policy-making.

IV. MANAGEMENT THEORIES

Lawyers are not alone in addressing the maximands of corporate governance. Beginning in the mid-1980s, a similar debate among management scholars has developed and has been running on nearly parallel tracks to the legal discourse. Both strands of theoretical analysis, however, feature their own versions of the monist, single-constituency shareholder paradigm versus the pluralist, multiple-constituency stakeholder paradigm. However, management scholars have made considerable progress with regard to the implementation problem of reconciling multiple conflicting interests. These theories have gone virtually

²³⁵ Tetlock, *supra* note 44, provides an excellent discussion of the relativity of these qualities.

²³⁶ *See supra* note 42.

unnoticed among legal commentators²³⁷ although it bears important implications for legal analysis. This Part aims to partially remedy this deficiency. Sections A through C review current theories and Section D assesses them against the theory of values and cognitive style.

A. *Stakeholder Theory*

Edward Freeman's landmark book *Strategic Management: A Stakeholder Approach* marks the inception of the stakeholder-stockholder debate in management studies.²³⁸ This book was written with a view to helping American managers cope with vast changes that had taken place in their business environment, in particular the increase in the external demands placed on the corporation in a turbulent period.²³⁹ "External change produces uncertainty," wrote Freeman, "It makes us uncomfortable because it cannot be readily assimilated into the relatively more comfortable relationship with suppliers, owners, customers and employees."²⁴⁰ The stakeholder management approach advanced by Freeman thus was designed to help managers reduce uncertainty and discomfort.²⁴¹ At the center of this theory stands the concept of stakeholders, defined as follows.

A stakeholder in an organization is (by definition) any group or individual who can affect or is affected by the achievement of the organization's objectives.²⁴²

²³⁷ Management scholars writing in the legal literature are aware of this body of knowledge, of course. See, e.g., Orts, *supra* note 167 (Orts is affiliated with the legal studies department at the Wharton School of Business); Dunfee, *supra* note 181; Bradley et al., *supra* note 215.

²³⁸ R. EDWARD FREEMAN, *STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH* (1984).

²³⁹ *Id.*, at v, 3-5.

²⁴⁰ *Id.*, at 12-13.

²⁴¹ *Id.*, *id.*

²⁴² *Id.*, at 46. This definition of stakeholder draws on earlier definitions in the management literature that grew out of management practice. According to Freeman, *id.*, it first appeared in 1963 in a memorandum at the Stanford Research Institute (now SRI International, Inc.) as "those groups without whose support the organization would cease to exist." The list of stakeholders originally included shareholders, employees,

This definition implies that to the traditional list of stakeholders managers needed to add governments, competitors, consumer advocates, environmentalists, special interest groups, and the media.²⁴³ The crucial feature in this definition of stakeholders—and one that has engendered heated controversies—is the fact that it is free of legitimacy considerations. In fact, a stakeholder could be anyone – even a terrorist group. Freeman agnostically noted that if a terrorist group could affect the corporation then managers couldn't ignore it.²⁴⁴ One needs only to consider discount airlines after September 11, 2001 to see the point.²⁴⁵

The original value-free, practice-oriented version of stakeholder management theory soon gave rise to several branches of analysis that derived different theses from it.²⁴⁶ One way to understand stakeholder theory is as a descriptive thesis, presenting models that describe what the corporation is. Second, stakeholder theory is also an instrumental one, namely, dealing with practical prescriptions for corporations' survival and success in business. The more contentious interpretations of stakeholder theory, however, are the

customers, suppliers, lenders and society. SRI's work was heavily influenced by concepts that were developed in the planning department of Lockheed and further developed in IGOR ANSOFF, *CORPORATE STRATEGY* (1965). However, Freeman traces the history of the stakeholder concept before SRI to Adam Smith and Berle and Means. See FREEMAN, *id.*, at 32; R. Edward Freeman & John McVea, *A Stakeholder Approach to Strategic Management*, in *HANDBOOK OF STRATEGIC MANAGEMENT* 189, 189 (M. Hitt, E. Freeman, & J. Harrison, eds. 2001).

²⁴³ FREEMAN, *supra* note 238, at 11-22.

²⁴⁴ *Id.*, at 45, 53. (“[The] broad notion of “stakeholders” will include a number of groups who may not be “legitimate” in the sense that they will have vastly different values and agendas for action from our own. Some groups may have as an objective simply to interfere with the smooth operation of our business. For instance, some corporations must count “terrorist groups” as stakeholders.... Strategies must be put in place to deal with terrorists if they can substantially affect the operations of the business.”)

²⁴⁵ Nevertheless, opponents of stakeholder theories cite the reference to terrorist groups with an unmistakable innuendo. See Elaine Sternberg, *The Defects of Stakeholder Theory*, 5(1) *CORP. GOVERNANCE: INT'L REV.* 3, 4 (1997) (“Terrorists and competitors, vegetation and nameless sea creatures, and generations yet unborn are amongst the many groups which are now seriously considered to be business stakeholders.”) (footnotes omitted); Jensen, *supra* note 1, at 9n1 (same).

²⁴⁶ See Thomas Donaldson & Lee E. Preston, *The Stakeholder Theory for the Corporation: Concepts, Evidence, Implications*, 20 *ACAD. MGMT. REV.* 65, 66-67 (1995).

normative and managerial theses. As a normative thesis, the theory's focus is on the legitimacy of claims on the corporation from various groups and individuals. In this view, the theory implies that "each group of stakeholders merits consideration for its own sake and not merely because of its ability to further the interests of some other group, such as shareowners."²⁴⁷ Finally, stakeholder theory can also be seen as implying a managerial thesis in the sense of prescribing structures and practices for managing stakeholder affairs.²⁴⁸

The normative interpretation of stakeholder theory therefore rejects the idea of a single maximand for corporate governance on ethical grounds. Although Freeman originally did not develop this facet of his stakeholder management theory, the fields of business ethics and business and society have embraced stakeholder theory and extensively rely on it. These analyses infuse (or augment) the basic framework with value-based arguments that draw heavily on notions of individual autonomy and fairness toward all societal members.²⁴⁹ Adoption and implementation of stakeholder management as a normative thesis require that managers also subscribe to certain values and to "value-based-management." Managers need

²⁴⁷ *Id.*, at 67.

²⁴⁸ *Id.*, *id.*

²⁴⁹ For a sample of ethical analyses of stakeholder theory, see, e.g., Kenneth E. Goodpaster, *Business Ethics and Stakeholder Analysis*, 1 BUS. ETHICS Q. 53 (1991); William M. Evan & R. Edward Freeman, *A Stakeholder Theory of the Modern Corporation: Kantian Capitalism*, in ETHICAL THEORY AND BUSINESS 75 (Tom L. Beauchamp & Norman E. Bowie eds., 4th ed. 1993); John R. Boatright, *Fiduciary Duties and the Shareholder-Management Relation: Or, What's So Special About Shareholders?*, 4 BUS. ETHICS Q. 393 (1994); Ian Maitland, *The Morality of the Corporation: An Empirical or Normative Disagreement*, 4 BUS. ETHICS Q. 445 (1994); Thomas Jones, *Instrumental Stakeholder Theory: A Synthesis of Ethics and Economics*, 20 ACAD. MGMT. REV. 92 (1995); Robert Phillips, *Stakeholder Theory and a Principle of Fairness*, 7 BUS. ETHICS Q. 51 (1997); Thomas M. Jones & Andrew C. Wicks, *Convergent Stakeholder Theory*, 24 ACAD. MGMT. REV. 206 (1999); Robert Phillips & Joel E. Reichart, *The Environment as a Stakeholder: A Fairness-Based Approach*, 23 J. BUS. ETHICS 185 (2000).

to share a core set of values and incorporate these values as a key element of the strategic management process.²⁵⁰

An important outcome of grounding stakeholder theory in normative propositions that draw on values and ethics is that the theory immediately becomes political.²⁵¹ This outcome can hardly go unnoticed. However, one may find it difficult readily to classify the theory along a left-right dimension. Freeman himself has provided different political interpretations of stakeholder theory, ranging from liberal to libertarian interpretations.²⁵² The liberal element of stakeholder theory is based on the notions of autonomy, solidarity, and fairness as articulated by John Rawls²⁵³ and others. This element entails pursuit of basic equality among stakeholders in terms of their moral rights as these are realized in the firm.²⁵⁴ The libertarian element of this theory is reflected in the theory's reliance on a contractual model, which in turn connotes values of liberty of will and personal freedom.²⁵⁵ It is worth noting that both positions emphasize promotion of individual autonomy; they differ on the question of the appropriate relations between the autonomous person and the larger society. Liberalism more

²⁵⁰ Freeman & McVea, *supra* note 242.

²⁵¹ As a normative thesis, stakeholder theory also becomes relevant for legal matters. Given that this theory champions consideration of multiple stakeholders, it is not surprising that Dodd's work is cited as a matter of practice. *See*, e.g., Donaldson & Preston, *supra* note 246, at 65. As noted above, however, a lot remains to be done on the interface between corporate law and management theories.

²⁵² The reader is reminded that these political titles are notoriously difficult to pin down and may connote different political view in different countries. *See supra* note 44.

²⁵³ JOHN RAWLS, A THEORY OF JUSTICE (1971).

²⁵⁴ R. Edward Freeman, *The Politics of Stakeholder Theory: Some Future Directions*, 4 BUS. ETHICS Q. 409, 415 (1994).

²⁵⁵ *See* Freeman, *id.*, at 415; R. Edward Freeman & Robert A. Phillips, Stakeholder Theory: A Libertarian Defense (Darden Business School Working Paper No. 01-03 2003) available at http://papers.ssrn.com/paper.taf?abstract_id=263514.

than libertarianism calls on individual persons to consider other social members and voluntarily promote their interests.

Ethical and philosophical considerations aside, stakeholder theory, as a managerial thesis, puts the emphasis on the need to pay simultaneous attention to the interests of all appropriate stakeholders.²⁵⁶ This aspect points to two separate challenges that must be met: First, identifying all appropriate stakeholders, and second, managing these stakeholders. With regard to the first challenge, the question “Who is a stakeholder?” has received numerous answers over the years. While some scholars used narrow definitions that focused on the legitimacy of stakeholders’ claims (determined on a legal or moral basis), others preferred a broader definition (in line with Freeman’s original view) that emphasized the stakeholder’s power to influence the firm’s affairs, whether or not these are legitimate claims.²⁵⁷

In addition, stakeholder management also has to deal with the problem of balancing stakeholders’ conflicting interests beyond the general prescription of conducting a case-by-case analysis. What makes this a challenge is the fact that the theory “rejects the very idea of maximizing a single objective function... Rather, stakeholder management is a never-ending task of balancing and integrating multiple relations and multiple objectives.”²⁵⁸ Almost by necessity, stakeholder theory faces severe implementation problems resembling those that have encumbered multiple-constituency theories in corporate law for decades.

B. The Critique

²⁵⁶ Donaldson & Preston, *supra* note 246, at 67.

²⁵⁷ See Ronald K. Mitchell, Bradley Agle, & Donna J. Wood, *Toward a Theory of Stakeholder Identification and Saliency: Defining the Principle of Who and What Really Counts*, 22 ACAD. MGMT. REV. 853, 862 (1997). These authors, in 1997, counted no less than 27 definitions for stakeholders. *Id.*, at 858 tbl. 1.

²⁵⁸ Freeman & McVea, *supra* note 242.

It should come as little surprise that stakeholder theory is not without opposition among management scholars. The most prominent opponents probably are Michael Jensen and Elaine Sternberg, a British commentator. Sternberg tends to emphasize the ethical aspects, arguing that stakeholder theory cannot be justified. In brief, it is argued that the fact that some groups may have power over the corporation does not give those groups legitimate authority over it, or the right to hold it to account. Stakeholder theory, so runs the argument, is both “deeply dangerous and wholly unjustified” because it “undermines private property, denies agents’ duties to principals, and destroys wealth.”²⁵⁹

Jensen too employs strong language to criticize stakeholder theory, focusing primarily on the problem of multiple maximands.

“What is commonly known as stakeholder theory, while not totally without content, is fundamentally flawed because it violates the proposition that any organization must have a single valued objective as a precursor to purposeful or rational behaviour... It is logically impossible to maximise in more than one dimension at the same time... Telling a manager to maximize [several objectives] leaves the managers with no objective. The result will be confusion and lack of purpose that will fundamentally handicap the firm in its competition for survival.”²⁶⁰

Jensen’s reasoning weaves together several arguments. First, there is an economic theory argument, under which maximizing the firm’s financial value, defined as the sum of

²⁵⁹ See Sternberg, *supra* note 245, at 6-9; see also ELAINE STERNBERG THE STAKEHOLDER CONCEPT: A MISTAKEN DOCTRINE (1999).

²⁶⁰ Jensen, *supra* note 1, at 300-301.

equity and other financial claims on the firm, is efficient.²⁶¹ Second, there is a governance argument, according to which managers that owe duties to several stakeholders are accountable to none and are bound to prefer their own self-interest.²⁶² Third, Jensen makes a political objection, because, as a basis for action, stakeholder theory politicizes the corporation.²⁶³ Finally, and most important, Jensen makes a psychological argument. Stakeholder theory is deficient under this argument because it confuses managers, and confusion is bound to handicap the firm.²⁶⁴

Now these arguments all ring familiar, of course, as they replicate claims made by lawyers since the inception of the Berle -Dodd dialogue. The novelty in Jensen's position in my mind lies not in the economic analysis (which is old, as Jensen indeed emphasizes) but rather in the stress he puts on the psychological drawbacks of stakeholder theory. Moreover, inspired by Friedrich Hayek's work on the modern market economy,²⁶⁵ Jensen seems to hold

²⁶¹ *Id.*, at 301-04. For a similar analysis, see Anant K. Sundaram & Andrew C. Inkpen, *The Corporate Objective Revisited*, ORGANIZATION SC. (forthcoming 2003).

²⁶² *Id.*, at 305 ("Because stakeholder theory provides no definition of better, it leaves managers and directors unaccountable for their stewardship of the firm's resources... Stakeholder theory plays into the hands of self-interested managers allowing them to pursue their own self-interest.")

²⁶³ *Id.*, at 300.

²⁶⁴ *Id.*, at 301. For similar reasons, Jensen, *id.*, at 310 *et seq.*, also criticizes a management theory called "The Balanced Scorecard." This theory was designed to improve current performance measurement systems by providing alternatives to managing organizational performance exclusively through financial measures. The Balanced Scorecard tracks key elements of an organization's strategy by allowing the organization to view its performance through multiple lenses. See ROBERT S. KAPLAN & DAVID P. NORTON, *THE BALANCED SCORECARD TRANSLATING STRATEGY INTO ACTION* (1996); see also ROBERT S. KAPLAN & DAVID P. NORTON, *THE STRATEGY-FOCUSED ORGANIZATION: HOW BALANCED SCORECARD COMPANIES THRIVE IN THE NEW BUSINESS ENVIRONMENT* (2000). According to Jensen, "[t]he Balanced Scorecard is the managerial equivalent of stakeholder theory. Like stakeholder theory, the notion of a 'balanced' scorecard appeals to many, but it is similarly flawed... Just as in the case of multiple constituencies, ... a decision maker cannot make rational choices without some overall single dimensional objective to be maximized. Given a dozen or two dozen measures and no sense of the tradeoffs between them, the typical manager will be unable to behave purposefully, and *the result will be confusion.*" (italics added).

²⁶⁵ *Id.*, at 306-07 (citing Friedrich A. Hayek, *The Fatal Conceit*, in *THE COLLECTED WORKS OF F.A. HAYEK* 14 (W.W. Bartley, ed. 1988)).

that financial value maximization is sharp and modern while stakeholder management is not only confusing but outright primeval:

“Stakeholder theory taps into the deep emotional commitment of most individuals to the family and tribe. For tens of thousands of years those of our ancestors who had little respect for loyalty to the family, band, or tribe probably did not survive... Many People are drawn to stakeholder theory through their evolutionary attachment to the small group and family.”²⁶⁶

Notwithstanding the sharp differences between stakeholder theorists and their opponents over the question “What are the right maximands?” both sides resemble in being unable to provide satisfactory solutions for addressing non-shareholder constituencies. Even a manager who is a staunch believer in shareholder value maximization somehow must deal with workers, local politicians, NGOs, and so forth. To this end, Jensen advances what he calls the “enlightened stakeholder theory.” This approach builds on stakeholder theory in terms of designing ways for the firm to manage its relations with all-important constituencies and adds to it the injunction that the maximand of the firms is its long-term market value. This objective function, Jensen surmises, “gives managers a way to assess the tradeoffs that must be made among competing constituencies.”²⁶⁷ Exactly how managers should assess this tradeoff when long-term market value may call for sacrificing shareholder value remains unspecified, however. Managers are left to their own devices.²⁶⁸

C. Toward a Dynamic Stakeholder Theory

²⁶⁶ *Id., id.*

²⁶⁷ Jensen, *supra* note 1, at 309-310.

²⁶⁸ *Id.*, at 308 (likening this task to telling players to score goals in football or soccer without telling them how to win the game.)

Like legal commentators, management scholars of all persuasions share the view that corporate fiduciaries face multiple conflicting claims and interests, which they have to identify and deal with on a constant basis. In contrast with legal commentators, however, management researchers have made some progress toward addressing this challenge. Mitchell, Agle, and Wood advance a model of stakeholder salience that covers both stakeholder identification and stakeholder management. Mitchell et al. argue that the stakeholder framework cannot readily explain the complex considerations that are involved in giving priorities to competing stakeholder claims.²⁶⁹

Mitchell et al. claim that beyond identifying stakeholders using the standard test of ability to affect and being affected, a managerial theory also needs to consider stakeholder salience, namely, the factor that can explain to whom and to what managers pay attention. Mitchell et al. propose that classes of stakeholders can be identified by three attributes: (1) the stakeholder's power to influence the firm; (2) the legitimacy of the stakeholder's relationship with the firm; and (3) the urgency of the stakeholder's claim on the firm. These three attributes together create different levels of stakeholder salience, which point out to managers whom they should pay attention to.²⁷⁰

To define "power," Mitchell et al. combine a variety of definitions, which, in the end, all draw on Max Weber's conceptualization of "the probability that one actor within a social relationship would be in a position to carry out his own will despite resistance."²⁷¹ This is

²⁶⁹ Mitchell et al., *supra* note 257, at 854.

²⁷⁰ *Id.*, *id.*

²⁷¹ *Id.*, at 865 (citing MAX WEBER, THE THEORY OF SOCIAL AND ECONOMIC ORGANIZATION (1947)). Other definitions cited by Mitchell et al. are essentially identical.

essentially the definition advanced by Hohfeld earlier in the twentieth century.²⁷² Weber’s definition is broader in scope in that it also encompasses coercive uses of power, while Hohfeld was interested only in legal relations. This notion of “power” is also central in the concept of governance generally and corporate governance in particular.²⁷³

The attribute of legitimacy in Mitchell et al.’s theory loosely refers to socially accepted or expected structures of behavior. The authors adopt a definition of legitimacy that integrates several approaches that together refer to a generalized perception or assumption about what is desirable, proper, or appropriate within a socially constructed system of norms, values, beliefs, and definitions.²⁷⁴ Mitchell et al.’s definition of legitimacy is nearly identical to definition of “social norms” and “culture” in social psychology and other social sciences. I return to this aspect below. At this point suffice is to say that once a theory of stakeholder identification is based on social norms and cultural values, it immediately ceases to be universal and becomes contextual—that is, it depends on characteristics that may (and do) vary across societies and time.²⁷⁵

Finally, the attribute of urgency reflects the degree to which stakeholders’ claim call for immediate attention. It combines a dimension of time sensitivity (how pressing is the claim in that delays in addressing it would be damaging) and criticality (how important it is to the stakeholder).

²⁷² See *supra* note 199.

²⁷³ See Licht, *supra* note 88.

²⁷⁴ Mitchell et al., *supra* note 257, at 866 (citing Mark C. Suchman, *Managing Legitimacy: Strategic and Institutional Approaches*, 20 ACAD. MGMT. REV. (1995)).

The significant contribution of the stakeholder salience model lies in the distinction it makes between stakeholders that *deserve* to be addressed (under any view of corporate governance) and stakeholders whose claim actually *gets* to be addressed. Sometimes, a claim that deserves attention gets neglected while managers invest resources in addressing a claim that should have been ignored. The pivotal factor here is the managers. “It is the firm’s managers who determine which stakeholders are salient and therefore will receive managerial attention,” aver Mitchell et al.²⁷⁶ Managers’ personal characteristics thus play a role as moderators between stakeholders’ attributes in the abstract and corporate action. Managers, however, vary greatly in their personal capabilities and values. A theory of stakeholder management therefore must account for individual qualities of decision makers.

Empirical support for Mitchell et al.’s theory was provided by a study conducted by Agle, Mitchell, and Sonnenfeld.²⁷⁷ These researchers further elaborate the mediating factor of managers’ characteristics and argue that they are likely to be connected to managers’ individual values of self-interest versus other-regarding interest. They also assert that managerial perception is critical to the salience of stakeholders and that values are critical to perception.²⁷⁸ Agle et al. surveyed 70 CEOs out of 650 corporations in the Standard and

²⁷⁵ Mitchell et al, *supra* note 257, at 866-67, note that this definition is representative of sociologically based definition of legitimacy and that analyzing legitimacy should be done at multiple levels, the most common among which are the individual, organizational, and societal.

²⁷⁶ *Id.*, at 871.

²⁷⁷ Bradley Agle, Ronald K. Mitchell, & Jeffrey A. Sonnenfeld, *Who Matters to CEOs? An Investigation of Stakeholder Attributes and Salience, Corporate Performance, and CEO Values*, 42 ACAD. MGMT. J. 507 (1999).

²⁷⁸ *Id.*, at 510-511 (“In short, we argue that people perceive as important the things that are somehow connected with their values.”)

Poor's 500 list and 150 other large U.S. corporations.²⁷⁹ CEOs were asked to evaluate the aforementioned attributes (power, legitimacy, urgency) for each of Freeman's generic stakeholder groups (shareholders, employees, customers, government bodies, and community/charitable groups). The results provided strong support to the hypothesis that the stakeholder attributes of power, legitimacy, and urgency are indeed related to stakeholder salience. With regard to the moderating role of managers' values, however, the overall pattern of results was one of nonsignificance.²⁸⁰ Agle et al. also failed to find evidence for a relationship between stakeholder salience and corporate performance and for a relationship between CEO values and corporate performance.²⁸¹

D. Assessment

The present theory of values and cognitive style lends itself to assessing the major positions in management studies and to generalizing Mitchell et al.'s theory. When one

²⁷⁹ The final number of CEO responses might seem low but is normal for the mail survey methodology, especially for respondents of this seniority level. *See id.*, at 513.

²⁸⁰ Other-regarding CEO values were nonetheless found to significantly moderate the attribute-salience relationship for employees. *Id.*, at 519-20.

²⁸¹ The question whether it is profitable to implement a multiple-constituency -oriented corporate governance is of utmost – some would say ultimate – importance, of course. This is a theoretical and empirical question that exceeds the scope of the present paper notwithstanding its importance. From a theory perspective, it is not clear whether traditional financial performance measures should be dispositive and there is no agreement over measurement methods for non-financial performance, often referred to as “corporate social performance.” Current empirical findings are notoriously vague. For a critical review of the evidence, *see* Joshua Margolis & James Walsh, *Misery Loves Companies: Whither Social Initiatives by Business?* (Harvard Business School Social Enterprise Series working paper No. 19 2001) available at <http://www.hbs.edu/research/facpubs/workingpapers/papers2/0001/01-058.pdf>. In addition to Agle et al., *id.*, *see* also Jeffrey S. Harrison & R. Edward Freeman, *Stakeholders, Social Responsibility, and Performance: Empirical Evidence and Theoretical Perspectives*, 42 *ACAD. MGMT. J.* 479 (1999); Shawn L. Berman et al., *Does stakeholder orientation matter: The relationship between stakeholder management models and firm financial performance*, 42 *ACAD. MGMT. J.* 488 (1999); Gary R. Weaver, Linda Klebe Trevino, & Philip L. Cochran, *Integrated and Decoupled Corporate Social Performance: Management Commitments, External Pressures, and Corporate Ethics Practices*, 42 *ACAD. MGMT. J.* 539 (1999); Sandra A. Waddock & Samuel B. Graves, *The Corporate Social Performance-Financial Performance Link*, 18 *STRATEGIC MGMT. J.* 303 (1997); Amy J. Hillman & Gerald D. Keim, *Shareholder Value, Stakeholder Management, and Social Issues: What's the Bottom Line?*, 22 *STRATEGIC MGMT. J.* 125 (2001). For an early theoretical analysis, *see* Max B.E.

considers Freeman's stakeholder management theory and Jensen's critique in light of the present framework one can readily see how both are grounded in value preferences and the need for cognitive closure. Freeman's original theory is universal in that it does not hinge on a particular profile of value preferences and cognitive style. Nor is this theory tailored to societal values prevailing in the United States or in particular other countries.²⁸² Stakeholder theory is value-free but not value-neutral, however. Management in line with this theory is bound to differ in accordance with particular managers' individual characteristics and with the cultural orientations of the country in which they operate. This framework, therefore, can accommodate political positions but does not imply specific political persuasions.

In contrast, Jensen's position reflects a view of managers as having only a specific set of personal traits. Jensen portrays managers as individuals with strong preference for values of security, tradition, and conformity (Conservation), and power, achievement, and hedonism (Self-enhancement) and exceedingly high need for cognitive closure. By exaggeration, Jensen's repeating claim, that multiple stakeholders would confuse managers beyond control, might sound as if managers cannot walk and chew gum at the same time. This position can be justified only if one believed that this is a good portrait of the average American manager.

One may further object to Jensen's depiction of the emotions and values of stakeholder theory supporters as vestiges of primeval times. This aspect is best understood against a theoretical backdrop of societal-level value dimensions. There is no denying that

Clarkson, *A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance*, 20 *ACAD. MGMT. REV.* 92 (1995).

²⁸² Needless to say, the normative interpretation given to Freeman's theory by subsequent scholars, *supra* note 249, is value-laden. The liberal interpretations of this theory (especially those that rely on Rawls) reflect a blend of Autonomy and Egalitarianism cultural orientations.

communitarian commentators indeed support the multiple constituency version of corporate governance.²⁸³ There is nonetheless a significant difference between stakeholder management and ancient communal preferences. Depending on the context, a widely -followed injunction to consider others may express cultural orientations of Embeddedness or Egalitarianism that prevail in many advanced economies, although not in the United States.²⁸⁴ Stated otherwise, stakeholderism can be as modern as shareholder primacy is.

Mitchell et al.'s stakeholder identification and salience model makes a significant progress in the theory of corporate stakeholders by turning it from a static theory into a dynamic one. According to this theory, two factors affect "who gets what" in the business corporation: (1) the values of the society in which the corporation operates, and (2) the personal characteristics of those who control the corporation, be they executive managers or controlling shareholders. Thus, the theory encompasses both the societal as well as the individual levels of analysis – a quality that virtually all the analyses in the legal literature seem to lack. In addition, Mitchell et al.'s theory implies that at the individual level, several factors may operate, including managers' own personal values and their different levels of urgency, or time pressures. It therefore comes close to identifying managers' cognitive style as potentially significant factor in the working of stakeholder management. Time pressure and urgency increase the need for cognitive closure. Managers with higher levels of such need may thus invest personal and corporate resources to deal with more pressing

²⁸³ See *supra* text to note 215.

²⁸⁴ See below text to note 305 *et seq.*

constituencies. They would tend to prefer a simple, single-maximand accountability regime to one that features multiple maximands.²⁸⁵

Finally the present theory points to a possible reason for Agle et al.'s failure to find supportive evidence in respect with a moderating role of managers' values in determining stakeholder salience. In order to capture managers' values, Agle et al. used a limited set of value items, which they culled from Rokeach's value inventory.²⁸⁶ These items all reflect values that belong to the Self-enhancement/Self-transcendence dimension.²⁸⁷ Agle et al. failed to consider the Openness to change/Conservation dimension, which seems highly relevant for managing multiple stakeholders and is related to the need for cognitive closure.²⁸⁸ The value dimension framework thus makes it possible to identify such omissions and to point out directions for future research.

V. A COMPARATIVE PERSPECTIVE

The debate over the maximands of corporate governance is no longer limited to the United States. While the American corporate governance system adheres to shareholder primacy, its German and Japanese counterparts feature strong protections for employees, creditors, and other non-shareholder constituencies in general. These protections rest on a combination of legal rules, structural arrangements, and informal social norms, sometimes loosely referred to as culture. As it happens, the specific cases of the United States, Germany,

²⁸⁵ The notion of salience, however, may encompass additional factors that bear on perception and other aspects of cognition not dealt with in the present scope.

²⁸⁶ See *supra* text to note 16 *et seq.*

²⁸⁷ Specifically, Agle et al. used the items of comfortable life, wealth, helpful, and compassion to produce a measure of self-interestedness versus other-regarding value preference. See Agle et al., *supra* note 277, at 514. The equivalents of these items belong to the values of power, hedonism, benevolence, and universalism in the Schwartz individual level model. See Table 1 and Figure 1.

and Japan represent wider groupings of corporate governance regimes. This Part demonstrates the usefulness of the value dimension framework the analysis of comparative issues. Section A begins with a comparative review of corporate governance groupings. This is followed by an overview of the convergence dynamics in what regards stockholders versus stakeholders in Section B.

A. *Major Groupings of Corporate Governance*

Systems of corporate governance similar to that of the United States exist in other English-speaking countries, including the United Kingdom, Australia, and Canada.²⁸⁹ These countries share a legal system that is based on English common law and equity principles (the latter being especially influential in matters of corporate law due to historical reasons). Shareholder primacy is the predominant norm in these countries.²⁹⁰ Subject to the legal doctrine of separate corporate personality, shareholders are assumed to be the indirect owners of the corporation and only they have voting rights on nominating the board of directors.²⁹¹ Public companies in the U.S. and U.K. in particular tend to be internationally unique in that

²⁸⁸ Note that this omission is similar to the one committed by Blair and Stout. *See supra* note 233.

²⁸⁹ To be sure, differences do exist between corporate governance systems in various English-speaking countries, but they pale in comparison to other countries. *See, generally*, Brian R. Cheffins, *Putting Britain on the Roe Map: The Emergence of the Berle-Means Corporation in the United Kingdom*, in CONVERGENCE AND DIVERSITY IN CORPORATE GOVERNANCE REGIMES AND CAPITAL MARKETS (Joseph McCahery & Luc Renneboog, eds. 2001); Janis Sarra, *Corporate Governance in Global Capital Markets: Canadian and International Developments*, 76 TUL. L. REV. 1691 (2002); Kerry Shannon Burke, *Regulating Corporate Governance Through the Market: Comparing the Approaches of the United States, Canada and the United Kingdom*, 27 IOWA J. CORP. L. 341 (2002); Ruth O. Kuras, *Corporate Social Responsibility: A Canada-U.S. Comparative Analysis*, 28 MAN. L.J. 303 (2002); Brian R. Cheffins, *Corporate Governance Convergence: Lessons from Australia*, 16 TRANSNAT'L LAW. 13 (2002); Paul von Nessen, *The Americanization of Australian Corporate Law*, 26 SYRACUSE J. INT'L L. & COM. 239 (1999).

²⁹⁰ *See, e.g.*, Bradley et al., *supra* note 215, at 37-38, 48.

²⁹¹ For a detailed comparative analysis of the role of shareholders in common law countries, *see* Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 101 (2000).

they have a widely dispersed shareholder body.²⁹² Finally, The United Kingdom has its own version of a *Dodge*-like precedent.²⁹³ This decision was followed by a legislative amendment somewhat akin to American other-constituency statutes.²⁹⁴

In Western Europe, German corporate governance is a prime example of a stakeholder-oriented system.²⁹⁵ German corporate law directs managers' fiduciary duties to a diverse group of multiple constituencies, including shareholder, employees, and society as a

²⁹² See La Porta et al., *Corporate Ownership*, *supra* note 313. The historical reasons that supported the emergence of dispersed shareholding in the U.S. and the U.K. may be different in each country. See MARK J. ROE, *Strong MANAGERS, WEAK OWNERS – THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE* (1994); Brian R. Cheffins, *Does Law Matter?: The Separation of Ownership and Control in the United Kingdom*, 30 J. LEGAL STUD. 459 (2002).

²⁹³ *Parke v Daily News Ltd.* [1962] Ch 927. In this case, a newspaper publishing company suffered substantial trading losses on its newspapers to the point where it would have dissipated all its assets. The board had decided to sell all the company's assets and to distribute the balance of the purchase money by giving compensation to the company's employees and pensioners beyond their legal and contractual entitlements in order "to alleviate the suffering and hardship which may occur." Citing the famous adage that "[t]he law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company." (*Hutton v. West Cork Railway Co.* (1883) 23 Ch.D. 654, 673, C.A.), the *Parke* court held that the intended payments cannot go forward and that the proceeds of the sale should be distributed to shareholders.

²⁹⁴ Section 309 of the Companies Act 1985 was enacted in 1980 (then as part of section 46 of the Companies Act 1980) to respond to the *Parke* decision. This section states that directors are authorized take into account the interests of employees when performing their functions for the company. This duty is to be regarded as a fiduciary duty owed to the company. In addition, section 719 to the Companies Act enables a company to provide for its employees if the company's business is wound up. However, under section 309, only the company (possibly through its shareholders) can challenge the decisions of the directors and employees do not have standing to do so. The legal situation is identical with regard to section 719. Consequently, and in parallel with U.S. other-constituency statutes, section 309 does not provide employees with substantial protection. See L. S. Sealy, *Directors' "Wider" Responsibilities - Problems Conceptual, Practical and Procedural* 13 MON. U. L. REV. 164, 177 (1987) (arguing that section 309 "is either one of the most incompetent or one of the most cynical pieces of drafting on record.")

²⁹⁵ The following text draws on Theodor Baums & Kenneth E. Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany* (Working paper 2003); Mark G. Robilotti, *Recent Development: Codetermination, Stakeholder Rights, and Hostile Takeovers: A Reevaluation of the Evidence from Abroad*, 38 HARV. INT'L L.J. 536 (1997). On German corporate governance, see, generally, Hwa-Jin Kim, *Markets, Financial Institutions, and Corporate Governance: Perspectives from Germany*, 26 LAW & POL INT'L BUS. 371 (1995); Thomas J. Andre, Jr. *Cultural Hegemony: The Exportation of Anglo-Saxon Corporate Governance Ideologies to Germany*, 73 TUL. L. REV. 69 (1998). See also Mark J. Roe, *Some Differences In Corporate Structure In Germany, Japan, and the United States*, 102 YALE L.J. 1927 (1993); FRANKLIN ALLEN & DOUGLAS GALE, *COMPARING FINANCIAL SYSTEMS* (2000); but see Michael H. Bradley & Anant K. Sundaram, *The Emergence of Shareholder Value in the German Corporation* (working paper 2003) (arguing that large German corporations have become shareholder-oriented).

whole.²⁹⁶ The hallmark of the German system, however, is its codetermination regime, which provides employees with structural protection through representation in corporate institutions. Under German codetermination, firms have a two-tiered board structure. Companies are governed by a managing board (*Vorstand*) that conducts the day-to-day business of the firm and a supervisory council (*Aufsichtsrat*) that elects and monitors the firm's management and approves major corporate decisions. The German Codetermination Act of 1976 mandates that fifty percent of the *Aufsichtsrat* of large firms be elected by shareholders and fifty percent by employees, or by their delegates if the firm is very large.

Employee participation in the supervisory organ is also mandated (with qualifications) in Austria, Denmark, Germany, Luxembourg, the Netherlands, and Sweden.²⁹⁷ In France, Ireland, Portugal, and other EU Member States, the law includes aspects of employee participation in corporate governance.²⁹⁸ It should be emphasized that membership in the

²⁹⁶ Gérard Hertig & Joseph A. McCahery, *Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?* (ECGI Working Paper 2003) (citing H. Hirte, *Verteidigung gegen Übernahmeangebote und Rechtsschutz des Aktioners gegen die Verteidigung*, ZEITSCHRIFT FÜR UNTERNEHMENS UND GESELLSCHAFTSRECHT, 623, 643 (2002)). Other commentators are like-minded. See Bradley et al., *supra* note 215, at 52 (“Corporate law in Germany makes it abundantly clear that shareholders are only one of the many stakeholders on whose behalf the managers must operate the firm.”); Lawrence A. Cunningham, *Commonalities and Prescriptions in the Vertical Dimension of Global Corporate Governance*, 84 CORNELL L. REV. 1133, 1157 (1999) (“German law takes more seriously the idea that beneficiaries of directors' duties include corporate constituents other than shareholders”); Timothy L. Fort & Cindy A. Schipani, *Corporate Governance in a Global Environment: The Search for the Best of All Worlds*, 33 VAND. J. TRANSNAT'L L. 829, 846 (2000) (“German corporate law clearly shows that managers must operate the firm for the benefit of multiple stakeholders, not just shareholders.”); Klaus J. Hopt, *Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe*, 14 INT'L REV. L. & ECON. 203, 208 (1994) (“Maximization of shareholders' wealth has hardly ever been the objective of German stock corporations.”).

²⁹⁷ Luca Enriques, *Silence Is Golden: The European Company Statute as a Catalyst for Company Law Arbitrage* (ECGI Law Working Paper No. 07/2003 2003) (citing Weil, Gotshal & Manges LLP, *Comparative Study Of Corporate Governance Codes Relevant to the European Union And Its Member States*, Final Report & Annexes I-III, at 44 (2002)).

²⁹⁸ See Uwe Blaurock, *Steps Toward a Uniform Corporate Law in the European Union*, 31 CORNELL INT'L L.J. 377, 390 (1998); see also Antoine Rebérioux, *European Style Corporate Governance at the*

supervisory board does not give employees formal decision power. Nonetheless, the structural involvement of non-shareholder constituencies in firms' governance is effective in mitigating informational asymmetries and facilitates informal negotiations among corporate constituencies.

Asian corporate governance systems are perhaps the least comprehensible to the Western observer. For instance, both the Japanese and Korean models of corporate governance rest on a statutory infrastructure that consists of a German-inspired civil and commercial codes and an American-inspired corporate law. Both countries nonetheless have developed corporate governance systems that differ markedly from the German and American models, from one another,²⁹⁹ and from other Asian countries.³⁰⁰ Subject to these reservations, corporate governance in Japanese and Korean corporations tends to rely more extensively on interpersonal relationships. In Korea, these relationships are often based on extended family (clan) kinship. Corporate groups are the predominant form of business

Crossroads: The Role of Worker Involvement, 40 J. COMMON MARKET STUD. 111 (2002); Karel Lannoo, *A European Perspective on Corporate Governance*, 37 J. COMMON MARKET STUD. 269 (1999).

²⁹⁹ For recent discussion of Japan, see, e.g., Hideki Kanda & Curtis J. Milhaupt, Re-examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law (Columbia Law and Economics Working Paper No. 219 2003); Zenichi Shishido, *Japanese Corporate Governance: The Hidden Problems of Corporate Law and Their Solutions*, 25 DEL J. CORP. L. 189 (2000); Yoshiro Miwa, *Corporate Social Responsibility: Dangerous and Harmful, Though Maybe Not Irrelevant*, 84 CORNELL L. REV. 1227 (1999); Hideki Kanda, *Japan*, in THE LEGAL BASIS OF CORPORATE GOVERNANCE IN PUBLICLY HELD CORPORATIONS 111 (Arthur R. Pinto & Gustavo Visentini eds., 1998). On Korea, see, e.g., Kon Sik Kim & Joongi Kim, *Revamping Fiduciary Duties in Korea: Does Law Matter in Corporate Governance?*, in GLOBAL MARKETS, DOMESTIC INSTITUTIONS CORPORATE LAW AND GOVERNANCE IN A NEW ERA OF CROSS-BORDER DEALS (Curtis J. Milhaupt, ed. 2003); Hwa-Jin Kim, *Toward the "Best Practice" Model in a Globalizing Market: Recent Developments in Korean Corporate Governance*, in 5 YEARBOOK LAW AND LEGAL PRACTICE IN EAST ASIA 1 (2002); Bernard S. Black, *Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness*, 26 IOWA J. CORP. L. 537 (2001); Jill Frances Solomon, Aris Solomna, & Chang-Young Park, *A Conceptual Framework for Corporate Governance Reform in South Korea*, 10 CORP. GOVERNANCE: INT'L REV. 29 (2002).

³⁰⁰ See, e.g., Douglas M. Branson, *The Very Uncertain Prospect of 'Global' Convergence in Corporate Governance*, 34 CORNELL INT'L L.J. 321 (2001) (discussing Indonesia); Benny Simon Tabalujan, *Family Capitalism and Corporate Governance of Family-controlled Listed Companies in Indonesia*, 25 U. NSW L.J. (2002) (same).

organization. Both the Japanese *keiretsu* and the Korean *chaebol* exhibit extensive cross-holdings among corporations that engage in a variety of industrial and financial activities.³⁰¹ These Asian systems are generally perceived as stakeholder-oriented.³⁰² Commentators routinely make references to Asian cultures (especially to Confucianism with regard to Korea and Japan) as the bedrock of corporate governance practices.³⁰³

The preceding sketchy portraits of corporate governance systems in English-speaking, West European, and East Asian countries correspond with the cultural profiles of these regions under Schwartz's cultural-level model. Let us here focus on the English-speaking versus West European regions.³⁰⁴ Although countries in these two groups are usually lumped together as "Western," Schwartz and Ros find that West European nations and English-speaking nations constitute culturally different regions that cannot simply be characterized as "individualistic".³⁰⁵ In a global comparison, countries in both regions attribute high

³⁰¹ For a critical assessment of Japan, see, Yoshiro Miwa & J. Mark Ramseyer, *The Fable of the Keiretsu*, 11 J. ECON. & MGMT. STRATEGY 169 (2002); on Korea, see, e.g., Daehong T. Jaang, Kyung-soo Kim, Woo Tack Kim, & Sangsoo Park, *Cross Shareholding and Corporate Financial Policy: the Case of Korea* (Working Paper 2002).

³⁰² See Shishido, *supra* note 143, at 201 ("many will agree that Japanese corporate practice is employee-oriented rather than pro-shareholder"); Ronald J. Gilson & Mark J. Roe, *Lifetime Employment: Labor Peace and the Evolution of Japanese Corporate Governance*, 99 COLUM. L. REV. 508, 538 (1999) (same); Solomon et al., *supra* note 299, at 30-31 (same, with regard to Korea).

³⁰³ See, e.g., Meredith Woo-Cumings, *Diverse Paths toward "the Right Institutions:" Law, the State, and Economic Reform in East Asia* (ADB Institute Working Paper 18, 2001); Janis Sarra, *Corporate Governance in Global Capital Markets: Canadian and International Developments*, 76 TUL. L. REV. 1691, 1728-29 (2002); Branson, *supra* note 300, at 344-45.

³⁰⁴ In the Schwartz data, Korea's scores reflect societal preferences for Embeddedness over Autonomy, for Hierarchy over Egalitarianism, and for Mastery over Harmony. This profile is consonant with many analyses of Confucian culture. For a cultural value dimension analysis of Korean corporate governance see Licht, *supra* note 94. Japan presents an exception to profile of its cultural region. Several samples from Japan reveal strong cultural emphases on orientation that oppose one another. This finding suggests that Japanese culture has evolved in a manner different from most other and/or that is in a period of transition. Sagiv & Schwartz, *supra* note 100, at n.6.

³⁰⁵ See Shalom H. Schwartz & Maria Ros, *Values in the West: A Theoretical and Empirical Challenge to the Individualism-Collectivism Cultural Dimension*, 1 WORLD PSYCHOL. 93, 111 (1995).

importance to the two Autonomy orientations, with West European countries scoring particularly high on Intellectual Autonomy. These regions part ways, however, in their locations on the other two dimensions. West European countries attribute greater importance to Egalitarianism and Harmony while English-speaking countries (especially American samples) attribute greater importance to Hierarchy and Mastery.

As suggested by the theoretical analysis in Part II, the cultural differences between the United States and Western Europe are consistent with the different positions among these countries in regards with the maximands of corporate governance. West European countries emphasize the more complex orientations in the two dimensions that concern interrelations in and with the social and natural world. In contrast, the cultural profile of the United States emphasizes less complex orientations that promote power and control while championing the autonomy of the individual person. One can therefore expect that both regions will develop accountability regimes, but that the European accountability will feature multiple constituencies as accountees while the American accountability will seek to define power hierarchies among constituencies. This is indeed the case.

In addition to promoting shareholder wealth maximization, the combination of Autonomy and Hierarchy also may lead to greater tolerance toward hostile takeovers—a hallmark of American and English corporate governance.³⁰⁶ Such tolerance reflects acceptance of pursuit of wealth and power for the benefit of a single constituency or even few individuals. This may be the case even if ensuing layoffs could be more disruptive in comparison to layoffs in egalitarian societies that maintain better social safety nets.

Doubtless, tolerance toward the more hostile takeovers also conveys a societal taste for Mastery, a value type that connotes exploitation. This and other typically American norms³⁰⁷ share an attitude of legitimation – ranging from deference to respect to admiration – of individuals who take advantage of their wealth and/or power.

Among the socio-historical variables that might help to explain the unique value profiles of Western Europe and the United States, Schwartz and Ros note that “[i]n Western Europe more than in the United States, socialist governments that pursue the politics of the welfare state emerged... [whereas in] the United States, perhaps due to impacts of the frontier experience and of large corporations on societal developments, welfare socialism did not take root.”³⁰⁸ This conjecture links culture and politics and supports Mark Roe’s political theory of comparative corporate governance.³⁰⁹ According to Roe, the predominance of social democracy in Western Europe explains the rejection of the shareholder wealth maximization norm in countries like France, Germany, Italy, and in Scandinavia. The failure of social

³⁰⁶ See Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1287-90 (1999) (discussing the emergence of a hostile takeover norm in the United States).

³⁰⁷ Other characteristic norms of American corporate governance include high levels of executive compensation and deference to managerial discretion, as reflected in the (legal) norm of business judgment rule. See, respectively, Randall S. Thomas & Kenneth J. Martin, *The Effect of Shareholder Proposals on Executive Compensation*, 67 U. CIN. L. REV. 1021, 1025-30 (2000); Edward Rock & Michael Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1607 (2001).

³⁰⁸ *Id., id.*, at 114.

³⁰⁹ See Mark J. Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539 (2000) (hereinafter *Political Preconditions*); see also MARK J. ROE, *POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE* (2003). This work extends Roe’s groundbreaking work on the political roots of American corporate governance. See Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 32-37 (1991); MARK J. ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE* (1994).

democracy to take root in the United State therefore enabled the rise of widely dispersed shareholding and the adherence to shareholder wealth maximization.³¹⁰

B. Seeming Convergence Trends

Major economic and geo-political processes have joined together during the 1990s to broaden the scope of the stockholder-stakeholder debate such that today it spans the entire globe. At the turn of the previous decade, the American economy was still struggling in the wake of the turbulent downsizing period of the 1980s and was in fact heading toward a recession. In contrast, the Japanese and German economies were then at the apex of an unprecedented growth period. But then things changed. Japan declined into a deep recession from which it has not recovered to this day. The collapse of the Soviet Bloc from 1989 to the early 1990s created an urgent need for establishing market economies in former soviet countries. The unification of Germany, which was part of this process, burdened the German economy, while the United States began to grow briskly and re-assumed economic leadership, particularly in hi-tech industries. To complete the picture, a series of financial crises swept Latin America in the mid-1990s and in the late 1990s, another wave of financial crises crippled Asian economies, including several “tiger economies” that were considered poster children of economic growth, such as South Korea.

These events first engendered interest in non-American corporate governance systems with a view to adopting successful features of foreign corporate governance in the United

³¹⁰ Roe, *Political Preconditions, id.*, at 543 (“Social democracies do not strongly control public firm agency costs because they do not want unbridled shareholder-wealth maximization, and, hence, by weakening shareholder-wealth maximization institutions, they widen the gap between managers and dispersed stockholders. When the gap is wide enough, the large American-style public firm is rendered unstable.”)

States. Comparative corporate governance was born as an academic field of interest.³¹¹ At first, mostly lawyers were writing on these issues but in the mid-1990s economists too started to show interest in comparative corporate governance.³¹² Corporate governance has drawn tremendous attention in light of a growing consensus that an effective corporate governance system may be a crucial precondition for a thriving market economy. By that time, however, the German and Japanese corporate governance models have lost favor and the Anglo-American model came to be seen as superior.³¹³ Germany, along with other European economies, began to embrace the Anglo-American “equity culture” that gives primacy to shareholder value at the expense of other constituencies.³¹⁴ Motivated by the evidence that corporate governance matters for economic performance, international bodies began to endorse corporate governance reform that draws on American features as a standard

³¹¹ See Edward B. Rock, *America's Shifting Fascination with Comparative Corporate Governance*, 74 WASH U. L.Q. 367, 367 (1996) (“In the last few years, comparative corporate governance — German and Japanese corporate governance in particular — has been a hot topic in U.S. law reviews and conferences.”) (footnote omitted). The omitted footnote includes an extensive list of law review articles in this spirit, which is nevertheless far from exhaustive.

³¹² The pioneering works were produced by La Porta, Lopez-de-Silanes, Shleifer, and Vishny. See Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998). These studies prompted a flurry of studies that are too numerous to cite here. For a recent review, see Marco Becht, Patrick Bolton, & Ailsa Roell, *Corporate Governance and Control* (ECGI working paper no. 2/2002 2002).

³¹³ Beyond the obvious success of the American economy in the second half of the 1990s, this perception was to a large extent due to the work of La Porta et al., *id.*, which demonstrated strong associations between economic performance and a common law origin of countries’ legal systems, and vice versa for civil law origin. See also Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, *Corporate Ownership around the World*, 54 J. FIN. 471 (1999) (hereinafter *Corporate Ownership*); Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes, & Andrei Shleifer, *Tunneling*, 90 AM. ECON. REV. PAPERS & PROCEEDINGS 22 (2000). La Porta et al. thus concluded that “[i]n general, differences among legal origins are best described by the proposition that some countries protect all investors better than others, and not by the proposition that some countries protect shareholders while other countries protect creditors.” Rafael La Porta et al., *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3, 8 (2000).

³¹⁴ See Andre, *supra* note 296; Roger W. Mills & Bill Weinstein, *Beyond Shareholder Value - Reconciling the Shareholder and Stakeholder Perspectives*, 25 J. GENERAL MGMT. 79 (2000).

prescription for transition economies. International aid for distressed economies is conditioned on implementing such reforms. Again, Korea is a prominent example.³¹⁵

The shifts of attention, and favor, from American to non-American corporate governance and back again to the American model were accompanied by parallel shifts with regard to stockholder vs. stakeholder interest as the desirable maximands of corporate governance. During the 1990s, corporate governance analysis entered a new phase when study groups in the public and private sector alike began to promulgate codes of principles for optimal corporate governance. The turning point was the 1992 Cadbury Report, commissioned by the Financial Reporting Council, the London Stock Exchange and the accountancy profession.³¹⁶ It marked a conceptual change with regard to corporate governance reform as it called for “soft regulation”—namely, the use non-binding rules and practices—and underscored the importance of private, market-driven improvements in corporate governance.

The Cadbury Report was followed by similar initiatives in many countries in Europe³¹⁷ and in other parts of the world, including Asia and Latin America.³¹⁸ The large majority of these documents have been promulgated since 1999, however. To understand the

³¹⁵ Hwa-Jin Kim, *Toward the “Best Practice” Model in a Globalizing Market: Recent Developments in Korean Corporate Governance*, in 2 J. CORP. L. STUD. (2002). On the alleged role of corporate governance in the Korean crisis, see Tomas J.T. Balino & Angel Ubide, *The Korean Financial Crisis of 1997: A Strategy for Financial Sector Reform* (IMF Working Paper WP/99/29 1999); Magdi Iskander et al., *Corporate Restructuring and Governance in East Asia*, 36(1) FIN. & DEVELOPMENT (1999), available at <<http://www.imf.org/external/pubs/ft/fandd/1999/03/iskander.htm>>.

³¹⁶ REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE (1992) (“Cadbury Report”) available at http://www.ecgi.de/codes/country_documents/uk/cadbury.pdf.

³¹⁷ The list includes, by order of promulgation, France, The Netherlands, Spain, Belgium, Greece, Italy, Portugal, Finland, Germany, Denmark, and Austria. The texts of the respective documents are all available at http://www.ecgi.de/codes/all_codes.htm.

popularity of these “codes of best principles” one should be aware of two major factors that provided strong incentives for countries and firms to follow this route. The first factor was indeed market-driven. During the 1990s, institutional investors in the U.S. and the U.K. grew in terms of the size of their managed funds and particularly the share of their portfolios earmarked for foreign securities. Some of the largest institutional investors have adopted an “active” investment policy that focused on corporate governance in their portfolio companies and sought to improve it.³¹⁹ These investors also drafted documents on optimal corporate governance that dovetailed the Cadbury Report and its progeny. These two policies combined together well to exert pressure on foreign corporations to adopt legal and structural measures that would bring them in line with the recommended “optimum.” Investor associations jumped the bandwagon and contributed their own documents.³²⁰ Building on these developments, a new industry of corporate governance rating services has emerged, which measures compliance with these principles as part of corporate governance consulting.³²¹

³¹⁸ In Asia: Japan and Korea. In Latin America: Brazil, Mexico, and Peru.

³¹⁹ For a review and critical analysis of institutional investor activism, *see* Bernard S. Black, *Shareholder Activism and Corporate Governance in the United States*, in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 459 (Peter Newman ed., 1998). On CalPERS's interest in foreign corporate governance as an extension of its interest in corporate governance in general, *see, e.g.*, Claire Crutchley et al., *The Shareholder Wealth Effects of CalPERS' Activism*, 7 FIN. SERV. REV. 1 (1998).

³²⁰ The European Corporate Governance Institute (ECGI) keeps track of corporate governance codes around the world. As of August 2003, the ECGI had recorded 118 such documents, promulgated by 38 countries and four multinational organizations. A comprehensive list of these documents and their text can be found at http://www.ecgi.de/codes/all_codes.htm.

³²¹ The new rating agencies derive from the codes of best principles (or from similar documents) lists of features that companies should have in their articles of association, the structure of the board and its committees, and so forth. These ratings may create economic incentives for firms to adopt these features and thus render corporate governance reform genuinely market-driven. For a review and empirical analysis of corporate governance rating based on data from Credit Lyonnais Securities Asia, *see* Krishna Palepu, Tarun Khanna, & Joseph Kogan, *Globalization and Similarities in Corporate Governance: A Cross-Country Analysis* (Harvard University Strategy Unit Working Paper No. 02-041 2002).

The picture would not be complete without considering the second factor, to wit, the Principles of Corporate Governance adopted by the OECD Ministers in 1999 and revised in 2004.³²² These non-binding principles are intended to serve as a reference point for countries' efforts to evaluate and improve their own legal, institutional and regulatory framework. Shortly thereafter, the OECD and the World Bank signed a Memorandum of Understanding. The signatory parties agreed to adopt the OECD Principles as the point of reference in their corporate governance reform initiatives in transition economies and developing countries.³²³ The parties also established the Global Corporate Governance Forum with a similar mission statement.³²⁴ Moreover, CalPERS and other institutional investors adopted the Principles as guiding principles for their corporate governance agenda for foreign portfolio companies.³²⁵ These developments obviously have given the OECD Principles clout far exceeding their seeming non-binding character. The Principles now constitute a benchmark for the myriad codes around the world, which in 2003 numbered well over a hundred.³²⁶

The upshot of the code of principles movement is that, either thanks to moral suasion or due to pressure from markets and financial institutions, similar codes of principles are

³²² See *supra* note 85. The Principles came in the wake of earlier activities. In 1996, the OECD set up a Business Sector Advisory Group on Corporate Governance to review and analyze international corporate governance issues and to suggest priorities for the work of the OECD in this area. The Advisory Group reported in April 1998, and suggested "that the OECD recommended minimum standards of corporate governance to promote fairness, transparency, accountability, and responsibility. Rejecting a "one-size-fits-all" approach to corporate governance, [it] advocate[d] the need for pluralism and adaptability in corporate governance." See Licht, *supra* note 19, at 150 (describing adoption of OECD 1999 PRINCIPLES).

³²³ MEMORANDUM OF UNDERSTANDING BETWEEN THE OECD AND THE WORLD BANK (1999), available at <http://www.gcgf.org/aboutus/munderstanding.htm>.

³²⁴ See GLOBAL CORPORATE GOVERNANCE FORUM, CORPORATE GOVERNANCE AN ISSUE OF INTERNATIONAL CONCERN (2003) available at <http://www.gcgf.org/about.htm#initiative>; see also THE WORLD BANK, CORPORATE GOVERNANCE: A FRAMEWORK FOR IMPLEMENTATION (2001), available at www.worldbank.org/html/fpd/privatesector/cg/docs/gcgfbooklet.pdf.

³²⁵ Licht, *supra* note 19, at 153-57.

peddled globally today as reflecting optimal corporate governance. These codes cover a variety of issues but their dominant focus is on boards and board-related issues,³²⁷ with a clear view to improving protection of public shareholders from managers and controlling shareholders alike. This is both understandable and warranted if the concerns of institutional investors are to be addressed such that they would be willing to invest in foreign equities. It is debatable, however, how much of an impact this (apparent) budding consensus might have on the issue of stockholder vs. stakeholder interests.³²⁸

The OECD Principles consider corporate stakeholders rather vaguely and halfheartedly. The Principles state at the outset that “[e]mployees and other stakeholders play an important role in contributing to the long-term success and performance of the corporation, while governments establish the overall institutional and legal framework for corporate governance.”³²⁹ When it comes to implementation, however, the Principles adopt a complete deference approach as they call for recognizing the rights of stakeholders but limit the latter only to rights established by law. When law protects such rights, the Principles call for

³²⁶ See *supra* note 320.

³²⁷ Becht et al., *supra* note 312, at 67.

³²⁸ More generally, one may doubt whether genuine progress toward convergence to a global optimum in shareholder protection could be achieved through the code movement or other standardized legal reforms. For critical discussions, see Katharina Pistor, *The Standardization of Law and Its Effect on Developing Economies*, 50 AM. J. COMP. L. 97 (2002); Janis Sarra, *Convergence Versus Divergence, Global Corporate Governance at the Crossroads: Governance Norms, Capital Markets & OECD Principles for Corporate Governance*, 33 OTTAWA L. REV. 177 (2001/2002). The skeptical tone of these articles stands in contrast with the high spirit that is commonly found in contemporary discussions of corporate social responsibility. See, e.g., Holly J. Gregory & Jane G. Pollack, *Corporate Responsibility*, GLOBAL COUNSEL, March 2002, at 41, available at www.practiallaw.com/global (surveying codes). The latter discussions often fail to distinguish between declarations in codes and actual corporate or national reality – a mistake that is identical to reading the other constituency statutes in the United States as attesting to a paradigm shift toward favoring stakeholders in this country.

³²⁹ OECD 2004 PRINCIPLES, *supra* note 85, at 12. The OECD 1999 PRINCIPLES, *supra* note 85, at 3, used identical language.

respecting them, albeit weakly, primarily through effective disclosure (transparency).³³⁰ The difficult job of reconciling conflicting interests of various stakeholders is relegated to the board of directors.³³¹ It should be obvious at this point that in discharging this duty, directors will be affected by their different values and cognitive styles.

Notwithstanding the OECD Principles, a comparative study of corporate governance codes relevant to the European Union commissioned by the European Commission finds differences in the legal status of stakeholders across Europe, in line with the above review. The traditional differences between English and continental European corporate governance in what regards non-shareholder constituencies remain intact notwithstanding calls in the

³³⁰ Principle IV of the OECD 2004 PRINCIPLES, *id.*, at 21, reads as follows.

The Role of Stakeholders in Corporate Governance

The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

- A. The rights of stakeholders that are established by law or through mutual agreements are to be respected.
- B. Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.
- C. Performance-enhancing mechanisms for employee participation should be permitted to develop.
- D. Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.
- E. Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.
- F. The corporate governance framework should be complemented by an effective, efficient insolvency framework and by effective enforcement of creditor rights.

The language of the OECD 1999 PRINCIPLES was largely similar.

³³¹ See Nestor Stilpon, INTERNATIONAL EFFORTS TO IMPROVE CORPORATE GOVERNANCE: WHY AND HOW (2001) (“The Principles make it clear that it is the duty of the board to act fairly with respect to all groups of shareholders and with stakeholders, and to assure compliance with applicable laws.”) (Stilpon was Head of Corporate Affairs Division at the OECD).

U.K. for assessing risks and opportunities for these constituencies.³³² This study too points to national culture as underlying these differences.³³³ Moreover, in the wake of the Enron-WorldCom wave of scandal, the pendulum seems to be shifting back as European fascination with American corporate governance has abated considerably. The European Union recently adopted a policy to promote corporate social responsibility (CSR), defined as “a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.”³³⁴

A sober analysis of the code of principles movement therefore leads to the conclusion that it has so far had a negligible effect on the stockholder-stakeholder issue. To paraphrase a critique on the English supposedly pro-employee legislation, the stakeholder-related provisions in the OECD Principles and the codes that follow them may be considered either cynical or incompetent.³³⁵ In contrast with the issue of shareholder protection, on which codes adopt strong normative positions intended to improve it, the codes either preserve different national positions, or, in the case of international codes, fully defer to such positions. Moreover, virtually no progress can be related to the code movement with regard to resolving the implementation problem that has bedeviled proponents of other constituency interests since the time of Berle and Dodd. In light of the cultural orientations to which these issues are linked, this is not entirely surprising.

³³² EUROPEAN COMMISSION, INTERNAL MARKET DIRECTORATE GENERAL, A COMPARATIVE STUDY OF CORPORATE GOVERNANCE CODES RELEVANT TO THE EUROPEAN UNION AND ITS MEMBER STATES 34-37 (2002), available at http://europa.eu.int/comm/internal_market/en/company/company/news/corp-gov-codes-rpt_en.htm.

³³³ *Id.*, at 29.

³³⁴ Several EU bodies are involved in promoting CSR, including the Commission, the Employment and Social Affairs Council, and the Parliament. For a concentration of related documents, *see* http://europa.eu.int/comm/employment_social/soc-dial/csr/csr_index.htm.

VI. CONCLUSION

This article has sought to broaden our understanding the *raison d'être* of corporations as it is reflected in the maximands of corporate governance. The debate over the appropriate maximand has been raging for decades and is still taking place as vigorously as ever. Advances in economic theory have not only failed to resolve this debate, but have established that the problem is graver than what many may have estimated. Notwithstanding this theoretical impasse, corporate managers and recently also policy makers around the world face the maximands problem regularly.

This paper has put forward a new theory about the factors that determine these maximands. Drawing on recent advances in psychological research, this theory points to value emphases at the individual and societal levels and to the need for cognitive closure as such factors. This theory further proposes the notion of complexity of values as an organizing element that may associate certain value emphases with cognitive style. The present theory aims to extend rather than replace economic analyses of the maximands issue. Overall, the present theory is able to provide explanations for various features of the stockholder-stakeholder debate in the United States and in international settings, to identify gaps in other theoretical accounts, and to generate testable hypotheses for empirical research. Extant evidence largely supports this theory.

³³⁵ See Sealy, *supra* note 294.

TABLES AND FIGURES

Table 1. The Schwartz Individual-level Value Types and Values that Represent Them

Self-Direction	Independent thought and action-choosing, creating, exploring (creativity, freedom, independent, curious, choosing own goals)
Stimulation	Excitement, novelty and challenge in life (daring, a varied life, an exciting life)
Hedonism	Pleasure and sensuous gratification for oneself (pleasure, enjoying life)
Achievement	Personal success through demonstrating competence according to social standards (successful, capable, ambitious, influential)
Power	Social status and prestige, control or dominance over people and resources (social power, authority, wealth)
Security	Safety, harmony and stability of society, of relationships and of self (family security, national security, social order, clean, reciprocation of favors)
Conformity	Restraint of actions, inclinations and impulses likely to upset or harm others and violate social expectations or norms (self-discipline, obedient, politeness, honoring parents and elders)
Tradition	Respect, commitment and acceptance of the customs and ideas that traditional culture or religion provide (accepting my portion in life, humble, devout, respect for tradition, moderate)
Benevolence	Preservation and enhancement of the welfare of people whom one is in frequent personal contact (helpful, honest, forgiving, loyal, responsible)
Universalism	Understanding, appreciation, tolerance and protection for the welfare of all people and for nature (broadminded, wisdom, social justice, equality, a world at peace, a world of beauty, unity with nature, protecting the environment)

Table 2. The Schwartz Cultural-Level Value Dimensions

Embeddedness/Autonomy	This dimension concerns the desirable relationship between the individual and the group. Embeddedness represents a cultural emphasis on maintenance of the status quo, propriety, and restraint of actions or inclinations that might disrupt the solidary group or the traditional order. The opposite pole describes cultures in which the person is viewed as an autonomous, bounded entity who finds meaning in his or her own uniqueness.
Hierarchy/Egalitarianism	This dimension refers to guaranteeing responsible behavior that will preserve the social fabric. Hierarchy represents a cultural emphasis on obeying role obligations within a legitimately unequal distribution of power, roles, and resources. Egalitarianism represents an emphasis on transcendence of selfish interests in favor of voluntary commitment to promoting the welfare of others.
Mastery/Harmony	This dimension refers to the relation of humankind to the natural and social world. Mastery stands for a cultural emphasis on getting ahead through active self-assertion whereas Harmony represents an emphasis on fitting harmoniously into the environment.

Table 3. The Hofstede Cultural-Level Value Dimensions

Individualism/Collectivism	Valuing loosely knit social relations in which individuals are expected to care only for themselves and their immediate families versus tightly knit relations in which they can expect their wider in-group (e.g., extended family, clan) to look after them in exchange for unquestioning loyalty;
Power Distance	Accepting an unequal distribution of power in institutions as legitimate or illegitimate
Uncertainty Avoidance	Feeling uncomfortable or comfortable with uncertainty and ambiguity and therefore valuing or devaluing beliefs and institutions that provide certainty and conformity.
Masculinity/Femininity	Valuing achievement, heroism, assertiveness, and material success versus relationships, modesty, caring for the weak, and interpersonal harmony.
Long-Term Orientation	Having a long-term time orientation; emphasizing Confucian work ethics such as thrift and persistence.

Figure1. The Structure of Relations Among Individual Values

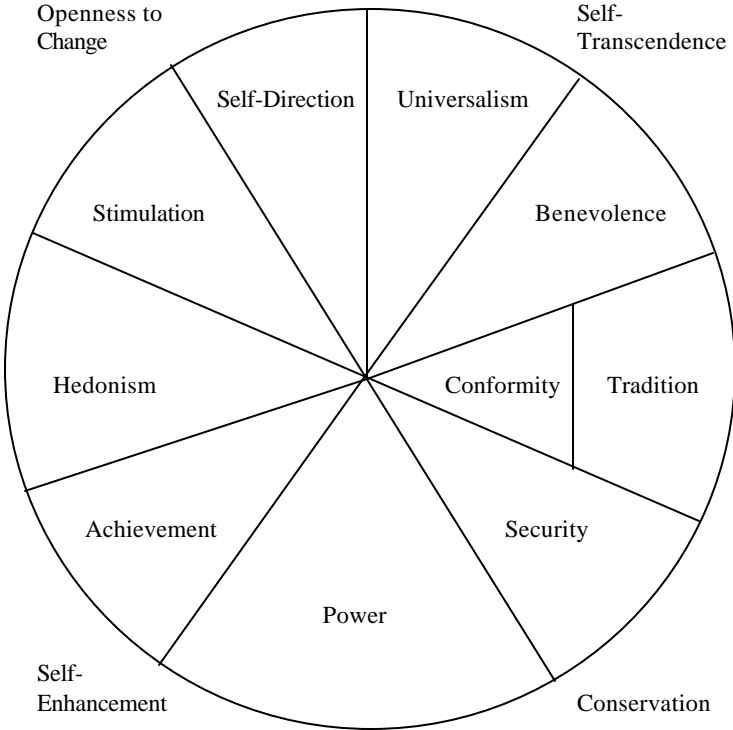


Figure2. The Structure of Relations Among Cultural Orientations

