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SECTION THREE

BEYOND COMMAND AND CONTROL

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TEN

What Opportunity Is Knocking? Regulating Corporate Governance in the United States[1]

Mary A. O'Sullivan

I. Introduction

A series of major corporate scandals around the turn of the millennium prompted a burst of regulatory changes that together represented the most significant development in corporate regulation since the New Deal. The most prominent reform was the Sarbanes-Oxley Act of 2002 (SOX), but the Securities and Exchange Commission (SEC) also implemented a host of important rule changes, and stock exchanges made significant alterations to their listing requirements. The new regulations elicited considerable controversy, with business elites and their political allies vehemently complaining about the burdens that they imposed on firms and managers. As the corporate scandals retreated from the front pages of newspapers, the impetus for reform waned. However, the recent change in the political leadership of the United States and, crucially, the context of a worsening financial crisis in which it occurred, seem certain to renew the momentum for further reform of the corporate economy.

The various proposals for increased regulation of America's corporations find intellectual support in academic research, where there is a lively debate about the villain of the piece in recent American corporate and financial scandals. Different diagnoses abound: Some scholars emphasize the failure of gatekeepers – especially auditors, analysts, and rating agencies – to protect investors; others stress the inadequacies of corporate boards as internal oversight mechanisms; still others focus on an alleged cause of weak corporate boards and other flaws in the governance of American corporations – insufficient rights for shareholders. Although, on the surface, these alternative perspectives have generated a wide range of heterogeneous ideas for

[1] I would like to gratefully acknowledge the excellent advice and suggestions of Ed Balleisen in the process of writing this article.

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reform, on closer scrutiny there is a striking unanimity in the fundamental goal of reform at the root of these ideas – to make the reality of corporate governance in the United States more closely approximate the shareholder theory of the firm.

Understanding how shareholder value came to be the pervasive ideology for corporate governance in the United States, and the particular way in which shareholder value was put into practice, goes a long way toward explaining how the debate on corporate governance ended up where it is today. In thinking about the possible role of academics and other intellectuals in this debate, there is considerable work to be done to advance governance reforms, even if one remains committed to the logic of shareholder value. However, there is good reason to challenge that logic in an effort to reorient the basic terms of the debate on corporate governance in the United States by considering alternative perspectives to shareholder value as the benchmark for good corporate governance. Scholars have already invested considerable effort in developing such perspectives and have taken a renewed interest in doing so in recent years. The leading approaches are often grouped as "stakeholder theories of governance," but this is a loose grouping, representing a motley collection of theories. Indeed, their heterogeneity has weakened the influence of stakeholder theories but it is also true that their impact has been muted by their need to grapple with some fundamental issues central to a persuasive theory of corporate governance.

A broader range of theoretical options would certainly create a more meaningful debate about improving the U.S. system of corporate governance. Yet, it is also important to recognize that the challenges of, and opportunities for, corporate governance will never be fully understood using general theories of corporate governance that ostensibly hold for all societies in all eras. Everything we know from comparative–historical research on the institutions of corporate governance, and on capitalism more generally, suggests that countries do not choose their system of corporate governance by selecting from a menu of general options. Instead, these institutions emerge through the messiness of history and are inextricably linked to broader economic, political, and cultural contexts. Therefore, the scope for fundamental change in corporate governance systems is profoundly conditioned by much broader societal dynamics. Only by understanding this process of conditioning, such as how the political system creates opportunities for, and constraints on, systems of corporate governance, can we appreciate what types of regulatory initiatives might forge novel directions in corporate governance, and thereby determine what opportunity is knocking for reform of American corporate governance.

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II. The Momentum behind Regulatory Reform

During the late 1990s, many observers argued that the U.S. system of corporate governance, which fostered a fervent commitment by corporations to the maximization of shareholder value, was a crucial contributor to the country's economic dynamism. This interpretation was not confined to Americans; prominent academics and policymakers in other countries around the world often expressed this view and, in some cases, worked hard to change their institutions to emulate the U.S. system of corporate governance. Then, at the beginning of the new millennium, the United States was rocked by a wave of scandals involving some of the leading corporate lights of the 1990s. In December 2001, Enron, an aggressive energy company and a darling of Wall Street and the business press, filed for bankruptcy, the largest in U.S. history until that time. Shortly afterward, the scale of its failure was surpassed by the demise of WorldCom. Moreover, the accounting and other improprieties that brought these companies down reverberated throughout the corporate sector in a large number of cases, including Sunbeam, Waste Management, Tyco, and Global Crossing.

These scandals brought major problems in U.S. corporate governance to the surface and generated a debate about what needed to be done to remedy them. A flurry of regulatory activity ensued as legislators, the SEC, and the leading stock exchanges introduced reforms to bolster the effectiveness and legitimacy of the U.S. system of corporate governance. The first and most dramatic response was the Public Company Accounting Reform and Investor Protection Act, which Congress enacted on July 30, 2002, less than a year after the Enron scandal broke. The legislation, described as Sarbanes–Oxley, Sarbox or SOX after its sponsors, Senator Paul S. Sarbanes (D-Md.) and Michael G. Oxley (R-Ohio),[2] primarily sought to restore the integrity of corporate disclosure. As such, its objectives mirrored the central aspirations of New Deal era securities regulation: The goal was not just to furnish a means of fixing some market failures, but to buttress the public confidence that underpins market activity – to create public institutions that constitute and sustain markets.[3]

In part, Sarbanes–Oxley sought to achieve this outcome by strengthening the oversight of the accounting profession and the relationship of auditors to firms. To that end, it created the Public Company Accounting Oversight Board (PCAOB) and made it responsible to the SEC, charging it with

[2] Oxley was the chairman of the House Financial Services Committee at the time.
[3] For an analogous purpose for pharmaceutical regulation, see Carpenter, this volume.

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oversight of the auditing of public companies and bringing the tradition of self-regulation of the accounting profession to an abrupt end ("SOX at 5: the profession reflects on a milestone," *Accounting Today*, August 20, 2007). The act also made it illegal for a public accounting firm that audits a company to provide it with nonaudit services, much as New Deal banking legislation partitioned commercial and investment banking. SOX also limited membership of corporate audit committees to independent directors and mandated that at least one of them had to be a financial expert. In parallel, it expanded the responsibilities of this committee, notably assigning it direct responsibility for the appointment, compensation, and oversight of the work of the company's accountants.

The Sarbanes–Oxley Act introduced additional measures to remedy perceived failures in corporations' internal controls. It required CEOs and CFOs to certify, on pain of criminal penalties, the accuracy of their firms' periodic financial reports, as well as the effectiveness of their companies' internal controls. It introduced a "clawback" provision that requires CEOs and CFOs to return incentive pay awarded to them based on fraudulent accounting. Section 404 of the act also contained a notorious requirement for corporations to produce annual reports on their internal controls that must be vetted by outside accountants.

The Act's various provisions sought to increase the transparency of America's corporations to investors not only through the disclosure of more information but also by improving its quality. In this sense, it fit with the general emphasis of federal securities regulation since the New Deal on transparency and information. Important regulatory changes were also proposed and introduced by the SEC, the primary body responsible for the regulation of the country's financial markets. Most of these new rules also embodied additional disclosure requirements, notably with respect to proxy voting policies and records by mutual funds and other investment companies; the operating procedures of board nominating committees and the mechanisms, if they exist, for security holders to communicate with board members; as well as executive pay. The move to require information about the governance of U.S. corporations, and not just their business operations, was controversial and the SEC moved further in that direction with the enactment of a rule on board independence for investment companies. Perhaps most dramatically, the SEC acted to reduce conflicts of interest in investment banking that were deemed to have corrupted the recommendations issued by its research analysts. In 2003, acting in concert with state regulators, notably the former attorney general for the state of

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New York, Eliot Spitzer, the SEC reached an agreement with the world's leading investment banks to sever reporting and compensation links between their research and investment banking businesses.

In addition to these public initiatives, a number of private bodies changed their norms and practices in ways that have implications for the governance of the corporate economy. Both the New York Stock Exchange and NASDAQ revised their listing requirements, mandating new standards for the composition of boards of directors and shareholder voting on equity-based compensation plans. For companies listed on the NYSE, for example, a majority of directors must now be independent. Listed firms must have wholly independent audit, compensation, and nominating committees, while at least one member of the audit committee must have accounting or related financial management expertise. In addition, NYSE required shareholder approval for a company's overall equity-based compensation plan.

These reforms proved highly controversial and almost certainly would not have been successful without the media scrutiny and public attention stimulated by the wave of corporate scandals. The Sarbanes–Oxley Act was the brainchild of the Democrats and the Republicans initially refused to support it, preferring their own, less restrictive legislation. However, the WorldCom scandal brought them on board and, in the end, the bill was passed with the unanimous approval of the Senate and the overwhelming approval of the House, where it garnered 423 votes in favor and only 3 against. However, immediately after its passage, it attracted an avalanche of criticism, much of it remarkably vitriolic, with one noted legal commentator, Roberta Romano, going so far as to describe it as "quack corporate governance" (Romano, 2005, for a general discussion of academic critiques of Sarbanes–Oxley, see Brown 2006). In the policy realm, some detractors suggested that the Act profoundly damaged America's position as a global financial center (McKinsey & Co., 2006, p. ii).

Much of the criticism of SOX focused on the increased costs to public companies of strengthening their internal controls to comply with Sec tion 404 of the Act. However, the Act itself, and several SEC rules adopted subsequent to its passage, granted several compliance extensions to smaller companies, the focus of greatest concern. Moreover, the PCAOB approved the adoption of a new auditing standard that gave auditors more scope to tailor their audits to the scale of the company being audited as well as to exercise more discretion in interpreting the provisions of the Act. Most knowledgeable observers regarded these technical adjustments as having considerably reduced the costs of implementation of Sarbanes–Oxley, an

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assessment supported by the increasing capacity of companies and auditors to meet its provisions. As accumulated experience lessened the costs of implementation of the Act, the steam subsided from challenges to its survival.

SOX may have weathered the storm of criticism it faced, but visceral attacks stymied the progress of other regulatory proposals to overhaul the governance of the country's corporations. Of particular note were proposed changes to the rules that determine the rights of shareholders to participate in the nomination and election of corporate directors. These changes proved to be a lightning rod for debate on corporate governance. In the fall of 2007, after a lengthy process drawn out over several years, SEC commissioners voted down the proposed change to the status quo by a 3–1 vote. In doing so, they restated their support for the existing rules, which prohibit shareholders from accessing the company proxy to nominate directors to corporate boards ("Corporate voting rights package fails," *Daily Deal*, November 29, 2007).

Investor groups had feared this outcome from the moment that President Bush appointed Christopher Cox as chairman of the SEC in 2005. When he took office, Cox initially defused these concerns by promising to prove vigilant in upholding the SEC's mission of protecting investor rights. He encouraged a greater attention to enforcement at the SEC, sponsoring an important effort to enforce the clawback provision of the Sarbanes–Oxley Act by initiating an investigation of option-backdating practices.[4] He also sought to build consensus, looking to forge agreement among the SEC commissioners, who tended to divide along partisan lines on contentious issues ("New head of SEC defies sceptics," *International Herald Tribune*, November 8, 2006, p. 16).

However, the debate on changes to the SEC rules on shareholder rights to nominate and elect directors brought an end to such accommodation. Faced with starkly opposing views among his commissioners, Cox eventually sided with the other two Republican commissioners against the lone Democratic

[4] "Backdating" refers to the practice of retroactively setting the date of issue of stock option grants. The practice is not illegal in the United States but the practice must be disclosed. In the process, it investigated more than 150 American corporations and initiated proceedings against large numbers of them ("New head of SEC defies sceptics," *International Herald Tribune*, November 8, 2006, 16). The settlements were delayed as SEC commissioners reportedly argued over the details of how large the penalties should be ("The Slow Pace of Justice on Options Backdating," *New York Times*, February 23, 2007, 2) but agreement was finally reached on a method for penalty assessment and the first settlements were announced in 2007.

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commissioner.[5] As the *Washington Post* put it: "Chairman Chris Cox gave up on his effort to find a compromise between shareholder activists who want a way to allow investors to nominate candidates for corporate directorships and his Republican colleagues, who believe deeply that investors aren't mature enough to vote on such weighty matters. Unable to find a middle ground, Cox sided with the corporate Putinists to kill any shareholder access to the corporate proxy ("Regulatory Pushback," *Washington Post*, Dec. 2, 2007, p. F03)." Earlier in 2007, Cox also proposed two other rule changes for consideration that many regulatory experts viewed as diminishing investor rights. As a result, he faced increasing criticisms of his chairmanship of the SEC, standing accused of hijacking the SEC's mission by pandering to the interests of business at the expense of investors' concerns (*New York Times*, Feb. 13, 2007).

Reflecting on the more general political climate for corporate reform, observers issued gloomy prognoses. They pointed out that the moment of bipartisanship that had allowed the passage of SOX had given way to a much more partisan and contentious debate as Republicans and Democrats settled into anti- and pro-regulation camps with respect to corporate governance. By 2004, that trend, and the Republican majorities in both houses, led observers to predict an end to corporate governance reform (see, e.g., Cioffi 2006).

However, only a couple of years of later, the outlook for corporate reform looked a lot better. The midterm elections of November 2006 brought Democratic majorities in the House and the Senate and an important change in personnel with Barney Frank (D-Mass.) replacing Oxley as chairman of the House Financial Services Committee. Frank, who had long railed against growing income inequality in the United States, quickly made executive compensation a target of his reform efforts and promised more action on shareholder rights. He introduced a bill to give shareholders an advisory vote on executive compensation, which passed easily through the House.[6] When the sponsor of that bill in the Senate, Barack Obama, swept to a historic victory in the 2008 presidential election, the advocates of corporate reform became more bullish still.

[5] She was Annette Nazareth. Roel Campos, the other Democratic commissioner, resigned in 2007 to go into private practice. Cox could have delayed the vote until another Democratic commissioner was appointed but he refused to do so on the grounds that the issue needed to be resolved before the 2008 proxy season began. In any case, this would not have changed the outcome since Cox would still have had the deciding vote.

[6] There was a bigger split on this bill in the Republican camp with as many as 55 "Ayes" to 129 "Noes."

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It was not just the political change that seemed promising but the fact that it occurred in the context of the most serious financial crisis since the 1930s. Although nobody would say that the U.S. system of corporate governance possesses primary responsibility for the credit crisis, some of its flaws, especially the structure of executive compensation packages, have been cited as important contributing factors (see Eichengreen, this volume). Such logic led to the inclusion of a provision against executive incentives for "unnecessary and excessive risks" in the American government's $700 billion Emergency Economic Stabilization Act of 2008. Even as analysts expressed doubts that the provision would have any significant effect, they suggested that it might change the broader discussion of executive pay in America. As the *Wall Street Journal* put it: "Pay experts say the provision is sparking debates on the link between pay and risk, and how to tweak incentives to limit risky bets. Some of those ideas run counter to long-held tenets of good compensation plans, such as tying pay closely to financial results or stock price" (*Wall Street Journal*, October 6, 2008, p. B5). Moreover, debates on other issues fostered by the financial crisis, such as the behavior and role of ratings agencies, as well as the vigilance and resources of the SEC, will surely spill over into more general debates on corporate governance.

III. The Leading Diagnoses of the Problems of U.S. Corporate Governance

Immediately after the corporate scandals of the new millennium broke, some policymakers, scholars, and pundits attributed them to the egregious behavior of a few bad apples. However, as the number of scandals increased and patterns of behavior emerged across cases, most commentators came to the conclusion that the U.S. system of corporate governance was beset by systemic shortcomings. But exactly what shortcomings? Here scholars can be classified into a number of categories.

Perhaps the most influential diagnosis of the problems afflicting American corporate governance shined the spotlight on the financial markets' gatekeepers, the "independent professionals who pledge their reputational capital to protect the interests of dispersed investors who cannot easily take collective action" (Coffee 2004, p. 302). These include, *inter alia*, the auditors who sign off on a company's accounts, the financial analysts who assess the quality of its stock, and the rating agencies who evaluate its creditworthiness. Protagonists of this view argued that, in the 1990s, far from protecting the interests of dispersed investors, these gatekeepers "acquiesced in managerial fraud – not in all cases, to be sure, but at a markedly higher rate than

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during the immediately preceding period" (Coffee 2004). One important piece of evidence to support this view was the growing number of earnings restatements during the 1990s. A variety of sources also suggested a substantial breakdown in the quality of analysts' reports over the course of the 1990s (see, e.g., Attorney General of the State of New York 2002; Hong and Kubik 2003) and recent analyses confirm suspicions of serious conflicts of interest at the ratings agencies (SEC 2008).

As we have seen, crucial elements of the Sarbanes–Oxley Act followed the logic of the gatekeeper diagnosis. As the legal scholar John Coffee has noted with approval: "The Sarbanes–Oxley Act of 2002 understandably focused on gatekeepers and contained provisions regulating auditors, securities analysts and credit-rating agencies" (Coffee 2005, p. 11). Regulators' efforts to build Chinese walls between securities analysts and investment bankers reflect the same spirit. The regulatory impact of the gatekeeper analysis can also be seen in the recent rules for rating agencies introduced by the SEC to reduce conflicts of interest in, and increase disclosure of information about, the ratings process (*Wall Street Journal*, "Crisis on Wall Street: SEC Tightens Rules for Ratings Firms," December 4, 2008, p. C3).

A second diagnosis of the problems of U.S. corporate governance looks to the machinery of corporate governance within the corporation and, in particular, points to the shortcomings of corporate boards. In principle, the board of directors performs a variety of roles in the governance of the U.S. corporation, including selecting the CEO and other senior executives, monitoring their strategies and performance, and shaping their incentives through the design of executive compensation. Scholars, along with policymakers and pundits, have issued stern criticism of how the boards of U.S. corporations acquitted all of these roles in the late 1990s, but their performance on executive compensation has struck many commentators as particularly egregious (see, e.g., Bebchuk and Fried 2003; idem. 2004). Major structural changes in the compensation of U.S. corporate executives have occurred since the mid-1970s, leading to a massive increase in levels of executive pay, whether measured in real terms or relative to average workers' pay. These increases, which were especially pronounced in the 1980s and 1990s, were driven not only by the growing use of stock options in executive pay packages, but also by the fact that salaries and bonuses increased dramatically as well (for statistics on these trends, see Frydman and Saks 2007).

Executive pay in the United States has attracted criticism on the grounds that its link to corporate performance is weak, even though the rationale for more lavish compensation has always rested on its presumed positive

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impact on productivity. Critics point to several aspects of U.S. executive pay packages as especially problematic: the prevalence of rewards after the fact (mostly in the form of golden parachutes); rewards for absolute rather than relative performance (stock option packages that do not take the performance of comparable companies into account); rewards for manipulable performance measures (such as earnings statements that reflect questionable accounting assumptions, or options backdating); as well as rewards for short-term stock price movements rather than improvements in underlying long-term corporate performance (Murphy 1999; Grinstein and Hribar 2004; Bebchuk and Fried 2005; Bolton et al. 2006). Besides the waste of corporate resources that poorly structured pay packages entail, scholars have pointed out that there may be additional economic costs associated with the exorbitant pay of American corporate elites. In an era in which an emphasis on teamwork is pervasive, at least in corporate rhetoric, gargantuan compensation packages for top-level corporate managers, as the pay of other employees stagnates, may demotivate employees and undermine productivity growth.[7] Moreover, the structure of compensation plans, notably their reliance on stock option awards and severance packages, may induce executives to engage in excessive risk-bearing with company assets. This dynamic has become a central focus of the critiques of banks' behavior leading up to the financial crisis.

In looking for an explanation of the problems with U.S. executive compensation, many commentators have placed the blame on boards of directors, with the most common argument being that they are too dependent on management. Therefore, reform efforts have tended to focus on ensuring there are substantial numbers of "independent" directors on corporate boards and, in particular, the compensation and nomination committees. This type of diagnosis lay behind the stock exchanges' efforts to reform their listing standards to specify standards for board composition.

A third diagnosis of the ills besetting American corporate governance steps back from the internal and external mechanisms of corporate governance to focus on the overall representation of shareholder interests in the operation of the corporation (see, e.g., Bebchuk 2005, 2007). It emphasizes the lack of formal rights that shareholders have in the governance of the American corporation, with their limited role in the nomination and election of the boards of directors of public companies stimulating particular concern. In principle, the American corporation is a representative democracy in which boards of directors act as the elected representatives

[7] For the importance of fairness in inducing cooperation, see Benkler, this volume, 13–14.

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of shareholders. In practice, the owners of most large, publicly held American enterprises have little or no influence over the election and removal of directors. The nomination process for directors is typically controlled by incumbent directors and, in some cases, even by senior corporate executives. Under SEC Rule 14a-8, shareholders do not have access to the proxy to nominate candidates for the board. And, because most companies had plurality (rather than majority) voting for director elections until recently, only one favorable vote was required to elect a director. For all of these reasons, any effort by shareholders to propose alternative slates of directors faces substantial barriers of cost and collective organization. This interpretation of the problems of U.S. corporate governance has influenced the recent debates within the SEC over reforming the proxy process and, in particular, giving shareholders more of a practical say in the nomination and election of the board of directors.

In 2003, the SEC finally responded to pressure to increase shareholder rights by proposing a new rule to permit them to nominate one to three directors, depending on the size of the board, in opposition to the incumbent board's proposed slate. The proposal would permit shareholders to nominate directors only after one of the following two, rather restrictive, conditions were met. Either the shareholder body would have to register its disapproval of the directors to be opposed by withholding 35 percent or more of the votes cast at a meeting to elect them. Or a shareholder proposal to nominate a shareholder candidate would have to be passed before the nomination process could proceed. Moreover, the proposal would only allow shareholders with at least 1 percent of the company's voting equity to nominate their own candidates for director.

The proposed rule change proved to be a lightning rod for debate on the reform of corporate governance. It elicited 12,000 letters to the SEC, the highest number of comments on record for any proposed rule change by the SEC until then. Many public pension funds, union funds, and individual investors expressed support for the rule's basic thrust; an investment officer at one leading institutional investor was quoted as saying that the proposal was "perhaps the most important rule the SEC has put forth for the investing public in decades." Nevertheless, the strings attached to the specific proposed rule led some of them to question its value.

Even so, the constraints on shareholder action embodied in the proposed rule were not enough to assuage the concerns of its most vociferous critics. Representatives of corporate elites, such as the Business Roundtable, railed against the proposal, arguing that the proposed rules "exceed the commission's authority, would initiate sweeping and harmful changes in corporate

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governance and fail to achieve the commission's objective of improving the proxy process at unresponsive companies" ("Record response to SEC proposal," *Financial Times*, December 23, 2003, p. 20). The SEC commissioners themselves were reportedly divided over the proposal and, in the end, it was never put to a formal vote.

However, the issue refused to go away, reappearing in 2006 with a legal challenge to the SEC's rule on shareholder participation in director elections. Unable to reach consensus on board nominations by shareholders, the SEC issued two conflicting proposals for comment in July 2007. One would reiterate and, therefore, reinforce the existing situation, which excluded shareholders from using the proxy to nominate directors; the other would permit them some access to it but subject to greater restrictions than the rule that the SEC proposed in 2003; now it was suggested that only shareholders who could garner 5 percent or more of a company's voting equity would participate in director elections. Once again the proposed rule changes attracted enormous interest, breaking new records with 20,000 submitted comments. Most of them were from shareholders, many protesting both proposals. One public pension fund executive was quoted as saying "[o]ne proposal is bad and the other is worse . . . One is a repudiation of the concept of shareholder access to the proxy and the second is so onerous that it creates an illusion of access but, practically, it is useless. The thing to do is stop and start over" ("The owners who can't hire or fire," *New York Times*, October 14, 2007). As I noted earlier, the SEC commissioners eventually voted down to the rule change, leaving the *status quo* intact, but the academic and political support for advancing shareholder rights will ensure that it will find a place on the SEC's agenda again.

All of these disagreements – about how seriously one should view the problems afflicting corporate governance in the United States; about where one should locate the sources of those problems; and, about the appropriate remedies to redress them – are substantial and divisive. Yet for all of the debate about what is wrong and how to fix things, most of the discussion takes place within a relatively narrow intellectual frame. Specifically, the leading commentators maintain a commitment to the view that corporations ought to be run in the interests of shareholders. An appreciation of how the ideology of shareholder governance came to predominate in the United States, and the particular way in which policymakers and corporate leaders put it into practice, takes us a long way toward understanding the preoccupations and limitations of the contemporary debate.

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IV. Shareholder Value as the Dominant Ideology of Corporate Governance

That companies should be run to advance the interests of shareholders is certainly not a new idea in the history of American corporate governance. In the late nineteenth century and the early twentieth centuries, corporate executives in U.S. corporations typically contended that their control over corporate resources was based on property rights and that their primary responsibility was to run corporations in the interests of shareholders. The ideology that corporations were run in the interests of shareholders lived on through the Great Depression and after the Second World War. The theme of "People's Capitalism" – the idea that U.S. corporate enterprises were owned and controlled in the interests of masses of small stockholders – was frequently expounded by organizations like the New York Stock Exchange and many corporate managers were inclined to employ a similar rhetoric (Ott 2004).

However, the growing separation of ownership and control in many of the nation's leading corporations made managers' characterization of themselves as shareholder-designates seem coy. As Bayless Manning, the dean of Stanford Law School, put it in 1958: "People's Capitalism and Corporate Democracy are slogans with an inverse relationship. Each expansion of the first undermines the second. Every sale of common stock to a new small investor adds to the fractionation of share-ownership which lies at the root of the impotence of shareholder voting as a check on management" (Manning, 1965, p. 113). Faced with growing skepticism about the reality and legitimacy of the shareholder-oriented corporation, U.S. corporate managers sought other grounds for justifying the control that they exercised over the allocation of corporate resources. As early as the 1920s, senior executives at General Electric challenged the view that corporate managers were "the paid attorneys of capital." As corporate shareholding became more diffuse, their views resonated more broadly with corporate managers who increasingly represented themselves as trustees who acted in the interests of a variety of stakeholders.

This view of corporate management was by no means confined to the self-descriptions of executives. It was already apparent in the view expressed by Berle and Means in the early 1930s that corporate management could develop into a "purely neutral technocracy." A similar view of management is found among many journalists, writers, and leading scholars of the post-war period and was captured well by the editors of *Fortune* in 1951 when they declared that "[t]he manager is becoming a professional in the sense

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that like all professional men he has a responsibility to society as a whole" (Fortune 1951; see also Drucker 1949, pp. 35, 99, 102, 340, 342; Kaysen 1959; Sutton et al. 1956, pp. 57–58, 65, 86–87, 155, 163, 165, 359; *Fortune*, 1956).

Proponents of the "managerialist" thesis of the corporation assumed that professionalism would ensure that the broader objectives that corporate managers espoused would be achieved. These social responsibilities were certainly not enshrined in corporate law. Although the burst of federal securities regulation in the 1930s, as well as later regulatory initiatives such as industrial safety and accident laws, created new legal requirements that corporate managers had to take into account in their allocation of corporate resources, they did not interfere with the internal governance of the corporation in a way that would directly challenge managerial control. With the development of the "business judgment rule," the courts became more and more reluctant to challenge corporate management on decisions that were deemed to be part of the normal process of running a business (Kaufman et al. 1995, p. 51). The one exception to this pattern was bankruptcy law, where the Chandler Act of 1938 transformed existing practice in large-scale reorganizations by insisting that the firm's management and reorganization be entrusted, not to incumbent managers and the firm's investment bankers, as had been common since the late nineteenth century, but to a disinterested trustee. However, as David Skeel notes, the effect of the Chandler Act was to reduce the number of large-scale corporate reorganizations and to motivate a search for loopholes that allowed firms to escape its exacting provisions. Eventually the Bankruptcy Code of 1978 and, in particular, its Chapter 11, reintroduced "an explicitly manager-friendly approach to corporate reorganization" by obliterating the mandatory trustee requirement of the Chandler Act (Skeel 2001, Chapters 4, 6, and 8; quoted at p. 216).

Even though the governance of corporations remained firmly in the hands of managers, the acquiescence of corporate law and the courts to unilateral managerial control remained implicit. As the legal historian James Willard Hurst observed, with the exception of laws authorizing the use of corporate funds for philanthropic purposes, "the law added no definition of standards or rules to spell out for what purposes or by what means management might properly make decisions other than in the interests of shareholders" (Hurst 1970, p. 107). As Erber put it, "[T]he managers have not succeeded, either through legislation or adjudication, to resolve their ambivalent, contradictory status of power without property" (Erber 1986, p. 202). This left the legitimacy of managerial control vulnerable to challenge and, ultimately to a concerted attack from scholars and other pundits who

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were intent on reviving the philosophy that corporations should be run for the sole benefit of their shareholders.

The opening for that attack came as U.S. corporations confronted a combination of major productive and financial challenges beginning in the 1970s. U.S. corporations faced an intensification of international competition in a wide range of industries in which they had been dominant in the postwar period (for a detailed discussion, see O'Sullivan 2000, pp. 146–54). These competitive challenges demanded a response, but as U.S. enterprises struggled with what was going on in the productive sphere, as they attempted first to define the competitive problem and then to react to it, they discovered that the financial ground had shifted in ways that had important implications for the recalibration of industrial strategies.

Structural changes in U.S. financial institutions, and a related transformation of the way Americans saved, fostered their growing reliance on corporate securities, especially corporate stocks, to augment personal income and wealth. By 2001, 51.9 percent of U.S. households had direct or indirect stock holdings, up from 40.4 percent in 1995 and 31.6 percent in 1989 (U.S. Department of Commerce). Unlike the days when stockholding was fragmented among thousands of individual investors, households increasingly held stocks indirectly through pension and mutual funds and other institutional investors. By the late 1990s, more than 50 percent of American-owned equities were held by these aggregators of financial portfolios (O'Sullivan 2000, pp. 155–56).

This transformation in how American households saved greatly intensified the pressures on U.S. corporations to deliver higher returns on their corporate stocks. These pressures initially manifested themselves in a dramatic way in the 1980s, with the rise of a market for corporate control. In historical perspective, the "Deal Decade" was distinctive for the emergence of hostile transactions, the large size of the average target, and the unprecedented reliance on aggressive financial techniques to conclude transfers of corporate control.

Financial economists like Michael Jensen and legal scholars such as Henry Manne provided important intellectual support for this movement. They articulated a new theory of corporate governance, based on agency theory, casting shareholders as the principals in whose interests managerial agents should run corporations. However, the most important impetus for the Deal Decade came from members of the financial community, including investment bankers, private equity executives, and institutional investors, who showed how theory could be put into practice in ways that generated enormous financial returns.

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Crucial to the success of these transactions was the capacity of key players to rapidly raise huge amounts of capital to finance them, chiefly through borrowing. The new mechanisms of finance did not emerge automatically but depended in their early stages on the forging of an important network of relationships among bankers, private equity executives, and institutional investors and, subsequently, on the development of the junk bond market. As financial historians of the era have observed, Michael Milken and Drexel Burnham Lambert played crucial roles in developing the networks to make these markets hum.

By the end of the 1980s, of course, the Deal Decade came to an abrupt conclusion. In the wake of the 1987 stock market crash, investors became increasingly concerned about the risk that they were bearing on junk bonds. Other factors that contributed to the decline included the crisis in the savings and loan industry, which had played a critical role in the junk bond market, the criminal prosecution and conviction of several players in the market for corporate control, including Michael Milken, and the general slowdown of the U.S. economy. The enactment by most states of antitakeover statutes that permitted corporations to adopt mechanisms to fend off hostile bids, along with the adoption of a range of antitakeover defenses by a large number of public corporations, also helped in sharply curtailing mergers and acquisitions.

While the culture of the big deal lasted, institutional investors reaped huge profits in the market for corporate control, not only through their holdings of junk bonds and investments in leveraged buyout funds, but also as sellers of corporate stock in mergers and acquisitions (Useem 1996, pp. 25–26). With the demise of that new financial market, institutional investors turned to different means to enforce their demands for higher returns, an impulse only heightened by the dramatic decline in interest rates during the 1990s. In particular, from the mid-1980s and especially the late-1980s, a number of major institutional investors began to take a more aggressive stance vis-à-vis corporate managers in the proxy process.

Initially, this newfound activism by institutional investor activism sought to knock down barriers to the market for corporate control by sponsoring shareholder resolutions to reduce poison pills, greenmail, and golden parachutes, as well as by pressuring corporations to opt out of states' antitakeover statutes. Notwithstanding some success in these efforts, the nation's largest pension fund, the California State Public Employees Retirement System (CalPERS), and other institutional investor activists soon recognized that, by focusing narrowly on antitakeover provisions, they left corporate managers considerable latitude to fight back. Therefore, they widened the

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scope of their activism from antitakeover provisions in particular to the structure of the shareholder–management relationship in general.

Ultimately, these developments fostered a fundamental transformation in the relationship between the corporate economy and the stock market. Deregulation played an important role in this story, though in spheres such as financial regulation, pension policy, and tax policy rather than in the rules aimed primarily at the corporate sector.[8] In fact, corporate regulation continued to operate much as it had since the 1930s. If we focus, for example, on the proxy process, we find that it continued to operate through the 1990s, as it had since at least the 1950s, to protect managerial discretion from shareholder interference. Shareholders usually submitted their proposals under SEC Rule 14a-8 since, if the proposal was accepted, the shareholder then had the right to have it included, together with a 500-word supporting statement, in the proxy statement distributed by the corporation to its shareholders in advance of the annual shareholder meeting. There is an obvious cost advantage of this approach, but its primary disadvantage is that Rule 14a-8 restricts the subjects that can be raised by shareholders. The prevailing regulatory rules excluded (and still exclude) all shareholder proposals from a corporation's proxy materials if they dealt "with a matter relating to the conduct of the ordinary business operations" of the company. The "ordinary business rule" was adopted by the SEC in the early 1950s "to confine the solution of ordinary business problems to the board of directors and place such problems beyond the competence and direction of the shareholders," as the then-SEC chairman explained. He considered that "it is manifestly impracticable in most cases for stockholders to decide management problems at corporate meetings." (Statement of J. Sinclair Armstrong to the Subcommittee on Banking and Currency, 1957, quoted in Whitman 1997).

In the 1990s activist institutional investors put pressure on the SEC to reform the proxy process in ways that made it easier for them to press their concerns with U.S. corporations. Despite some successes, none of the changes that navigated the administrative rule making gauntlet constituted a major transformation in the regulation of corporate governance. Most of the efforts by activist shareholders to press for reform of the proxy process failed, in large measure because of strong resistance from powerful lobbying groups for corporate managers, especially the Business Roundtable. These corporate elites raised questions about the competence of

[8] For a discussion of the general trends toward deregulation in the United States from the 1970s, see Eisner, this volume, Section 1.

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institutional investor activists to play an important role in the governance of multibillion-dollar corporations (see, e.g., Wohlstetter 1993, p. 78). And, with public pension funds and unions as the most visible faces of pension fund activism, corporate managers also questioned the motivations behind these special interest groups' governance initiatives.

This same ideology of the sanctity of managerial discretion had initially led many corporate executives to resist the logic of shareholder value when it burst on the scene in the 1980s on the back of hostile takeovers. However, in the 1990s, executive resistance to shareholder value as the benchmark for corporate governance abated as upper management pay packages became more and more dependent upon equity compensation. Yet even as corporate managers embraced the rhetoric of shareholder value, they continued to brook little interference with their "right to manage."

These attitudes of corporate managers, and their success in clinging to them, generated a great irony in the system of U.S. corporate governance by the late 1990s. This system promoted a veritable obsession with shareholder value as the most important benchmark for corporate performance. It provided fantastic rewards for corporate executives who maintained that they were responsible for generating that value. But, the system actually provided very limited governance rights for shareholders themselves, and an increasingly wealthy managerial elite remained largely hostile to any reforms that might extend those rights.

V. The Intellectual Challenges of Corporate Governance Reform

Even this brief description of the historical evolution of corporate governance in the United States helps us understand why there is such a preoccupation with shareholder value here today. It simultaneously explains the widespread dissatisfaction with the way shareholder value has been put into practice in U.S. corporate governance and why, as a result, there is so much momentum behind reforms that would make the American system more closely accord with the theory of shareholder governance. Yet, even to deliver on the promise that momentum holds out, there are important intellectual challenges to be overcome by advocates of all three of the leading diagnoses of the failures of shareholder governance in the United States.

For those who call for reforms to address the shortcomings of gatekeepers, the primary task is to show that generating higher-quality information will make a substantial difference to the behavior of corporate shareholders. From the dawn of federal securities regulation, and even earlier by some accounts, Americans have placed primary emphasis on the virtue of

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disclosure and the transparency it supposedly fosters, in regulating their corporate sector. Yet the evidence that investors actively take advantage of public information at their disposal and put it to useful purpose in their investment decisions is remarkably thin on the ground.

For scholars who identify the behavior of corporate boards as the critical problem of American corporate governance, their primary challenge is to show that the widespread emphasis on board composition and, in particular, the role of independent directors, will truly make a difference. Even leaving aside concerns about whether independence, as conventionally interpreted, actually delivers what it implies, one might well doubt whether the presence of independent directors fosters a significant improvement in the behavior of boards. There is little encouraging evidence on this issue, with studies repeatedly failing to find any robust association between the role of independent directors and any kind of performance outcome. Absent such evidence, the widespread advocacy of an increased role for independent directors seems like a "political correctness" of board composition. And, indeed, some scholars have argued for greater attention to the way in which boards operate, rather than their structural characteristics, as a more likely means of improving their governance role.

Finally, for scholars who call for an increase in shareholder rights to participate in the governance of the American corporation, the major challenge is to show that shareholders have the incentives and abilities to exercise these rights. There is, in fact, good reason to be skeptical of the incentives of American shareholders to play an important role in corporate governance. The problem of collective action in this regard is well understood: The costs of intervening to improve corporate governance are substantial and borne only by the active shareholder, whereas the benefits of activism are spread across all investors. It is hardly surprising, therefore, that the vast majority of individual and institutional investors have displayed little interest in exercising the governance rights they already have. When it comes to voting on shareholder proposals, moreover, most institutional investors historically voted their proxies in support of management. These days, with greater public scrutiny of their proxy voting behavior, institutional investors are less inclined to such blatant passivity but they have opted for another, subtler form of it in their growing reliance on "proxy firms," which provide boilerplate voting advice on various issues.

The abilities of investors to intervene effectively in the governance of U.S. corporations must also be addressed. Since the middle of the 1970s, there has been a dramatic rise in the rate at which stockholders in America's corporations churn their shares. As a result, investors' ability to understand

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anything meaningful about the companies whose shares they own is limited. Corporate executives' critiques of investors' capacities to intervene in U.S. corporate governance are blatantly self-serving but they also are not entirely without foundation.

For all the substantial intellectual challenges associated with reforming corporate governance from within the confines of the shareholder theory, even greater ones await if we break loose of its intellectual strictures to consider fundamental alternatives to shareholder value. Yet there is good reason to make that intellectual leap. In recent years, scholarly critics have chipped away at the shareholder theory of corporate governance with increasing force making it increasingly implausible as the intelligent person's guide to corporate governance.

One key critique examines the theory of the firm on which arguments for shareholder governance build. A basic argument in this regard is that, as equity investors, shareholders are the only participants in the corporation for whom returns to their productive contributions are "residual." In contrast, the returns to all other groups who provide resources to the firm, whether employees, suppliers, or creditors, are characterized as deriving solely from contractual claims. As "residual claimants," shareholders supposedly bear the risk of the corporation's making a profit or loss and thus have an interest in allocating corporate resources to their best alternative uses to make the residual as large as possible. This assumption is essential to the shareholder theory's claim that the maximization of shareholder value will result in superior economic performance for corporations and the economy as a whole but it has been roundly criticized on several different grounds.

First there is the claim that other stakeholders in the corporation, besides shareholders, also take substantial risks for the benefit of corporations. Insofar as the investments that these stakeholders make are "firm-specific," we cannot assume that they are adequately rewarded by the market mechanism. Instead, that outcome is assured only by stakeholders' participating to some extent in the success or failure of the firm (Blair 1995). Second is a challenge to arguments that advance the claims of shareholders to enterprise residuals without providing an adequate explanation of how these residuals are generated. The way firms divide the returns from their activities affects their ongoing capacity to generate them, and focusing only on the distribution of returns without an analysis of the process through which value is generated by firms, as the shareholder theory does, may endanger the long-term value-creating potential of corporations. Instead, the relationship between productivity and reward in a firm should be guided by an analysis of the process through which firms develop and use resources to generate their

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so-called residuals (O'Sullivan 2000; Lazonick and O'Sullivan 2000, 2002). Third, there are critiques of the shareholder perspective that emphasize the limits of the agency theory it employs for understanding the crucial organizational interactions among economic agents that make firms tick. Concerns have been expressed even by advocates of agency theory about its relevance to the real world, with leading microeconomist Canice Prendergast admitting that "[t]he available evidence suggests that incentives do matter, for better or worse. It is much less clear, however, whether the theoretical models based on this premise have been validated in the data" (Prendergast 1999, p. 56). The criticism from outsiders has been even more scathing, with Herbert Simon, for example, contending that "[t]he attempts of the new institutional economics to explain organizational behaviour solely in terms of agency, asymmetric information, transaction costs, opportunism, and other concepts drawn from neoclassical economics ignore key organizational mechanisms like authority, identification, and coordination, and hence are seriously incomplete" (Simon 1991, p. 42; see also Perrow 1986).

Certainly there are good reasons for the considerable and growing skepticism about the theory of the firm on which the shareholder theory of corporate governance is built. In addition, the other crucial element of the shareholder theory of corporate governance, its perspective on the mechanisms that encourage or constrain corporate managers to maximize shareholder value, is also on increasingly shaky ground. Whether we are talking about pay for performance in executive compensation or the market for corporate control, all of these mechanisms depend for their efficacy on the process through which the stock market assigns prices to corporate securities. If that pricing process does not work effectively and, in particular, if it is subject to fads and bubbles, then these mechanisms may lead the corporate economy away from value creation rather than toward it. One of the intellectual forefathers of the shareholder theory of corporate governance, Michael Jensen, once remarked that the efficient markets hypothesis was one of the best-proven facts in the social sciences. Today he is a wiser man, urging managers to "just say no" to Wall Street and its fads and bubbles. More generally, the efficient markets hypothesis has taken a substantial beating, especially as behavioralists have gained influence in financial economics. Were the efficient market hypothesis a stock, it certainly would have been delisted in the current financial crisis.

In addition to identifying the weaknesses associated with the shareholder theory of governance, scholars have invested considerable energy in developing alternatives to it. In her book, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century*, for example, Margaret

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Blair has called for an analysis of corporate governance based on "a broader range of assumptions [than in the shareholder theory] about how wealth is created, captured, and distributed in a business enterprise" (Blair 1995, p. 15). Blair argues that the firm-specific investments made by employees and suppliers create significant claims as economic stakeholders, alongside shareholders. In a different approach, this author and William Lazonick have made the case for a theory of the firm that emphasizes the cumulative and collective nature of innovation as a crucial foundation for thinking about corporate governance (O'Sullivan 2000; Lazonick and O'Sullivan 2000, 2002). Blair, with a coauthor, Lynn Stout, has also emphasized the organizational foundations of firm performance in arguing for a theory of team production as a basis for thinking about corporate governance (Blair and Stout 1999; see also Kaufman and Englander 2005). Although in the 1990s in the United States these types of "stakeholder" theories of governance were given short shrift by most economists, they have attracted more attention in recent years (see, e.g., Gelter 2008; Allen, Carletti, and Marquez 2007; Goergen 2007). Distinct from these economic arguments described above is an older and still vigorous strand of stakeholder theory that appeals to philosophical arguments and moral justifications. Typically, this approach leads to a broader conception of stakeholders than the more instrumental logic of economic theories of stakeholding suggests. To paraphrase Donaldson and Preston (1995), stakeholders are those with a legitimate interest in the corporation regardless of whether the corporation has an interest in them (for a recent review and discussion, see Agle et al. 2008). That framework would certainly encompass the communities that host corporate facilities (and that often "invest" in them through tax breaks) as well as unskilled workers with little hope of economic reward.

Clearly, stakeholder theories of governance are a heterogeneous bunch and the differences and disagreements among them have undermined their impact, compared to the rather unitary shareholder theory. However, there are also important conceptual shortcomings of stakeholder theories of governance that require attention if they are to gain greater purchase on political debate and policymaking. For dealing with the firm, the greatest weakness of this perspective relates to the treatment of managerial behavior. Stakeholder theories have failed to explain exactly how a structure of corporate governance might systematically induce corporate managers to act as responsible stewards of the resources of firms, or to promote the development of their innovative capabilities, or to ensure that firms act as upstanding corporate citizens. It is precisely this failure that has made, and will continue to make,

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stakeholder theories vulnerable to attack from shareholder advocates who place so much emphasis on incentives.

Another shortcoming of stakeholder theories is their failure to specify the mechanisms of governance that would induce or require desirable behavior from corporations. In an edited volume on *Employees and Corporate Governance*, Margaret Blair and Mark Roe took a significant step in this direction with their specification of a number of mechanisms to give a voice to employees in corporate governance. The contributing authors explored several possibilities, including employee ownership and employee representation on boards of directors, but they wrestled with problems in the logic of these mechanisms. In general, the theoretical analysis of how stakeholder governance might actually work well in practice remains woefully underdeveloped.

Clearly, the intellectual challenges of developing a rigorous alternative to the shareholder theory of corporate governance are substantial. Yet it would be a mistake to invest all of our intellectual energy in resolving them to the neglect of an even more fundamental and provocative question about the relevance of stakeholder and shareholder and, indeed, all general theories of corporate governance. The assumption behind these theories, like many theories generated by social scientists, is that they have relevance across time and place. For dealing with corporate governance, there is good reason to subject that assumption to some critical scrutiny.

A society's system of corporate governance, which is essentially preoccupied with the distribution and exercise of power in the corporate economy, is inextricably linked to the broader socioeconomic characteristics and dynamics of that society. How that governance system operates depends, to an important degree, on the particular characteristics of time and place in which it operates. How it changes is conditioned by the history of the society in which it is instituted. To take an example, how stakeholder capitalism worked in postwar Germany was, in part, a function of the influence, interests, and ideas of German industrial workers at that time. We should not expect that codetermination, as a practice, can be airlifted by ambitious policymakers from this context and instituted in another and still operate in the same way.

Taken to an extreme, an emphasis on the importance of time and place for structuring systems of corporate governance would lead to an abandonment of any theoretical project for understanding how governance works and for guiding improvements to it. Yet, such an extreme position hardly seems justified. In corporate governance, as in capitalism more generally, there is, as Sewell puts it, "a recurrent logic at the centre of the flux that generates

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a continuous, monotonously repetitive pattern" (Sewell 2008, p. 521). This logic lends itself to generalization. Therefore, in seeking to better understand corporate governance the challenge is not to opt for either general theory or detailed contextualization. Instead, the generalizations that our theories make about corporate governance need to be made explicitly contingent on particular institutional characteristics and changes.

There are a variety of different questions that such an approach might address. One area deserving attention is the role of social attitudes in conditioning particular approaches to corporate governance. Another issue is the way that prevailing economic conditions, whether for particular firms, industries, or nations, create barriers against, inducements to, and possibilities for alternative forms of governance. Perhaps the most salient concern in thinking about the prospects for regulatory reform in the United States today is the role of politics in conditioning the prospects for, and path of, corporate governance reform.

This topic has begun to be explored in recent years with contributions from scholars such as Mark Roe (2003), John Cioffi and Martin Höpner (2006), and Gourevitch and Shinn (2005). Some of this work challenges intuitive ideas about partisan interests with respect to particular characteristics of corporate governance. Cioffi and Höpner highlight what they cast as a "striking paradox" – "[c]ontrary to common understandings of corporate governance reform," they note, "political conservatives were seldom enthusiastic reformers and often resisted pro-shareholder laws, while the center-left has tended to champion the cause of shareholders, and thus finance capital, in opposition to managers" (2006, p. 464). This point certainly echoes the historical experience of the United States, since the origins of the SEC and federal securities legislation are clearly rooted in a moment in which the "center-left" of American politics reigned. Casting the Democratic Party as an advocate of investor rights suggests that the recent shift in political power in the United States augurs well for the future of shareholder rights. However, closer scrutiny reveals that partisan lines on issues of corporate governance may no longer be drawn as they were in the past. Before the United States found itself mired in corporate scandals and financial crisis, important elements of the Democratic coalition articulated positions that paralleled those taken by leading Republicans; these conservative forces may reassert their influence over the Democratic Party as scandal and crisis wane. To be fair, Cioffi/Höpner recognize this possibility themselves, noting that the Democrats' commitment to corporate reform is "tempered by their evolution into a purely centrist and largely pro-business party" (Cioffi and Höpner 2006, p. 484; see also Cioffi 2006).

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If understanding the interests and ideas of America's new political leadership is important for understanding where the likely opportunities for reform of corporate governance, there is also the question of how extraordinary are these political times. There are historical examples of critical junctures that have allowed for systemic change in corporate governance, both in the United States and elsewhere.[9] Indeed, the most celebrated forms of stakeholder capitalism in Germany and Japan were forged in the economic and social chaos that followed World War II. But is the current economic crisis likely to prompt similar developments in corporate governance? An analysis of the conditions under which historical crises have allowed for the transformation of a system of corporate governance, from a system oriented toward one set of interests to one that favors another, would certainly give some sense of the plausible scope of the possible new futures for corporate governance in America.

VI. Conclusion

Given the continued support for shareholder value in the United States today, it seems almost certain that corporate reform in the near term will be about strengthening the regulatory foundations of shareholder capitalism. Even within that narrow frame, as I have emphasized in this article, there are substantial intellectual challenges to be met for the specific reforms that have been proposed to be compelling. Yet, there is also good reason to broaden the basic terms of the debate on corporate governance in the United States to consider alternatives to shareholder value as a benchmark for corporate governance, even if it demands greater substantial intellectual effort and creativity. Social scientists especially need to address the central weaknesses bedeviling existing stakeholder theories of governance, which remain the most promising alternatives to the shareholder perspective.

It is also imperative that we do more to understand how the broader socioeconomic context, especially the political context, constrains and encourages variety and change in systems of corporate governance. Certainly it would help us to better assess the prospects for substantial reform in corporate governance while the financial crisis is ongoing. Comparative–historical research on systems of corporate governance would also furnish an excellent laboratory for thinking about the potential influence of regulation in bringing about these futures. Intriguingly, and perhaps not surprisingly,

[9] For the role of crises in facilitating policy change by stimulating public outrage and blunting the blocking power of special interests, see Moss–Oey chapter, this volume.

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many of the critical junctures that drove major changes in corporate governance were characterized by much broader political change, raising the issue of whether the transformative role of corporate regulation depends on broader contexts of political crisis and reconstruction. As policymakers contemplate new regulations for corporate governance, they could surely use the findings of such research, which should offer pointers about whether reform should seek to identify and reflect broader political changes, or to pursue directions that are somewhat at variance with the existing political trajectory.

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