

THE MAXIMANDS OF CORPORATE GOVERNANCE:
A THEORY OF VALUES AND COGNITIVE STYLE

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ABSTRACT

This article 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 article turns this debate on its head: Instead of asking "What" or "Whose" interests corporations should maximize, the real question is, "Why is this debate taking place at all?" Aiming to extend current economic analyses of the maximands issue, this article 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, one of 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 article asks a new question that turns this debate on its head. Rather than asking "What" or "Whose" interests corporations should maximize, the inquiry becomes "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 governance. These codes invariably call for giving priority to shareholders' interests while acknowledging the interests of other stakeholders³—yet they give no guidance as to how this target can be met.

This article maintains that two hundred years has not been enough to resolve the debate over the maximands of corporate governance.⁴ Its goal is twofold—both constructive and critical. In the constructive mode, this article advances a new theory on the maximands of corporate governance

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 BREAKING THE CODE OF CHANGE 37 (Michael Beer & Nithan Nohia eds., 2000); UNFOLDING STAKEHOLDER THINKING 65 (Joerg Andriof et al. eds., 2002); 14 J. APPLIED CORP. FIN. 8 (2001); 12 BUS. ETHICS Q. 235 (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. REV. 1195, 1195 (1999) ("For centuries legal, political, social, and economic commentators have debated corporate social responsibility *ad nauseam*.")

³See *infra* Part V.B.

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

that identifies crucial but heretofore neglected elements that engender this problem. In the critical mode, this article advances a new reading of existing analyses of corporate constituencies as corporate governance maximands.

Theoretical analyses have thus far 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 belief, this article shows that Berle agreed with Dodd that the interests of non-shareholder constituencies should be advanced by corporate fiduciaries in tandem with shareholders' interests. Their disagreement revolved around 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.

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 in 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.

This position, however, does not, in reality, hold true. The fundamental flaw in this back-of-the-envelope economic analysis lies in its reliance on the notion of the 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, namely, 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, these other claims are assumed away from the analysis such that only the residual claim remains to be maximized. This assumption, however, is unrealistic. 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 each other, e.g., those of shareholders,

⁵See *infra* Part III.E.1.

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.

The corporate governance problem is therefore not one of maximizing over a single factor (the maximand). Rather, it calls for optimizing over several factors simultaneously. Two hundred years' worth of work in economics and finance is 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 to fully 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 two 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.

Every theory of corporate governance is, at heart, a theory of power. In this view, the corporation is a nexus of power relationships beyond being a nexus of contracts. The corporate setting is rife with agency relationships in which certain parties have the ability (power) to unilaterally 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

⁶Erik Berglöf & Ernst-Ludwig von Thadden, *The Changing Corporate Governance Paradigm: Implications for Developing and Transition Economies*, in ANNUAL WORLD BANK CONFERENCE ON DEVELOPMENT ECONOMICS 135, 139 (Boris Pleskovic & Joseph E. Stiglitz eds. 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.

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 article points out 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 styles (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 cognitive styles—among other things, in the 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. All of these advances seem to be taking place independently of one another and an integrative view of these issues has not been explicated.

The theoretical framework developed in this article 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 to both the micro level (individual persons or corporations) and the macro level (national and international). At the micro level, effective corporate governance requires corporate fiduciaries to first overcome their self-interest and second, to constantly coordinate the interests of several constituencies. Especially in pressing times, such as 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 will emphasize openness to change more than conservation, and self-transcendence more than self-enhancement.¹⁰ Other managers would exhibit the opposite qualities more.

⁸See *infra* Part II.C.1.

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 *infra* note 48 and accompanying text.

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

Furthermore, 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.

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. 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 between the social environments within 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 a specific society. This type of analysis is related to, but conceptually different than, the above reference to managers' 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 the general culture of each country.

While some readers at this point might consider the propositions set forth as intuitive and self-evident, it should be stressed that this is entirely not the case. This article 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. As a normative matter, the analysis proposed in this article vindicates Berle's position, that American managers should focus on maximizing shareholder wealth. The present analysis clarifies, however, that such a norm is justified only as a second-best policy in a particular national setting—specifically, in the U.S.

More generally, these assertions expand the boundaries of the emerging strand of behavioral law and economics and their application to corporate governance. These propositions are presented here as testable hypotheses that can be empirically confirmed or refuted. The theory advanced in this article 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 article 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, which is 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 the context 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 conjunction 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 extremes, 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 to simply 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

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

¹²See *infra* Part III.E.3.

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 can 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.

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. A new integrative framework for discussing these issues is then offered. Section D implements this framework to the subject of corporate governance maximands. Section E sets forth 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

¹³This Section draws on Peter B. Smith & Shalom H. Schwartz, *Values*, in 3 HANDBOOK OF CROSS-CULTURAL PSYCHOLOGY 77 (2d ed., John 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, *supra*, at 88-91. This dimension, however, was first formulated in a cultural-level context.

¹⁴See generally Clyde Kluckhohn et al., *Value and Value Orientations in the Theory of Action*, in TOWARD A GENERAL THEORY OF ACTION 388 (Talcott Parsons & Edward A. Shils eds., 1951) (defining values and value orientations and demonstrating how they operate in society); MILTON ROKEACH, *THE NATURE OF HUMAN VALUES* (1973) (developing a systematic "value approach" to the problems of society); 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 (Mark P. Zanna ed. 1992) (exploring value priorities in different contexts).

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., family, educational, economic, political, religious) function, their goals and their modes of operation express cultural value 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

Thus, values are featured at two distinct levels of analysis: individual and societal (or cultural). These values are considered in step.

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 Thereafter, Schwartz advanced a comprehensive model of individual-level values that represent universal requirements of 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

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

¹⁶ROKEACH, *supra* note 14, at 5-17.

¹⁷See Shalom H. Schwartz & Wolfgang Bilsky, *Towards a Universal Psychological Structure of Human Values*, 53 *J. PERSONALITY & SOC. PSYCHOL.* 550, 568 (1987); Shalom H. Schwartz & Wolfgang Bilsky, *Towards a Theory of Universal Content and Structure of Values: Extensions and Cross-Cultural Replications*, 58 *J. PERSONALITY & SOC. PSYCHOL.* 878 (1990).

African ones.¹⁸ Out of fifty-six items included in this inventory, forty-five have been shown to have equivalent content meaning across cultures.¹⁹ Table 1 provides definitions of the ten values types distinguished by Schwartz and the value items that reflect them.

Table 1. The Schwartz Individual-Level Value Types

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)

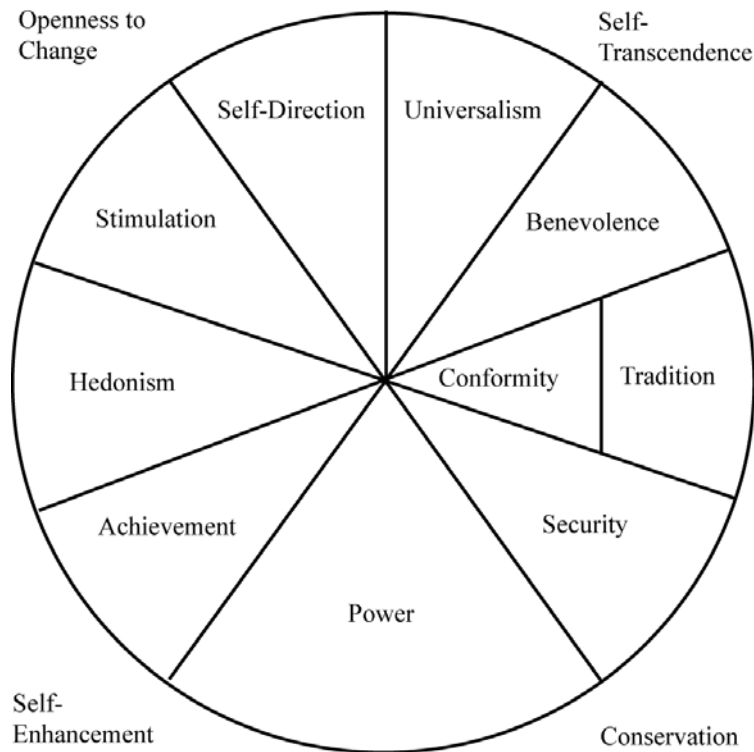
¹⁸See Schwartz, *supra* note 14; Shalom H. Schwartz et al., *Extending the Cross-Cultural Validity of the Theory of Basic Human Values with a Different Method of Measurement*, 32 J. CROSS-CULTURAL PSYCHOL. 519 (2001).

¹⁹For instance, "curious" 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 Schwartz, *supra* note 14; Shalom H. Schwartz, *Are There Universal Aspects in the Structure and Content of Human Values?* 50 J. SOC. ISSUES 19 (1994). For this survey, Schwartz also created versions of this inventory in other languages using procedures that ensured their language-equivalence.

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)

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. The Structure of Relations Among Individual Values



Multidimensional scaling analysis²⁰ 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.²¹ 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.²² In

²⁰For 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 DEL. J. CORP. L. 147, 173-75 (2001).

²¹The 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.

²²See Smith & Schwartz, *supra* note 13, at 87-88.

sum, the Schwartz model provides a nearly universal description of the content and structural relations of human values at the individual level.²³

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.²⁴ Defined in subjective terms, culture is the values, orientations, and underlying assumptions that are prevalent among the members of a society.²⁵ A common postulate in cross-cultural psychology is that all societies confront similar basic issues or problems when regulating human activity. The cultural responses to the basic problems that societies face are reflected, among other things, in prevailing value emphases of individuals.²⁶ Because values vary in importance, it is possible to characterize societies according to the relative importance attributed to these values in the society using dimensional models. This yields unique cultural profiles for societies or countries.²⁷

The importance of the distinction between the individual and the societal levels of analysis cannot be overstated. At the individual level, the relative importance of values for the individual person is analyzed, given the general challenges that he or she faces in conducting his or her life. At the societal level of analysis, the societal responses to challenges that societies face are sought. Although societies do not make conscious decisions or choices, they do struggle with the need to ensure subsistence and to establish social order, etc.—some societies more successfully than

²³There is now substantial supportive evidence that the Schwartz model indeed reflects a universal structure of human values. See 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); 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).

²⁴The 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 20. For further detail, see Schwartz, *supra* note 13.

²⁵This definition is similar to that adopted in studies of the effects of societal development; see, 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 (John Berry et al. eds., 2d ed. 1997).

²⁶See, for instance, ROKEACH, *supra* note 14; FLORENCE R. KLUCKHOHN & FRED L. STRODTBECK, VARIATIONS IN VALUE ORIENTATIONS (1961).

²⁷In this article the words "cultural" and "societal" are used interchangeably because the present focus is on national societies. It is possible, however, 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).

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 situation.²⁸ 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."²⁹

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.³⁰

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 sixty-seven nations.³¹ Schwartz derives three bipolar cultural value dimensions from three basic issues he identifies as confronting all societies: Embeddedness/Autonomy, Hierarchy/Egalitarianism, and Mastery/Harmony.³² In coping with these issues, societies exhibit greater or lesser emphasis on the values at one pole of each dimension.³³ Seven value orientations on which cultures can be compared derive from the analysis of the bipolar dimensions.³⁴ The theory also specifies the structure of relations among these types of values.³⁵ Table 2 provides definitions of the cultural value dimensions distinguished by Schwartz. Figure 2 presents graphically the relations among the value dimensions and orientations.

²⁸Smith & Schwartz, *supra* note 13, at 82-83.

²⁹*Id.* at 83 (emphasis added).

³⁰PETER B. SMITH & MICHAEL HARRIS BOND, SOCIAL PSYCHOLOGY ACROSS CULTURES 48-49 (2d ed. 1998)

³¹*See* Schwartz, *supra* note 13.

³²*Id.*

³³*Id.*

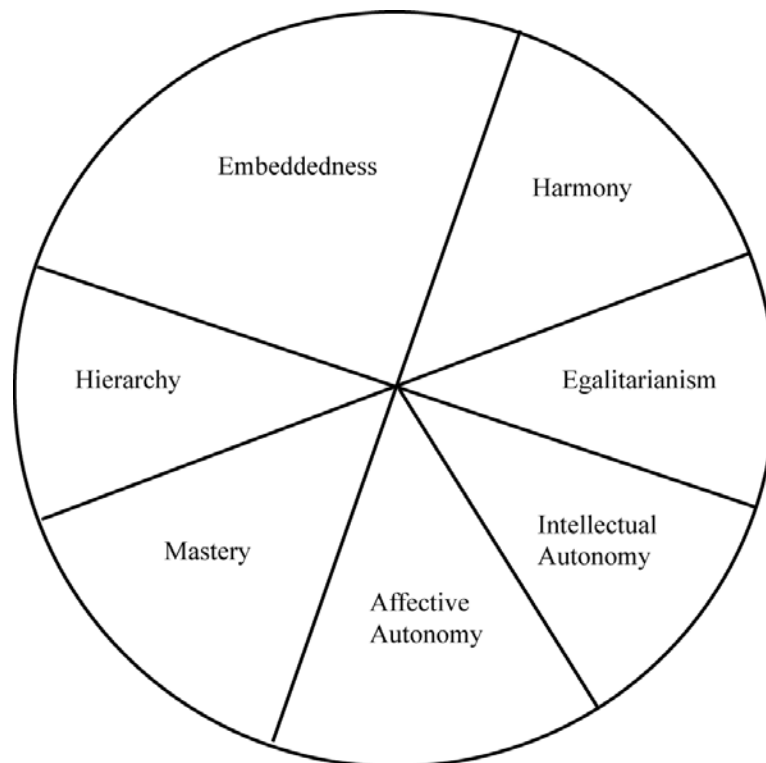
³⁴*Id.*

³⁵*See* Schwartz, *supra* note 13.

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.

Figure 2. The Structure of Relations Among Cultural Orientations



Another pioneering and still influential dimensional framework for characterizing cultures was advanced by Geert Hofstede.³⁶ His framework is widely used today in studies on management and accounting.³⁷ Hofstede

³⁶See GEERT HOFSTEDÉ, *CULTURE'S CONSEQUENCES: COMPARING VALUES, BEHAVIORS, INSTITUTIONS, AND ORGANIZATIONS ACROSS NATIONS* (2d ed. 2001) [hereinafter HOFSTEDÉ, *CULTURE'S CONSEQUENCES*]; GEERT HOFSTEDÉ, *CULTURE'S CONSEQUENCES: INTERNATIONAL DIFFERENCES IN WORK-RELATED VALUES* (1980) [hereinafter HOFSTEDÉ, *CULTURE'S CONSEQUENCES 1980*]; GEERT HOFSTEDÉ, *CULTURES AND ORGANIZATIONS: SOFTWARE OF THE MIND* (1991) [hereinafter HOFSTEDÉ, *SOFTWARE OF THE MIND*].

³⁷See Peter B. Smith, *The End of the Beginning?*, 1 INT'L J. CROSS-CULTURAL MGMT. 21 (2001). See also RICHARD MEAD, *INTERNATIONAL MANAGEMENT: CROSS-CULTURAL DIMENSIONS* (2d ed. 1998) (drawing on Hofstede's theory); 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"); 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) (drawing

identified four—and later, five—value dimensions: Individualism/Collectivism, Power Distance, Uncertainty Avoidance, Masculinity/Femininity,³⁸ and Long-term Orientation.³⁹ Table 3 provides definitions of the cultural value dimensions distinguished by Hofstede.

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.

on Hofstede's theory). Hofstede's work has also stirred objections on various grounds over the years. For a review and discussion of common objections, see HOFSTEDÉ, *CULTURE'S CONSEQUENCES*, *supra* note 36, at 73; *see also* Ulrich Schimmack et al., Individualism: A Valid and Important Dimension of Cultural Differences (Working Paper 2002), *available at* <http://www.erin.utoronto.ca/~w3psyuli/msIndividualism.pdf>.

³⁸This label has elicited negative responses. Writing originally in 1980, Hofstede was well aware of the problems 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. HOFSTEDÉ, *CULTURE'S CONSEQUENCES* 1980, *supra* note 36, at 277-78. In the 2001 edition, Hofstede follows the modern distinction between *sex* and *gender* and uses the latter term when referring to social function. HOFSTEDÉ, *CULTURE'S CONSEQUENCES*, *supra* note 36, at 280. For further discussions, see GEERT HOFSTEDÉ ET AL., *MASCULINITY AND FEMININITY: THE TABOO DIMENSION OF NATIONAL CULTURES* (1998).

³⁹This value dimension was not included in Hofstede's original study. It was added later, in HOFSTEDÉ, *SOFTWARE OF THE MIND*, *supra* note 36, at 14-15, in light of a study led by Michael Bond who named it "Confucian work dynamism." *See Chinese Values and the Search for Culture-Free Dimensions of Culture: The Chinese Cultural Connection*, 18 J. CROSS-CULTURAL PSYCHOL. 143 (1987). Notwithstanding its apparent link to 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.

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.

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.⁴⁰ Schwartz identified six cultural groups of nations: English-speaking, West European, East European, Far Eastern, Latin American, and African.⁴¹ A broader, more recent sample suggests that the Far Eastern cultural region comprises two sub-regions: South Asian and Confucian.⁴²

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 collection of 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."⁴³ The need for cognitive closure is primarily motivational. That is, "need"

⁴⁰HOFSTEDE, CULTURE'S CONSEQUENCES 1980, *supra* note 36, at 333-36. Note that the classification into more and less economically developed cultural regions dates from 1980.

⁴¹Schwartz, *supra* note 13, at 35-39.

⁴²Shalom 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 somewhat from the others.

⁴³ARIE W. KRUGLANSKI, LAY EPISTEMICS AND HUMAN KNOWLEDGE: COGNITIVE AND MOTIVATIONAL BASES 14 (1989).

denotes a motivational tendency or proclivity rather than a tissue deficit.⁴⁴ Cognitive closure is a goal that can bias individuals' choices 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.⁴⁵

The need for cognitive closure concept is close to similar constructs advanced earlier by psychologists such as closed mindedness,⁴⁶ certainty vs. uncertainty orientation, and need for cognition.⁴⁷ 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."⁴⁸ The need for cognitive closure involves tendencies to

⁴⁴Arie W. Kruglanski & Donna M. Webster, *Motivated Closing of the Mind: "Seizing" and "Freezing,"* 103 PSYCHOL. REV. 263, 264 (1996).

⁴⁵Lucia Mannetti et al., *A Cross-Cultural Study of the Need for Cognitive Closure Scale: Comparing Its Structure in Croatia, Italy, USA and the Netherlands,* 41 BRIT. J. SOC. PSYCHOL. 139, 140 (2002).

⁴⁶See MILTON ROKEACH, *THE OPEN AND THE CLOSED MIND* (1960).

⁴⁷Kruglanski & Webster, *supra* note 44, 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 a sense of autonomy, and a desire to adhere to predictable and familiar worlds."); *see also* Richard M. Sorrentino & Judith-Ann 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 uncertainty orientation. SORRENTINO & RONEY, *supra*, at 157-58. 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. *Id.*

⁴⁸John T. Jost et al., *Political Conservatism as Motivated Social Cognition*, 129 PSYCHOL. BULL. 339, 347 (2003) (citing Glenn D. Wilson, *A Dynamic Theory of Conservatism*, in *THE PSYCHOLOGY OF CONSERVATISM* 257, 259 (Glenn D. Wilson ed., 1973) (emphasis omitted)) [hereinafter Jost et al., *Political Conservatism*]. 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*

"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.⁴⁹ Individuals differ from one another in their stable degree of preference for closure and across situations to the extent which they are open to novel information and willing to invest the cognitive effort required for adjusting their knowledge base.⁵⁰

Kruglanski, Webster, and Klem have developed and validated a scale (survey questionnaire) for measuring the degree of individual need for cognitive closure.⁵¹ 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 choices, discomfort with ambiguity, and closed-mindedness.⁵² 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

is a Perilous Journey Indeed, THE SAN FRANCISCO CHRONICLE, Aug. 3, 2003, at D2; Byron York, *The "Conservatives Are Crazy" Study: Paid For by Taxpayers*, THE NAT'L REV. ONLINE (Aug. 1, 2003), at <http://www.nationalreview.com/york/york080103.asp>; David Fein, *Psychological Study Links Hitler to Reagan, Limbaugh*, at <http://www.crosswalk.com/news/1211434.html> (visited Dec. 20, 2004).

A thorny issue, which the various authors, *supra* note 48, abstract from, and this article will follow suit, is the validity of classifying political ideologies and orientations along a unidimensional left-right or conservative-liberal continuum. Philip Tetlock has argued that "it [was] 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 Politics of the 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." Shalom Schwartz, *Value Priorities and Behavior: Applying a Theory of Integrated Value Systems*, 8 ONTARIO SYMP. ON PERSONALITY AND SOC. PSYCHOL.: THE PSYCHOL. OF VALUES 1, 10 (Clive Seligman et al. eds., 1996). One is concerned with civil liberties and law and order; the other with economic issues.

⁴⁹See John T. Jost et al., *Effects of Epistemic Motivation on Conservatism, Intolerance, and Other System-Justifying Attitudes*, in SHARED COGNITION IN ORGANIZATIONS: THE MANAGEMENT OF KNOWLEDGE 91, 93 (Leigh L. Thompson et al. eds., 1999); Kruglanski & Webster, *supra* note 44, at 267.

⁵⁰See Kruglanski & Webster, *supra* note 44, at 264.

⁵¹Arie W. Kruglanski et al., *Motivated Resistance and Openness to Persuasion in the Presence or Absence of Prior Information*, 65 J. PERSONALITY & SOC. PSYCHOL. 861 (1993); Donna M. Webster & Arie W. Kruglanski, *Individual Differences in Need for Cognitive Closure*, 67 J. PERSONALITY & SOC. PSYCHOL. 1049 (1994).

⁵²See Kruglanski et al., *supra* note 51.

United States, Croatia, Italy, and The Netherlands,⁵³ and, separately, among Hong Kong Chinese.⁵⁴ Using this scale, Kruglanski, Webster, and colleagues have demonstrated that the need for cognitive closure produces similar consequences whether this need is evoked situationally (e.g., by time pressure or by ambient noise), or as an individual personality characteristic.⁵⁵

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, which allow for fast and frugal reasoning albeit at the price of systematic errors.⁵⁶ 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.⁵⁷

In the economics literature, Sonsino and colleagues have documented what they call "complexity-aversion," or "negative complexity effects in choice with uncertainty."⁵⁸ In particular, they show that more complex

⁵³Mannetti et al., *supra* note 45. 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, *Need for Closure and Political Orientation Among German University Students*, 137 J. SOC. PSYCHOL. 787 (1997).

⁵⁴See Chi-yue Chiu et al., *Motivated Cultural Cognition: The Impact of Implicit Theories on Dispositional Attribution Varies as a Function of Need for Closure*, 78 J. PERSONALITY & SOC. PSYCHOL. 247 (2000).

⁵⁵For further discussion and concentration of references, see Jost et al., *Political Conservatism*, *supra* note 48, at 348.

⁵⁶See GERD GIGERENZER ET AL., *SIMPLE HEURISTICS THAT MAKE US SMART* (1999) (presenting a collection of studies demonstrating how heuristics ("cognitive biases") can enable both living organisms and artificial systems to make smart choices, judgments, and predictions by employing bounded rationality).

⁵⁷JOHN W. PAYNE ET AL., *THE ADAPTIVE DECISION MAKER* 29-41 (1993); see also James R. Bettman et al., *A Componential Analysis of Cognitive Effort in Choice*, 45 ORG. BEHAVIOR & HUMAN DECISION PROCESSES 111 (1990).

⁵⁸See Doron Sonsino et al., *The Complexity Effects on Choice with Uncertainty—Experimental Evidence*, 112 ECON. J. 936, 937 (2002).

alternatives are less likely to be chosen, and that noise in the choice process increases with complexity.⁵⁹ 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.⁶⁰ In political decision making of voters, cognitive heuristics are at times employed by almost all voters, and they are particularly likely to be used when the choice facing voters is complex.⁶¹

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.⁶² In ambiguous, complex social interactions, culture provides easily accessible heuristics for reaching satisfactory solutions.⁶³ These solutions differ systematically, though, with people's culture.⁶⁴

Examination of the content of the need for closure construct suggests that it is closely related to the Conservation versus Openness to change dimension.⁶⁵ 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

⁵⁹See *id.*; 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).

⁶⁰See Philip E. Tetlock, *Cognitive Style and Political Belief Systems in the British House of Commons*, 46 J. PERSONALITY & SOC. PSYCHOL. 365 (1984); Philip E. Tetlock, *Cognitive Style and Political Ideology*, 45 J. PERSONALITY & SOC. PSYCHOL. 118 (1983).

⁶¹See Richard R. Lau & David P. Redlawsk, *Advantages and Disadvantages of Cognitive Heuristics in Political Decision Making*, 45 AM. J. POL. SCI. 951 (2001).

⁶²See *infra* note 64.

⁶³*Id.*

⁶⁴See 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 54, 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 *infra* note 69 and accompanying text.

⁶⁵See *supra* Table 1, notes 17-19 and accompanying text.

versus self-direction and stimulation values on the other hand.⁶⁶ 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, which conveys a sense of clarity.⁶⁷

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.⁶⁸ Studies by Schwartz and colleagues demonstrate relations of value priorities to behavior, some of it directly relevant to the liberal-conservative distinction.⁶⁹ 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

⁶⁶Kruglanski & Webster, *supra* note 44.

⁶⁷*Cf.* Jost et al., *Political Conservatism*, *supra* note 48, at 346.

⁶⁸*See, e.g.*, Tetlock, *supra* note 48; 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 et al., *Social and Cognitive Strategies for Coping with Accountability: Conformity, Complexity, and Bolstering*, 57 *J. PERSONALITY & SOC. PSYCHOL.* 632 (1989). For further discussion, see Jennifer S. Lerner & Philip E. Tetlock, *Accountability and Social Cognition*, in *ENCYCLOPEDIA OF HUMAN BEHAVIOR* (V.S. Ramachandran ed., 1994); 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).

⁶⁹*See* Anat Bardi & Shalom H. Schwartz, *Values and Behavior: Strength and Structure of Relations*, 29 *PERSONALITY & SOC. PSYCHOL. BULL.* 1207 (2003); Marina F. Barnea & Shalom H. Schwartz, *Values and Voting*, 19 *POLITICAL PSYCHOL.* 17 (1998); Schwartz, *supra* note 48. 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 contradicting values may be activated as a matter of course. *Cf.* Connie M. Kristiansen & Alan M. Hottel, *Morality and the Self: Implications for When and How of Value-Attitude-Behavior Relations*, 8 *ONTARIO SYMP. ON PERSONALITY AND SOC. PSYCHOL.: VALUES* 77 (Clive Seligman et al. eds., 1996) (questioning the causal relations between values and behavior); Kwok Leung et al., *How to Explain Cross-Cultural Differences: Values, Valences, and Expectancies?*, 1 *ASIAN J. PSYCHOL.* 70 (1995) (discussing mediating factors).

model of individual value dimensions. This article proposes that the notion of complexity may be a helpful organizing element for this purpose. 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, 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; that every human being is equipped with the same set of attentional, memorial, learning, and inferential procedures.⁷⁰ "Cognitive scientists' endorsement of the . . . universalistic position was . . . encouraged by the analogy between the human mind and the computer: brain = hardware, cognitive procedures . . . = operating principles and factory-installed software."⁷¹ According to Nisbett and Norenzayan, "[t]he heuristics and biases movement started by [Amos] Tversky and [Daniel] Kahneman encouraged the view that procedures such as judgment of

⁷⁰This is only one basic assumption of several. The literature on culture and cognition is outpouring. For sample reviews, on which the following paragraphs draw liberally, see Alan Page Fiske et al., *The Cultural Matrix of Social Psychology*, in *THE HANDBOOK OF SOCIAL PSYCHOLOGY* 915 (Daniel T. Gilbert et al., 4th ed. 1998); Richard E. Nisbett & Ara Norenzayan, *Culture and Cognition*, in *STEVENS' HANDBOOK OF EXPERIMENTAL PSYCHOLOGY: MEMORY AND COGNITIVE PROCESS* 561 (Douglas Medin ed. 3d ed. 2002); Richard E. Nisbett et al., *Cultures and Systems of Thought: Holistic versus Analytic Cognition*, 108 *PSYCHOL. REV.* 291 (2001); Kaiping Peng et al., *Culture and Human Inference*, in *THE HANDBOOK OF CULTURE AND PSYCHOLOGY* 245 (D. Matsumoto ed. 2001).

⁷¹Nisbett & Norenzayan, *supra* note 70, at 561 (citing Ned Block, *The Mind as the Software of the Brain*, in 3 *THINKING: AN INVITATION TO THE COGNITIVE SCIENCE* 377 (Edward E. Smith & Daniel N. Osherson eds., 2d ed., 1995)). Note, anecdotally, that Hofstede considered culture to be the software of the mind. HOFSTEDE, *SOFTWARE OF THE MIND*, *supra* note 36.

probability by the representativeness heuristic and judgment of frequency by the availability heuristic, were primary, universal, and difficult to alter.⁷²

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.⁷³ Nisbett and Norenzayan argue that cultural practices encourage and sustain certain kinds of cognitive processes, which then perpetuate these cultural practices.⁷⁴

The vast majority of empirical studies compared Western subjects (mostly American) with East Asian subjects (mostly Chinese and Korean).⁷⁵ For instance, Americans were more inclined to assign causality and responsibility to individual group members in agency situations, while the Asians were more inclined to assign causality to attributes of the group as a whole.⁷⁶ In explaining causes of behavior, Asians more than Americans placed credence on situational and interactional factors.⁷⁷ Asians were also better able than Americans at recognizing the influence of situational constraints on individual behavior: Americans were more susceptible to the fundamental attribution error.⁷⁸ On the other hand, Asians were more

⁷²Nisbett & Norenzayan, *supra* note 70, at 561-62 (citations omitted). For law-oriented discussions, 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 et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998) (discussing law and economics analysis in light of actual human behavior).

⁷³See, e.g., Tanya Menon et al., *Culture and the Construal of Agency: Attribution to Individual versus Group Dispositions*, 76 J. PERSONALITY & SOC. PSYCHOL. 701 (1999).

⁷⁴Nisbett & Norenzayan, *supra* note 70, at 562.

⁷⁵*Id.*

⁷⁶Menon et al., *supra* note 73.

⁷⁷Ara Norenzayan et al., *Cultural Similarities and Differences in Social Inference: Evidence from Behavioral Predictions and Lay Theories of Behavior*, 28 PERSONALITY & SOC. PSYCHOL. BULL. 109 (2002).

⁷⁸Incheol Choi & Richard E. Nisbett, *Situational Salience and Cultural Differences in the Correspondence Bias and Actor-Observer Bias*, 24 PERSONALITY & SOC. PSYCHOL. BULL. 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).

susceptible to the hindsight bias, believing that they could have predicted outcomes that in fact one could not have predicted.⁷⁹ This finding may stem from the fact that in analyzing a situation, Asians consider more factors as relevant than Americans do.⁸⁰

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.⁸¹ In this view, the Western construal of the self is characterized by a sense of autonomy and distinctiveness from others.⁸² In the East Asian construal of the self, one's identity is diffused socially across significant others in one's in-group.⁸³ These polar views are close to the polar orientations on Schwartz's Autonomy/Embeddedness dimension.⁸⁴ They are also reminiscent of, but not identical to, Hofstede's and Harry Triandis' Individualism/Collectivism distinction.⁸⁵ 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.⁸⁶

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.⁸⁷ It should be emphasized, however, that the need for cognitive closure construct applies at the individual level, not the societal level.⁸⁸ 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."⁸⁹

Preliminary evidence suggests that people in different cultures vary in their typical level of need for cognitive closure. Chiu and his colleagues

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

⁸⁰Incheol Choi et al., *Culture and Judgment of Causal Relevance*, 84 J. PERSONALITY & SOC. PSYCHOL. 46 (2003).

⁸¹Hazel R. Markus & Shinobu Kitayama, *Culture and the Self: Implication for Cognition, Emotion, and Motivation*, 98 PSYCHOL. REV. 224 (1991).

⁸²*Id.*

⁸³Peng et al., *supra* note 70, at 248.

⁸⁴See *supra* notes 31-35 and accompanying text; Figure 2.

⁸⁵See HARRY C. TRIANDIS, *INDIVIDUALISM AND COLLECTIVISM* (1995).

⁸⁶See Fiske et al., *supra* note 70, at 322-24.

⁸⁷See Jost et al., *Political Conservatism*, *supra* note 48, at 348 (citing Hofstede).

⁸⁸*Id.*

⁸⁹*Id.*

administered the Kruglanski and Webster scale to Hong Kong Chinese and to non-Asian Americans.⁹⁰ They found that compared to the Chinese participants, Americans participants scored lower on the subscales that reflect preference for predictability, discomfort with ambiguity, and closed-mindedness.⁹¹ 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."⁹² This finding, the authors argue, is in line with broader views in the cultural psychology literature on cognitive styles.⁹³

Compared with Western systems of thought, the East Asian systems of thought (as 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."⁹⁴ East Asian subjects have been found to be more tolerant to apparent contradictions and in fact exhibit a clear preference for contradicting, dialectical statements.⁹⁵ The metaphor of cultures as "systems of thought" vividly captures this pattern.⁹⁶

3. Cultural Orientations, Complexity, and Need for Closure

The aforementioned evidence raises the question of 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, this article proposes that such relationships are to be expected, and argues 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. The discussion now examines 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

⁹⁰Chiu et al., *supra* note 54, at 249-50.

⁹¹*Id.* at 252.

⁹²*Id.* On the relations between these subscales, see *supra* note 53.

⁹³*See id.* at 252-53.

⁹⁴Nisbett et al., *supra* note 70, at 293.

⁹⁵*See* Kaiping Peng & Richard E. Nisbett, *Culture, Dialectics, and Reasoning about Contradiction*, 54 AM. PSYCHOLOGIST 741 (1999).

⁹⁶*See* Nisbett et al., *supra* note 70.

ideal of social structure that rests on the "Five Relationships" being a prime example.⁹⁷ 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 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 terms of 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 that place much emphasis 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 to which people are expected to adjust.

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.⁹⁸ 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

⁹⁷Formulated 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.

⁹⁸The text anthropomorphizes cultures but it should be obvious that cultures do not consciously choose strategies. This usage, however, is common shorthand for non-human players.

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 social esteem would compensate people for the potential disutility of the extended cognitive process.⁹⁹ 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. In 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 irrespective of the complexity of cultural orientations). This is the thrust of Hofstede's Uncertainty Avoidance dimension.¹⁰⁰ Such mechanisms can take on various forms, from inhibiting multiple choices to setting fixed scripts for social functions 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.¹⁰¹

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

⁹⁹See 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 approbrium).

¹⁰⁰HOFSTEDE, *CULTURE'S CONSEQUENCES*, *supra* note 36, at 153-212; HOFSTEDE, *SOFTWARE OF THE MIND*, *supra* note 36, at 109-37.

¹⁰¹Schwartz notes:

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 Vincken et al., eds. 2004).

levels could vary in accordance with different cultural profiles.¹⁰² Yet the extant evidence from Chiu and his colleagues remains suggestive at this stage.¹⁰³ 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.¹⁰⁴

¹⁰²It 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 would be relevant to actual average levels, of course.

¹⁰³See Chiu et al., *supra* note 54.

¹⁰⁴On standardization in cross-cultural research, see Ronald Fischer, *Standardization to Account for Cross-Cultural Response Bias: A Classification of Score Adjustment Procedures and Review of Research in JCCP*, 35 J. CROSS-CULTURAL PSYCHOL. 263 (2004); Ulrich Schimmack et al., *Individualism: A Valid and Important Dimension of Cultural Differences* (Working Paper 2002), available at <http://www.erin.utoronto.ca/~w3psyuli/msIndividualism.pdf>.

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.¹⁰⁵ In the context of the maximands of corporate governance, the debate is framed as accountability only to shareholders versus accountability to multiple constituencies or stakeholders. The latter may also be called "accountees." In addition to identifying the parties who owe accountability and those to whom accountability is owed, a full description of accountability relationships also must specify the content of the duties it entails.

In social psychology, "[accountability] 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."¹⁰⁶ 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."¹⁰⁷ The concept of accountability is deeply rooted in English traditions.¹⁰⁸ Nevertheless, it is now commonly being

¹⁰⁵ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, OECD PRINCIPLES OF CORPORATE GOVERNANCE (2004), available at <http://www.oecd.org/dataoecd/32/18/31557724.pdf> [hereinafter OECD 2004 PRINCIPLES] (according to Principle VI, "[t]he 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 GOVERNANCE, DOCUMENT SG/CG (99) 5, 9 (1999) [hereinafter OECD 1999 PRINCIPLES]. For a critical analysis of the OECD Principles, see *infra* note 364 and accompanying text.

¹⁰⁶Lerner & Tetlock, *supra* note 68, at 1.

¹⁰⁷*Id.* at 1-2 (discussing G.R. SEMIN & A.S.R. MANSTEAD, THE ACCOUNTABILITY OF CONDUCT: A SOCIAL PSYCHOLOGY ANALYSIS (1983)).

¹⁰⁸See Amir N. Licht, Accountability and Corporate Governance (Working Paper 2002), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=328401; Mel Dubnick, *Clarifying Accountability: An Ethical Theory Framework*, in PUBLIC SECTOR ETHICS: FINDING AND IMPLEMENTING VALUES 68, 69 (Charles Samford et al. eds. 1998).

used as a general term to describe who should bear responsibility and to whom that responsibility is directed.¹⁰⁹

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.¹¹⁰ American courts 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.¹¹¹ 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.¹¹² 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.¹¹³

The current theoretical framework highlights the strength with which these basic issues are tied to psychological and cultural elements.

¹⁰⁹See Licht, *supra* note 108. For a representative description of public sector accountability in the United States, see Barbara S. Romzek & Melvin J. Dubnick, *Accountability*, in 1 THE 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 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.

Id.

¹¹⁰See Licht, *supra* note 108.

¹¹¹Consider 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.

Id. (internal citation omitted)

¹¹²For a thorough review, see ROBERT C. CLARK, *CORPORATE LAW* 160-80 (1986).

¹¹³Melvin Eisenberg makes a similar distinction between "self-interest" and "positional conflict." See MELVIN ARON EISENBERG, *CORPORATIONS AND OTHER BUSINESS ORGANIZATIONS, CASES AND MATERIALS* 707 (8th ed. 2000).

Accountability regimes that regulate the exercise of power in corporations are determined by a host of factors ranging from legal rules to court decisions to social norms. Every time decision makers face a situation that is not directly and exhaustively governed by legal rules or court decisions, they would fall back on social norms and on their sense of what is appropriate or at least acceptable. None of these factors can sensibly be assumed to be immune to the impact of politics and culture and, more fundamentally, the psyche 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 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 accountee,¹¹⁴ hence, its legitimation of certain economic outcomes of power differences in the corporation and 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-than-average need for cognitive closure whose individual value emphases 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

¹¹⁴As originally noted by R.H. Coase, in *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. 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. *Id.* 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. Schwartz, *supra* note 42, at 8.

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 would at least produce different outcomes.¹¹⁵ These differences may also have far-reaching implications on corporate decisions, because managers appear to be very attentive to public opinion.¹¹⁶

Granted, economic incentives to individuals and nations alike also factor into 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 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

At this point it is possible 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 the maximand of multiple constituency interests. 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

¹¹⁵See Amir N. Licht, *Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform*, 22 BERKELEY J. INT'L L. 195 (2004).

¹¹⁶See 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 evidence that media affects companies' policy toward the environment and the amount of corporate resources that are diverted to the sole advantage of controlling shareholders).

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, policy makers and people in decision-making positions in corporations are expected to be more receptive to multiple-constituency corporate governance the more they emphasize the values of Openness to change versus Conservation and, to a lesser extent, 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 as their level of need for cognitive closure increases.
- 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 that place emphasis on Harmony. In contrast, societal emphases on Autonomy together with Hierarchy, and perhaps 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, the concentration is on the available evidence. Together with additional evidence, it will be put in more detailed context in subsequent parts.

First, the individual level will be discussed. A study by Tetlock investigated the relations between American managers' political positions and need for cognitive closure versus their views on a variety of organizational problems.¹¹⁷ Among other things, subjects were presented

¹¹⁷Tetlock, *supra* note 48.

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.¹¹⁸

Analysis at the societal level is based on comparative studies. A well-known survey by Charles Hampden-Turner and Fons Trompenaars has found suggestive evidence for significant relations between culture and stakeholder issues.¹¹⁹ These researchers surveyed international managers from several countries and asked them about their attitudes toward corporate profit.¹²⁰ Specifically, managers were asked "to choose one of the following as an accurate statement of the proper goals 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 various stakeholders, such as employees, customers, etc."¹²¹ 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

¹¹⁸Tetlock, *supra* note 48, at 319. Tetlock vividly summarizes these interviews: [C]onservatives, both authoritarian and libertarian, 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 both of 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 inexhaustible source of excuses for poorly performing managers to put off long-suffering shareholders. As one freshly minted M.B.A. 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."

Id.

¹¹⁹CHARLES HAMPDEN-TURNER & FONS TROMPENAARS, *THE SEVEN CULTURES OF CAPITALISM* 31-34 (1993).

¹²⁰*Id.* at 32.

¹²¹This question essentially replicates the famous "Friedman Doctrine," which stated that "the social responsibility of business is to increase its profits." *See infra* note 197 and accompanying text.

ranking at the top of the list.¹²² In contrast, Germany, France, Singapore, and Japan ranked lowest.¹²³

Lilach Sagiv and Shalom Schwartz have reanalyzed data compiled by Hampden-Turner and Trompenaars on managers' preferences about solving social dilemmas in organizations.¹²⁴ 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.¹²⁵ 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 Adolf Berle and Merrick Dodd is often said to have been "settled" during the 1930s, arguably in favor of Dodd's view.¹²⁶ 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, perhaps 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.*

¹²²*Id.*

¹²³Ranking in the middle were Italy, Sweden, the Netherlands, and Belgium. *Id.* Unfortunately, a more recent version of this study does not report results for this question. See FONS TROMPENAARS, RIDING THE WAVES OF CULTURE: UNDERSTANDING DIVERSITY IN GLOBAL BUSINESS (1997).

¹²⁴Lilach 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 M. Ashkanasy et al. eds. 2000) (referring to HAMPDEN-TURNER & TROMPENAARS, *supra* note 119, at 10-11).

¹²⁵*Id.*

¹²⁶*See infra* Part III.B.

*Ford Motor Co.*¹²⁷ 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 ideas, to progressive views, to recent hierarchical models of the corporation. Section F connects the debate to the theoretical framework as outlined in Section E.

A. Dodge v. Ford Motor Co.

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 million cars annually.¹²⁸ The plan also called for a reduction in the price of a Model T car from \$440 to \$360 although the market apparently could sustain the higher price even if for a lower volume.¹²⁹ It was further decided not to distribute as dividends rather huge funds that the company had earned, but to invest them back in the business. 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 their homes."¹³⁰ In 1919, the Supreme Court of Michigan, in a suit brought by the Dodge brothers as minority shareholders, emphasized 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."¹³¹

¹²⁷170 N.W. 668 (Mich. 1919).

¹²⁸*Id.* at 683.

¹²⁹*Id.*

¹³⁰*Id.* Henry Ford had expressed these views repeatedly. In his memoirs, Ford had said: I don't believe we should make such an awful profit on our cars. A reasonable profit is right, but not too much. I hold that it is better to sell a large number of cars at a reasonable small profit. . . . I hold this because it enables a larger number of people to buy and enjoy the use of a car and because it gives a larger number of men employment at good wages. Those are the aims I have in life.

HENRY JONES FORD, *MY LIFE AND WORK* (1922), available at <http://www.webroots.org/library/usabios/mlawhf03.html> (visited Dec. 20, 2004). See also JAMES C. COLLINS & JERRY I. PORRAS, *BUILT TO LAST: SUCCESSFUL HABITS OF VISIONARY COMPANIES* 55 (1997); ALLAN NEVINS & FRANK E. HILL, *FORD: EXPANSION AND CHALLENGE, 1915-1933*, at 97 (1957) (citing an interview in the *Detroit News* in which Ford made similar statements). On Ford's religious upbringing and personality, see generally NEIL BALDWIN, *HENRY FORD AND THE JEWS: THE MASS PRODUCTION OF HATE* (2001); *Henry Ford and the Model T* in DANIEL GROSS ET AL., *FORBES® GREATEST BUSINESS STORIES OF ALL TIME* (1996), available at <http://www.wiley.com/legacy/products/subject/business/forbes/ford.html>.

¹³¹*Dodge*, 170 N.W. at 684.

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.¹³²

The proposition that shareholders are the primary beneficiaries of the corporation and hence, that 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.¹³³ 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.¹³⁴ The courts of Michigan, where *Dodge*

¹³²*Id.* 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.

¹³³*See, e.g.,* MICHAEL P. DOOLEY, FUNDAMENTALS OF CORPORATION LAW 97 (1995) (noting that 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 J. CORP. L. 277, 278 (1998) ("Corporate directors have a fiduciary duty to make decisions that are in the best interests of the shareholders.").

¹³⁴*See* Hall v. John S. Isaacs & Sons Farms, Inc., 163 A.2d 288, 295 (Del. 1960) (citing *Dodge*, 170 N.W. at 668), 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.

originated, also consider *Dodge* a standard case of management discretion.¹³⁵ One Michigan court in fact noted that *Dodge* was *not* a case of action against shareholders' interests.¹³⁶

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.¹³⁷ 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.¹³⁸ Yet such a reading clearly would also be partial—obscuring more than it revealed. 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.¹³⁹

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 judicial and legislative actions in which interests of non-shareholder constituencies were invoked, e.g., with regard to anti-takeover statutes and

Blackwell v. Nixon, No. 9041, 1991 Del. Ch. LEXIS 150, at *12 (Del. Ch. Sept. 26, 1991), *reprinted in* 17 DEL. J. CORP. L. 1083, 1090 (1992) ("[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 v. Ford Motor Co.* 170 N.W. 668 (Mich. 1919).

¹³⁵*See* Lytle v. Malady, 566 N.W.2d 582, 593 n.25 (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).

¹³⁶*See* Miller v. Magline, Inc., 256 N.W.2d 761, 772 (Mich.Ct. App. 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.").

¹³⁷Smith, *supra* note 133, at 279.

[T]he 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.

Id.

¹³⁸*Id.* at 319.

¹³⁹It 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 is true. 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 *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) (directors' duty of care), and *Perlmann v. Feldman*, 219 F.2d 173 (2d Cir. 1955) (sharing of control premium upon sale of control).

court rulings on anti-takeover defense tactics.¹⁴⁰ 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 management 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 of the case, 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. 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 revisit Berle and Dodd aiming to identify the historical intellectual roots of the maximands of corporate governance.

Berle fired the opening shot in a 1931 article titled "Corporate Powers as Powers in Trust."¹⁴¹ "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."¹⁴² At first blush, Berle's claim reads like a restatement of *Dodge*, yet it is not. Noting that "through the very nature of the corporate entity, responsibility goes with power,"¹⁴³ 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 to a *cestui que* trust.

¹⁴⁰For a discussion, see *infra* Part III.D.

¹⁴¹A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931).

¹⁴²*Id.* at 1049.

¹⁴³*Id.* at 1050.

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 *Dodge* was cited as supporting authority only to the proposition that "[t]he 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."¹⁴⁴ 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.¹⁴⁵

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?,"¹⁴⁶ 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.¹⁴⁷ 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.¹⁴⁸ 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 Great Depression and the budding New Deal.¹⁴⁹ In the reformed economy, he prophesied, there would be "modifications of the maximum-profit-for-the-stockholders-of-the-individual-company formula."¹⁵⁰

¹⁴⁴*Id.* at 1060.

¹⁴⁵When Berle mentions the "general good of the community," he does so to indicate Henry Ford's personal whims as a controlling shareholder. Berle, *supra* note 141, at 1061. In a similar vein, Berle cites *Channon v. Channon Co.*, 218 Ill. App. 397 (Ill. App. Ct. 1920) as an example of a case where a majority shareholder was directed to 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. Berle, *supra* note 141, at 1061 n.31.

¹⁴⁶E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932).

¹⁴⁷Dodd writes: "The present writer is thoroughly in sympathy with Mr. Berle's efforts to establish a legal control which will more effectively prevent corporate managers from 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.

¹⁴⁸*Id.* at 1146. Dodd, however, stresses that "[n]either the language of the opinion nor the relief granted necessarily involves an unqualified acceptance of the maximum-profit-for-stockholders formula." *Id.* at 1158 n.31.

¹⁴⁹Dodd 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.

¹⁵⁰Dodd, *supra* note 146, at 1152.

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 few prominent figures in the business community of the time.¹⁵¹ Dodd interpreted these sporadic statements as harbingers of an emerging, more general trend in American society toward greater concern for non-stockholder constituencies.¹⁵²

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 very well may "come to feel as strong a community of interest with their fellow workers as with a group of investors" (namely, ethical concerns).¹⁵³ 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, Berle, in responding to Dodd's article,¹⁵⁴ did not really dispute Dodd's theoretical position.¹⁵⁵ Nevertheless, Berle literally lashed out at Dodd for making a fallacious move from the normative to the descriptive.¹⁵⁶ Desirable as it may be in theory, social responsibility was not in fact pursued by corporations and corporate insiders, nor could it be pursued. This implementation problem, Berle believed, is insurmountable, as there is no mechanism that could enforce social responsibility on corporations.¹⁵⁷

¹⁵¹Dodd 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.

¹⁵²*Id.* at 1156.

¹⁵³*Id.* at 1156-57.

¹⁵⁴A.A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932).

¹⁵⁵*Id.* at 1366 ("As a matter of economics and social theory, Professor Dodd's argument is not only sound but familiar.").

¹⁵⁶*Id.* at 1367-68.

¹⁵⁷*Id.* at 1367.

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

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.¹⁵⁸

During his exchanges with Dodd, Berle was already engulfed in his collaborative study with Gardiner Means that would yield their seminal book, *The Modern Corporation and Private Property*.¹⁵⁹ 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. 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.¹⁶⁰ 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 placed the community in a position to demand that the modern corporation should serve not alone the owners or the control but all society."¹⁶¹

Berle and Means' position looks strikingly similar to Dodd's position, which Berle so forcefully criticized in his note of the same year,¹⁶² leaving several commentators 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."¹⁶³ Several decades earlier, Joseph Weiner also argued that Berle was offering contradictory

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."

Id.

¹⁵⁸Berle, *supra* note 154, at 1367.

¹⁵⁹ADOLPH A. BERLE, JR. & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (rev. ed. 1933).

¹⁶⁰*Id.* at 356.

¹⁶¹*Id.* at 355-56.

¹⁶²*See supra* notes 155-59 and accompanying text.

¹⁶³William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737, 761 (2001).

resolutions to the corporate governance problem and was in fact changing positions on managerial accountability to shareholders or community.¹⁶⁴

Although Bratton is willing to forgive Berle for this inconsistency,¹⁶⁵ this article would argue that no such forgiveness is called for, as there is no incoherence in Berle's writings.¹⁶⁶ 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 Means' opus is dedicated to a positive analysis of the separation between ownership and control in American corporations.¹⁶⁷ Their normative analysis is mostly confined to a small number of pages in the closing chapter.¹⁶⁸ 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.¹⁶⁹ Traditionally, two possible ways are (1) to provide legal protection to public shareholders through the trusteeship,¹⁷⁰ and (2) to give the groups in control powers which are

¹⁶⁴Wilber G. Katz, *Responsibility and the Modern Corporation*, 3 J.L. & ECON. 75 (1960); Joseph L. Weiner, *The Berle-Dodd Dialogue on the Concept of the Corporation*, 64 COLUM. L. REV. 1458 (1964).

¹⁶⁵Bratton, *supra* note 163, at 761-62.

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.

Id. (footnotes omitted).

¹⁶⁶As a technical matter, one may note that *The Modern Corporation and Private Property* is repeatedly cited in Berle's article. See Berle, *supra* note 154, at 1366 n.4, 1367 n.7, & 1369 n.9.

¹⁶⁷BERLE & MEANS, *supra* note 159, at 352-57.

¹⁶⁸*Id.* 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 163.

¹⁶⁹BERLE & MEANS, *supra* note 159, 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.").

¹⁷⁰*Id.* at 354. This strategy is described in more detail in an earlier chapter titled *Corporate Powers as Powers in Trust*, *id.* at 247-76, which draws on Berle's article of the same title. Berle, *supra* note 141.

absolute and not limited by any implied obligation with respect to their use.¹⁷¹ Of these two alternatives, the former is said to be the lesser of two evils.¹⁷² Berle and Means did not stop there, however. They instead 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.¹⁷³ Should this "third way" be implemented, Berle and Means claimed, in contrast to the ruling in *Dodge*, courts would approve of managerial programs that benefited employees and communities at the expense of shareholders and bondholders.¹⁷⁴

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."¹⁷⁵ Only "[w]hen a convincing system of community obligations is worked out and is generally accepted . . . the passive property right of today must yield before the larger interests of society."¹⁷⁶ 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.¹⁷⁷ The interests of

¹⁷¹BERLE & MEANS, *supra* note 159, at 354.

¹⁷²*Id.* at 355.

¹⁷³*Id.* at 355.

¹⁷⁴*Id.* at 355-56

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.

Id. at 356.

¹⁷⁵BERLE & MEANS, *supra* note 159, at 356.

¹⁷⁶*Id.*

¹⁷⁷*Id.* at 355.

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.

Id. Berle, *supra* note 154, at 1371-72.

non-stockholder constituencies may receive protection through other means.¹⁷⁸

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.¹⁷⁹ In another lesser-known article,¹⁸⁰ however, 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.¹⁸¹ In this respect, advancing the interests of employees, consumers, and the general community appeared to Dodd to be

The shareholder who now has a primary property right over residual income after expenses are met, may ultimately be conceived of 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.

Id.

¹⁷⁸Increased 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 Diversity in Securities Regulation: Roadblocks on the Way to Convergence*, 20 CARDOZO L. REV. 227, 259-63 (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.

¹⁷⁹E. Merrick Dodd, Jr., *The Modern Corporation and Private Property*, 81 U. PA. L. REV. 782, 785 (1933) (reviewing ADOLPH A. BERLE, JR., *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932) ("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.")).

¹⁸⁰E. Merrick Dodd, Jr., *Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?*, 2 U. CHI. L. REV. 194 (1934).

¹⁸¹*Id.* at 199.

[T]he 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. 1607 (2001) (exploring the renewed interest in the roles of norms in corporate law).

"less abnormal" than shareholder value maximization.¹⁸² 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."¹⁸³

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.¹⁸⁴

The immediate reason that led Berle to concede defeat was the ruling in *A.P. Smith Manufacturing Co. v. Barlow*,¹⁸⁵ in which a corporate donation to Princeton University was upheld. Berle, however, later clarified that "he did not intend to indicate that Professor Dodd was right all along."¹⁸⁶ Bearing in mind that the *Barlow* court cited long-term business interests among the justifications for the donation to Princeton¹⁸⁷—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

¹⁸²Dodd, *supra* note 180, at 203 ("Service to one's fellow workers, to those who have need of one's products, or to the social and political community of which one is a member would seem a less abnormal aim than vicarious profit-seeking.").

¹⁸³*Id.* at 207. In this article, *id.* at 206, the author only repeats the references he made in Dodd, *supra* note 146.

¹⁸⁴ADOLF 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, 37-38 n.14 (1991); *see also* Adolf A. Berle, *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.").

¹⁸⁵98 A.2d 581 (N.J. 1953).

¹⁸⁶Adolf A. Berle, Jr., *Foreword to THE CORPORATION IN MODERN SOCIETY* xii (Edward S. Mason ed., 1959), *cited in* Sommer, *supra* note 184 ("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.").

¹⁸⁷*A.P. Smith Mfg. Co.*, 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.¹⁸⁸ At the same time—much like Dodd of the 1930s—Berle provided no practical details as to exactly how managers could bring about this utopian vision. Perhaps he never believed they could.¹⁸⁹

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 1950s through the 1970s witnessed America undergoing several cycles of renewed interest in corporate social responsibility, which is 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.¹⁹⁰ 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, drew the attention of American commentators. During the 1950s, journalists, academics, and other critics (including Berle) were musing on the ways to harness corporate power to socially desirable goals.¹⁹¹ Contemporary contributors were unable to propose specific mechanisms to curb corporate power or direct it in socially beneficial directions.¹⁹² 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,¹⁹³ Rostow said:

¹⁸⁸BERLE, *supra* note 184, at 56 ("[T]he 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.").

¹⁸⁹Tellingly, Berle titled the fifth chapter of his book, *id.*, *Corporate Capitalism and the City of God*.

¹⁹⁰These 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 U. KAN. L. REV. 77 (2002), on which the following paragraphs draw.

¹⁹¹*See id.* at 99-110.

¹⁹²*Id.* at 108.

¹⁹³*See supra* note 1 and accompanying text.

"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."¹⁹⁴

The 1960s and 1970s brought new reasons for concern over 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.¹⁹⁵ These campaigns mostly failed or had a negligible lasting effect.¹⁹⁶ 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*.¹⁹⁷ 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.¹⁹⁸ Friedman remained silent about the content and scope of that "ethical custom" which would legitimate diversion of resources away from

¹⁹⁴Wells, *supra* note 190, at 109 (quoting Eugene V. Rostow, *To Whom and for What Ends Is Corporate Management Responsible?*, in *THE CORPORATION IN MODERN SOCIETY* 63 (Edward S. Mason ed., 1959)).

¹⁹⁵Under a proposal advanced by Ralph Nader, Mark Green, and Joel Seligman in *RALPH NADER ET AL., Taming the Giant Corporation* 126 (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, another for community relations, and so on. As Wells pointedly notes, 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. Wells, *supra* note 190, at 121-23.

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).

¹⁹⁶See Wells, *supra* note 190, at 111-23.

¹⁹⁷Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, § 6 (Magazine), at 33.

¹⁹⁸*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).

maximizing profits. Yet it is clear that such ethical considerations would be extremely narrow.¹⁹⁹

In terms of positive law too, little has 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*,²⁰⁰ upholding the directors' decision not to install lights in Wrigley Field despite the loss of potential profits, similarly noted that "the long run interests of the corporation in its property value at Wrigley Field might demand all efforts to keep the neighborhood from deteriorating."²⁰¹

D. Other-Constituency Statutes

The controversy over the appropriate maximands of corporate governance erupted in earnest again during the 1980s. This was largely due to the tidal wave of hostile takeovers and the 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.²⁰² These statutes

¹⁹⁹According to Friedman, "social responsibilities" that do *not* warrant departure from profit maximization include providing employment, eliminating discrimination, reducing pollution, preventing inflation, and fighting poverty. FRIEDMAN, *supra* note 198, at 33.

²⁰⁰237 N.E.2d 776 (Ill. App. Ct. 1968).

²⁰¹*Id.* at 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 and also relating to claims of corporate waste 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, Inc.*, 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).

²⁰²See Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 26-27 (1992).

have engendered numerous legal commentaries,²⁰³ but fortunately, this sizeable literature need not be engaged here for too long.

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.²⁰⁴ 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.²⁰⁵

²⁰³Scholarly 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: For Whom are Managers Fiduciaries?*, 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 Conference: Introduction*, 43 U. TORONTO L.J. 297 (1993); Symposium, *New Directions in Corporate Law, Communitarians, Contractarians, and the Crisis 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 Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971 (1992); William J. Carney, *Does Defining Constituencies Matter?*, 59 U. CIN. L. REV. 385 (1990); Ronn S. Davids, *Constituency Statutes: An Appropriate Vehicle for Addressing Transition Costs?*, 28 COLUM. J.L. & SOC. PROBS. 145 (1995); Morey W. McDaniel, *Stockholders and Stakeholders*, 21 STETSON L. REV. 121 (1991); 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); Orts, *supra* note 202; Lynda J. Oswald, *Shareholders v. Stakeholders: Evaluating Corporate Constituency Statutes Under the Takings Clause*, 24 J. CORP. L. 1 (1998); Steven M.H. Wallman, *The Proper Interpretation of Corporate Constituency Statutes and Formulation of Director Duties*, 21 STETSON L. REV. 163 (1991).

²⁰⁴Orts, *supra* note 202, at 20.

²⁰⁵This 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 16; *Who Can Stop the Raiders of Corporate America?*, 291 ECONOMIST 77 (Apr. 7, 1984).

In 1983, Pennsylvania adopted the first other constituency statute.²⁰⁶ This statute served as a model for several other states.²⁰⁷ 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 change of control).²⁰⁸ Delaware never adopted a constituency statute of this type. The Delaware Supreme Court, in its 1985 decision in *Unocal Corp. v. Mesa Petroleum Co.*, nonetheless 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)."²⁰⁹ Courts in other jurisdictions followed suit and approved of considering the interests of other constituencies.²¹⁰ These courts, however, emphasized that such consideration cannot be made unless benefits to shareholders can be identified, thus echoing earlier decisions mentioned above.²¹¹

²⁰⁶The statute provided that

[i]n 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 202, at 27.

²⁰⁷Orts, *supra* note 202, 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-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 203, at 279-93.

²⁰⁸*See* Oswald, *supra* note 203, at 4-6 (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).

²⁰⁹*Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985).

²¹⁰*See* *Amanda Acquisition Corp. v. Universal Foods Corp.*, 708 F. Supp. 984, 1009, 1015-16 (E.D. Wis.), *aff'd*, 877 F.2d 496 (7th Cir. 1989) ("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"); *GAF Corp. v. Union Carbide Corp.*, 624 F. Supp. 1016, 1019-20 (S.D.N.Y. 1985) (same).

²¹¹*See* *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1282 n.29, 1285 n.35 (Del. 1989) (concluding that, 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"); *Revlon*,

It has been noted that the other constituency statutes have received only cursory attention from the courts,²¹² and have played a negligible part, if any, in litigation involving directors' decisions.²¹³ These statutes are generally interpreted as having made hardly any change in American corporate law.²¹⁴ This article argues that the reason 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.²¹⁵ 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.²¹⁶ The legal technology for thwarting management-

Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) (explaining that the "board may have regard for various constituencies in discharging its responsibilities, *provided there are rationally related benefits accruing to the stockholders*") (emphasis added); 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.").

²¹²See Orts, *supra* note 202, at 31-35 (analyzing court opinions); Oswald, *supra* note 203, at 7 n.37 (same).

²¹³See Oswald, *supra* note 203, 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.

Id.

²¹⁴In 1990, the Committee on Corporate Laws of the Section of Business Law of the American Bar Association (ALI-ABA), as part of the preparation of the Revised Model Business Corporation Act (the 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).

²¹⁵Orts, *supra* note 202, at 24-25. 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. *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.

²¹⁶See Thomas W. Dunfee, *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).

unfriendly takeovers has progressed since the mid-1980s such that today it relies on other means.²¹⁷ Moreover, once the consideration of other constituencies' interests were 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.²¹⁸

The second explanation for the low impact that the other constituency statutes have had on American corporate law returns to the subject of this article. 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 bore by 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 principle²¹⁹ of managers' trusteeship to multiple stakeholders for a second-best regime of duty to shareholders. To use the words of Berle and Means', what was (and remains) lacking is a convincing "system of community obligations" that is framed "with clarity and force."²²⁰ Neither the courts nor academic commentators have succeeded in devising such a system.²²¹

²¹⁷For a review and analysis of anti-takeover techniques, 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 et al., *The Powerful Antitakeover Force of Staggered Boards: Further Findings and a Reply to Symposium Participants*, 55 STAN. L. REV. 885 (2002) (confirming the position that staggered boards do not appear to have a significant beneficial effect on premiums in negotiated transactions, and arguing that the alternative positions provided by others does not convincingly explain the evidence); Lucian Arye Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887 (2002) (concluding that overall effective staggered boards did not provide enough benefit in terms of increased premiums, in relation to the added costs of remaining independent, and that takeover rules should be reconsidered in this area).

²¹⁸For 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) (arguing that while acknowledging the importance and desirability of protecting stakeholders, a board veto should not be the tool for such protection, and should not be the justification for the existence of the board veto).

²¹⁹See *supra* note 188.

²²⁰See *supra* text accompanying note 175.

²²¹The 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

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 purest form by Frank Easterbrook and Daniel Fischel's 1991 book summarizing their work on corporate law.²²² In line with their general contractual view of the corporation,²²³ 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

business activities with a view to enhancing corporate profit and shareholder gain." PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(a) (1994) (citation omitted). 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, which reflects the case law described above. *Id.* § 6.02. 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.

²²²EASTERBROOK & FISCHEL, *supra* note 4.

²²³The view of the corporation as a contractual arrangement—or a "nexus of contracts"—raises prickly questions. The nexus metaphor is attributed to Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972), and Michael C. Jensen & William H. Meckling, *The Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976). For a critical analysis, see Melvin A. Eisenberg, *The Conception that the Corporation is a Nexus of Contracts and the Dual Nature of the Firm*, 24 J. CORP. L. 819 (1999); see also William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZ L. REV. 261 (1992); Jeffrey Nesteruk, *Persons, Property, and the Corporation: A Proposal for a New Paradigm*, 39 DEPAUL L. REV. 543 (1990).

creditors and employees—have fixed claims whose value is known in advance, at least in expectancy, or no (valid) claim at all.²²⁴

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.

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."²²⁵

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."²²⁶ It explicitly ignores other social issues. Indeed, Easterbrook and Fischel deny that such issues have to do

²²⁴EASTERBROOK & 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.

Id.

²²⁵*Id.* at 38.

²²⁶For 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] . . . [i]n 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.

Id. See also Allen, *supra* note 223, at 269-70 (same).

with corporate governance.²²⁷ Other scholars have joined Easterbrook and Fischel's camp of those endorsing shareholder value as the proper maximand relying on a variety of arguments.²²⁸ Common to this commentary 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."²²⁹

2. Incomplete Contracts and Power

The traditional economic analysis case for shareholder primacy as described above is susceptible to a number of criticisms. These criticisms challenge different aspects of the traditional case; but on the whole they 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. Indeed, courts have

²²⁷EASTERBROOK & FISCHEL, *supra* note 4, at 39 ("To view pollution, or investment in South Africa, or other difficult moral and social questions as *governance matters* is to miss the point."). 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. Writers, however, not identified with this group also include a broader set of issues in "corporate governance." *See, e.g.*, Dyck & Zingales, *supra* note 116 (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).

²²⁸*See, e.g.*, Stephen M. Bainbridge, *In Defense of Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423 (1993); 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); Alan J. Meese, *The Team Production Theory Of Corporate Law: A Critical Assessment*, 43 WM. & MARY L. REV. 1629 (2002); Oswald, *supra* note 203; Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923 (1984); Mark E. Van Der Weide, *Against Fiduciary Duties to Corporate Stakeholders*, 21 DEL. J. CORP. L. 27 (1996).

²²⁹Oliver Hart, *An Economist's View of Fiduciary Duty*, 43 U. TORONTO L.J. 299, 303 (1993).

underscored the fact that bondholder protection is determined only by the language of the indenture. Thus, bondholders were denied any further vague and open-ended protection under a duty of loyalty paradigm.²³⁰ In light of this 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.²³¹

This apparent perfectness is misleading. Developments in the economic theory of contracts, especially since the late 1980s, have highlighted the problem of incomplete contracts.²³² 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.²³³ 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 will never occur. Even if all future contingencies were foreseeable the cost of spelling them out, negotiating for an agreed outcome and putting 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 contingencies. Parties may fail to contract on certain contingencies

²³⁰See *Simons v. Cogan* 542 A.2d 785, 785-791 (Del. Ch. 1987); see also William W. Bratton, Jr., *The Economics and Jurisprudence of Convertible Bonds*, 1984 WIS. 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.").

²³¹The *Simons* court thus referred to the "highly negotiated and exhaustively documented commercial relationship between an issuer of convertible securities and the holders of such securities." *Simons*, 542 A.2d at 791. 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).

²³²See generally OLIVER HART, *FIRMS, CONTRACTS AND FINANCIAL STRUCTURE* (1995) (highlighting differences between well-established contractual transactions in market trading, and contracting performed between firms and other types of economic institutions where contractual incompleteness and power play important roles). For further economic analyses, see Douglas B. Bernheim & Michael Whinston, *Incomplete Contracts and Strategic Ambiguity*, 88 AM. ECON. REV. 902 (1998); Sharon Gifford, *Limited Attention and the Optimal Incompleteness of Contracts*, 15 J. L. ECON. & ORG. 468 (1999); Oliver D. Hart, *Incomplete Contracts and the Theory of the Firm*, 4 J. L. ECON. & ORG. 119 (1988); Oliver Hart & John Moore, *Incomplete Contracts and Renegotiation*, 56 ECONOMETRICA 755 (1988); Gur Huberman & Charles Kahn, *Limited Contract Enforcement and Strategic Renegotiation*, 78 AM. ECON. REV. 471 (1988); Kathryn E. Spier, *Incomplete Contracts and Signaling*, 23 RAND J. ECON. 432 (1992); Jonathan Thomas & Tim Worrall, *Income Fluctuation and Asymmetric Information: An Example of a Repeated Principal-Agent Problem*, 51 J. ECON. THEORY 367 (1990).

²³³*Cf.* the court's statement in *Simons*, *supra* note 231.

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 those which one party (the agent) has the ability to unilaterally affect the interest of the other party (the principal) are likely to be ubiquitous. In these situations, the former has power over the latter.²³⁴

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 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. Therefore, one can say that in such cases, shareholders have power over 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 Bank Nederland, N.V. v. Pathe Communications Corp.*,²³⁵ 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

²³⁴The Restatement (Second) of 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." RESTATEMENT (SECOND) OF AGENCY § 6 (1958). 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, *Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 26 YALE L.J. 710 (1917); Wesley Newcomb Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 23 YALE L.J. 16 (1913). According to Hohfeld, "the person (or persons) whose volitional control is paramount may be said to have the (legal) power to effect the particular change of legal relations that is involved in the problem." *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* (Walter Wheeler Cook, ed. 1919; reprint 1964). For a general analysis of Hohfeld's framework, see ANDREW HALPIN, *RIGHTS AND LAW: ANALYSIS AND THEORY* (1997).

²³⁵No. 12,150, 1991 Del. Ch. LEXIS 215 (Del. Ch. Dec. 30, 1991), *reprinted in* 17 DEL. J. CORP. L. 1099 (1992).

shareholders or any single constituency.²³⁶ "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."²³⁷ In a situation like this, management may need to harm shareholder value by accepting fire-sale prices for corporate assets.²³⁸ This is because the "board or its executive committee [has] an obligation to the community of interest that sustained the corporation."²³⁹

Credit Lyonnais and its progeny²⁴⁰ thus go explicitly against the traditional economic analysis injunction, that shareholder value, as it reflects the residual claim on the corporation, 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 makers²⁴¹ are called to consider the interest of a nebulous "corporate enterprise" and to give regard to its multiple constituencies.²⁴²

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

²³⁶*Id.* at *108, reprinted in 17 DEL. J. CORP. L. at 1156.

²³⁷*Id.* at *108, reprinted in 17 DEL. J. CORP. L. at 1155.

²³⁸*Id.*

²³⁹*Credit Lyonnais Bank Nederland*, 1991 Del. Ch. LEXIS 215, at *108, reprinted in 17 DEL. J. CORP. L. at 1155.

²⁴⁰In 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).

[W]here 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."

Id. (citation omitted). 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 (Bankr. D. Del. 1994) (concluding that the board of directors 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) (reaching the same conclusion as *In re Buckhead* by applying the *Credit Lyonnais* decision).

²⁴¹One 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.

²⁴²"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.*, 5 A.2d 503, 510 (Del. 1939). The real issue is which maximand fiduciaries should choose in fulfilling their obligations toward the corporation.

of court rulings, because the current board structure makes "the same persons arbiters for conflicting interests with accountability to none."²⁴³ Brudney indeed opines that "it is hard to 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."²⁴⁴

²⁴³Victor Brudney, *Contract and Fiduciary Duty in Corporate Law*, 38 B.C.L. REV. 595, 645-46 (1997). Brudney 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.

Id. Note the similarity between Brudney's first requirement and Berle's requirement for a system of community obligations" that is framed "with clarity and force." See *supra* text accompanying note 218.

²⁴⁴*Id.* at 645-46 n.128. 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); *Brandt v. Hicks, Muse & Co. (In re Healthco Int'l, Inc.)*, 208 B.R. 288, 300 (Bankr. D. Mass. 1997) (holding that directors owe fiduciary duties to creditors when a transaction leaves the corporation insolvent or with unreasonably small capital); *Odyssey P'ship v. Fleming Cos.*, 735 A.2d 386, 420 (Del. Ch. 1999) (holding that the board of an insolvent corporation was under a duty to balance the effect of corporate action on "shareholders, creditors and other corporate constituencies"); *Geyer v. Ingersoll Publ'ns Co.*, 621 A.2d 784, 787-90 (Del. Ch. 1992) (acknowledging fiduciary duties to creditors). Note, however, that even insolvent corporations that 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) (stating that 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 Alon Chaver & Jesse M. Fried, *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 that the duty to maximize the value of only one category may be inefficient); Jonathan C. Lipson, *Directors' Duties to Creditors: Power Imbalance and the Financially Distressed Corporation*, 50 UCLAL. REV. 1189 (2003) (arguing that fiduciary duties of distressed corporations should shift only toward relatively weaker creditors, who lack volition, cognition, and exit); Lynn M. LoPucki, *The Nature of the Bankrupt Firm: A Reply to Baird and Rasmussen's "The End of Bankruptcy,"* 56 STAN. L. REV. 645 (2003) (arguing that no single class of residual owners exists in most bankrupt firms). For additional analyses of the relationships between shareholders and creditors as corporate constituencies, see Zipora Cohen, *Directors' Negligence Liability to Creditors: A Comparative and Critical View*, 26 IOWA J. CORP. L. 351 (2001); Laura Lin, *Shift of Fiduciary Duty Upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors*, 46 VAND. L. REV. 1485 (1993); Ann E. Conaway Stilson, *Reexamining the Fiduciary Paradigm at Corporate Insolvency and Dissolution: Defining Directors' Duties to Creditors*, 20 DEL. J. CORP. L. 1 (1995); Gregory V. Varallo & Jesse A. Finkelstein, *Fiduciary Obligations of Directors of the Financially Troubled Company*, 48 BUS. LAW. 239 (1992).

The conflict of interest between shareholders and creditors is only 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.

Similar problems exist between shareholders and other constituencies.²⁴⁵ In particular, employees have been said to suffer when shareholder value is 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.²⁴⁶ In other words, employees are exposed to the power of corporate decision makers and, consequently to the power of shareholders.

3. The Progressive View

As noted above, American legislators and courts, primarily in the context of other constituency statutes,²⁴⁷ have opened the door for consideration of the interests of employees by corporate decision makers. Yet, they have 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.²⁴⁸ Many of these calls are part of the Progressive Corporate Law

²⁴⁵*Cf.* Chaver & Fried, *supra* note 244, 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.

Id.

²⁴⁶This 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.

²⁴⁷*See supra* text accompanying notes 201-19.

²⁴⁸*See* O'Connor, *supra* note 203 (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

movement whose members advocate using and, to the extent necessary, reforming corporate law in order to promote the interests of non-shareholder constituencies, namely, employees, local communities, and the environment.²⁴⁹

The Progressive Corporate Law movement is ideologically associated with the communitarian movement headed by Amitai Etzioni and can generally be characterized as of left-of-center persuasion.²⁵⁰ The communitarian view argues for the ability to choose different rules for different situations in corporate law²⁵¹ and for discharging fiduciary duties toward various constituencies on a case-by-case, situation-specific basis.²⁵² That this would create uncertainty is readily admitted by these scholars and is actually posited as an advantage.²⁵³ 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 conservatives.²⁵⁴ To the latter, the need to address multiple interests under

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

²⁴⁹For general background, see PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed., 1995); see also 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) (book review); David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223 (1991); David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201 (1990); Lawrence E. Mitchell, *A Critical Look at Corporate Governance*, 45 VAND. L. REV. 1263 (1992); 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)).

²⁵⁰See, e.g., Michael Bradley et al., *The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads*, 62 LAW & CONTEMP. PROBS. 9, 41-44 (1999). See generally AMITAI ETZIONI, *THE MORAL DIMENSION: TOWARD A NEW ECONOMICS* (1988); AMITAI ETZIONI, *THE SPIRIT OF COMMUNITY: THE REINVENTION OF AMERICAN SOCIETY* (1993).

²⁵¹Orts, *supra* note 249, at 1581.

²⁵²O'Connor, *supra* note 203, at 1259.

²⁵³*Id.*

²⁵⁴See Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856 (1997).

uncertainty renders multiple-constituency corporate governance unworkable.²⁵⁵

4. Hierarchical Models

The journey through the intellectual history of the stockholder-stakeholder debate 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.²⁵⁶ Blair and Stout propose the adoption of 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.²⁵⁷ 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.²⁵⁸ The public corporation, it is argued, is better viewed as a "mediating hierarchy" in which the directors are the "mediating hierarchs."²⁵⁹ The board enjoys ultimate decision-making authority to determine the use of corporate assets and to reconcile all conflicting interests and disputes that may arise among corporate constituencies.²⁶⁰

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 for own personal benefit; and second, how should these hierarchs exercise their power to reconcile conflicts of interest among constituencies. Blair and Stout

²⁵⁵See Stephen M. Bainbridge, *The Bishops and the Corporate Stakeholder Debate*, 4 VILL. J.L. INVESTMENT MGMT. 3 (2003) (arguing that requiring directors to make trade-offs between shareholder and stakeholder interests would prove unworkable).

²⁵⁶Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999) [hereinafter Blair & Stout, *Team Production*]; Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735 (2001) [hereinafter Blair & Stout, *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 Blair & Stout, *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)*, 28 DEL. J. CORP. L. 1 (2003).

²⁵⁷Blair & Stout, *Team Production*, *supra* note 256, at 265-76.

²⁵⁸*Id.* at 276-87.

²⁵⁹*Id.* at 278-87.

²⁶⁰*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); and their mediating hierarchy view is influenced by Raghuram G. Rajan & Luigi Zingales, *Power in a Theory of the Firm*, 113 Q.J. ECON. 387 (1998). Blair & Stout, *Team Production*, *supra* note 256, at 265, 271.

propose an answer to the first question but eschew the second question altogether.²⁶¹

In regards with the problem of curbing managerial opportunism (which is largely beside the focus of this article), 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 neo-classical economic theory, subjects quite often behave in ways that appear altruistic: They would sacrifice self-reward to achieve an outcome that benefits others, or act in ways that appear compatible with an abstract ethical principle (e.g., fairness).²⁶²

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 conflicts 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, which 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 conflicts of interest among constituencies, Blair and Stout's approach suggests that directors should not be under the direct control of either shareholders or other stakeholders, although they believe that shareholders would benefit from granting directors discretion to favor other constituencies.²⁶³

²⁶¹Blair & Stout, *Team Production*, *supra* note 256, at 276-87.

²⁶²As 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 256. 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).

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 256, at 315. Whether these factors are sufficient for preventing managerial opportunism in extreme settings like a hostile takeover bid is controversial. See Bebchuk, *supra* note 218, at 1023 n.133 (questioning the validity of Blair and Stout's argument in the takeover context). For a general critique of the mediating hierarchy model, see Meese, *supra* note 228.

²⁶³Blair & Stout, *Team Production*, *supra* note 256, at 255, 304; Blair & Stout, *Director Accountability*, *supra* note 256, 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. Blair & Stout, *Team Production*, *supra* note 256, at 255.

Stephen Bainbridge has advanced a "director primacy" theory that shares major features with Blair and Stout's mediating hierarch model.²⁶⁴ 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 proper locus of authority.²⁶⁵ 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."²⁶⁶ Unlike Blair and Stout, Bainbridge holds the view that shareholder value should be the sole maximand of corporate governance.²⁶⁷ 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.²⁶⁸

F. A New Look at the Old Debate

²⁶⁴Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1 (2002) [hereinafter Bainbridge, *Nexus of Contracts*]; Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791 (2002) [hereinafter Bainbridge, *Preliminary Reflections*]; Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003) [hereinafter Bainbridge, *Means and Ends*]; 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*, *supra*, 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," at the apex of which sits "a board of directors whose authority over the use of corporate assets is virtually absolute."

Id. (citing Blair & Stout, *Team Production*, *supra* note 256, at 251).

²⁶⁵Bainbridge, *Nexus of Contracts*, *supra* note 264, at 20 (citing KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 69-70 (1974)).

²⁶⁶Bainbridge, *Preliminary Reflections*, *supra* note 264, at 795.

²⁶⁷Bainbridge, *Means and Ends*, *supra* note 264, at 550 ("[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 228, 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.

Id. (citation omitted).

²⁶⁸Bainbridge, *supra* note 254, at 6. Bainbridge does not elaborate on the problem of unworkability although this position is compatible with tradition economic analyses that reject recognizing multiple maximands for this reason.

The standard reading of the stockholder-stakeholder debate used to be presented 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—i.e., whether corporate fiduciaries can, be systematically 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 but could not think of a way to implement it. Therefore, he advocated accountability only to shareholders as a distant second-best in order to mitigate the adverse effects of insiders' self-interest at a minimum.

Modern economic theory vindicates Berle's position. It 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 suggest different assumptions about the psychology of American managers and 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 such situations 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 to simultaneously consider the interests of multiple constituencies while coping 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 noted above, Tetlock's study of American managers provides evidence in support of this analysis.²⁶⁹ 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 of corporate governance, respectively. The Schwartz model of individual values offers a superior 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. Most theorists have mainly 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 alternatively 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 article points to the direction in which further research should continue.²⁷⁰

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

²⁶⁹Tetlock, *supra* note 48.

²⁷⁰Even the more sophisticated accounts, such as Blair and Stout's theory of the board mediating hierarchy, fail to account for the latter aspect in postulating the mechanisms that affect directors' behavior. Blair & Stout, *Behavioral Foundations*, *supra* note 256, points 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. Supposedly, 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 article argues, the latter two factors may play a significant role in determining the maximands of corporate governance.

individual value preferences and cognitive styles. 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.

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 self-interested opportunism. A legal reform that required directors to discharge their fiduciary duties simultaneously to multiple constituencies would thus 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 rubric of the duty of loyalty or the duty of care.

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 with a high need for closure. Also, 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.²⁷¹ 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.

²⁷¹For a development of this theme, see *infra* Part IV.

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 is 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 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 about conclusions that the present analysis does *not* entail deserve noting. 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 Openness to change and lower need for cognitive closure may lead to procrastination—a bad quality for managers.²⁷²

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.²⁷³ 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 will be better 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

²⁷²Tetlock, *supra* note 48, provides an excellent discussion of the relativity of these qualities.

²⁷³See *supra* note 47.

Lawyers are not alone in addressing the maximands of corporate governance. Beginning in the mid-1980s, a similar debate among management scholars developed and has been running on nearly parallel tracks with 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. Management scholars, however, have made considerable progress with regard to the implementation problem of reconciling multiple conflicting interests. Although it bears important implications for legal analysis, these theories have gone virtually unnoticed among legal commentators.²⁷⁴ 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.²⁷⁵ 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 with the increase in the external demands placed on the corporation in a turbulent period.²⁷⁶ "External change produces uncertainty,"²⁷⁷ wrote Freeman. "It makes us uncomfortable because it cannot be readily assimilated into the relatively more comfortable relationship with suppliers, owners, customers and employees."²⁷⁸ The stakeholder management approach advanced by Freeman was thus designed to help managers reduce uncertainty and discomfort.²⁷⁹ 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."²⁸⁰

²⁷⁴Management scholars writing in the legal literature are aware of this body of knowledge. See, e.g., Bradley et al., *supra* note 250; Dunfee, *supra* note 216; Orts, *supra* note 202. Orts is affiliated with the legal studies department at the Wharton School of Business.

²⁷⁵R. EDWARD FREEMAN, *STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH* (1984).

²⁷⁶*Id.* at v, 3-5.

²⁷⁷*Id.* at 12.

²⁷⁸*Id.* at 12-13.

²⁷⁹*Id.*

²⁸⁰FREEMAN, *supra* note 275, at 46. This definition of stakeholder draws on earlier definitions in the management literature that grew out of management practice. According to Freeman, 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."

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.²⁸¹ The crucial feature in this definition of stakeholders, which is 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 could not ignore it.²⁸² One needs only to consider discount airlines after September 11, 2001 to see the point.²⁸³

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.²⁸⁴ One understanding of stakeholder theory is as a descriptive thesis, presenting models that describe what the corporation is. Secondly, stakeholder theory can be viewed as an instrumental thesis, namely, dealing with practical prescriptions for corporations' survival and success in business. The more contentious interpretations of stakeholder theory, however, are the 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

Id. at 31. The list of stakeholders originally included shareholders, employees, 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). Freeman, however, traces the history of the stakeholder concept before SRI to Adam Smith and Berle and Means. See FREEMAN, *supra* note 275, at 32; R. Edward Freeman & John McVea, *A Stakeholder Approach to Strategic Management*, in *HANDBOOK OF STRATEGIC MANAGEMENT* 189, 189 (Michael A. Hitt et al. eds., 2001).

²⁸¹FREEMAN, *supra* note 275, at 11-22.

²⁸²*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.

Id. at 53.

²⁸³Nevertheless, opponents of stakeholder theories cite the reference to terrorist groups with an unmistakable innuendo. See Jensen, *supra* note 1, at 9 n.1; Elaine Sternberg, *The Defects of Stakeholder Theory*, 5 *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);.

²⁸⁴See Thomas Donaldson & Lee E. Preston, *The Stakeholder Theory for the Corporation: Concepts, Evidence, Implications*, 20 *ACAD. MGMT. REV.* 65, 66-67 (1995).

other group, such as shareowners."²⁸⁵ Finally, stakeholder theory can also be seen as implying a managerial thesis in the sense of prescribing structures and practices for managing stakeholder affairs.²⁸⁶

The normative interpretation of stakeholder theory 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.²⁸⁷ 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 to share a core set of values and incorporate these values as a key element of the strategic management process.²⁸⁸

An important outcome of grounding stakeholder theory in normative propositions that draw on values and ethics is that the theory immediately becomes political.²⁸⁹ This outcome can hardly go unnoticed. One, however, may find it difficult to readily classify the theory along a left-right dimension. Freeman himself has provided different political interpretations of stakeholder theory, ranging from liberal to libertarian interpretations.²⁹⁰ The liberal element of stakeholder theory is based on the notions of

²⁸⁵*Id.* at 67.

²⁸⁶*Id.*

²⁸⁷For a sample of ethical analyses of stakeholder theory, see, e.g., John R. Boatright, *Fiduciary Duties and the Shareholder-Management Relation: Or, What's So Special About Shareholders?*, 4 BUS. ETHICS Q. 393 (1994); 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); Kenneth E. Goodpaster, *Business Ethics and Stakeholder Analysis*, 1 BUS. ETHICS Q. 53 (1991); Thomas Jones, *Instrumental Stakeholder Theory: A Synthesis of Ethics and Economics*, 20 ACAD. MGMT. REV. 92 (1995); Thomas M. Jones & Andrew C. Wicks, *Convergent Stakeholder Theory*, 24 ACAD. MGMT. REV. 206 (1999); Ian Maitland, *The Morality of the Corporation: An Empirical or Normative Disagreement*, 4 BUS. ETHICS Q. 445 (1994); Robert Phillips, *Stakeholder Theory and a Principle of Fairness*, 7 BUS. ETHICS Q. 51 (1997); Robert A. Phillips & Joel Reichart, *The Environment as a Stakeholder?: A Fairness-Based Approach*, 23 J. BUS. ETHICS 185 (2000).

²⁸⁸Freeman & McVea, *supra* note 280.

²⁸⁹As 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 284, at 65. As noted above, however, much remains to be done on the interface between corporate law and management theories.

²⁹⁰The 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 48 and accompanying text.

autonomy, solidarity, and fairness as articulated by John Rawls²⁹¹ and others. This element entails pursuit of basic equality among stakeholders in terms of their moral rights as these are realized in the firm.²⁹² 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.²⁹³ It is worth noting that both positions emphasize promotion of individual autonomy while they differ on the question of the appropriate relations between the autonomous person and the larger society. Liberalism more 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 emphasis on the need to pay simultaneous attention to the interests of all appropriate stakeholders.²⁹⁴ This aspect points to two separate challenges that must be met: (1) identifying all appropriate stakeholders, and (2) 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.²⁹⁵

In addition, stakeholder management also deals with the problem of balancing stakeholders' conflicting interests beyond the general prescription of conducting case-by-case analyses. 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."²⁹⁶ Almost by necessity, stakeholder theory faces severe implementation problems resembling those that have encumbered multiple-constituency theories in corporate law for decades.

²⁹¹JOHN RAWLS, A THEORY OF JUSTICE (1971).

²⁹²R. Edward Freeman, *The Politics of Stakeholder Theory: Some Future Directions*, 4 BUS. ETHICS Q. 409, 415 (1994).

²⁹³*See id.* at 415; R. Edward Freeman & Robert A. Phillips, *Stakeholder Theory: A Libertarian Defense* (Darden Business School, Working Paper No. 01-03, 2001), http://papers.ssrn.com/paper.taf?abstract_id=263514.

²⁹⁴Donaldson & Preston, *supra* note 284, at 67.

²⁹⁵*See* Ronald K. Mitchell et al., *Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts*, 22 ACAD. MGMT. REV. 853, 862 (1997). In 1997, these authors counted no less than twenty-seven definitions for stakeholders. *Id.* at 858 tbl. 1.

²⁹⁶Freeman & McVea, *supra* note 280, at 194.

B. *The Critique*

It should come as little surprise that stakeholder theory is not without opposition among management scholars. The most prominent opponents are probably 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 accountable. 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."²⁹⁷

Jensen's critique of stakeholder theory focuses 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 organisation 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 [T]elling a manager to maximise [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.²⁹⁸

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 equity and other financial claims on the firm, is efficient.²⁹⁹ 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.³⁰⁰ Third, Jensen makes a political objection, because, as a basis for action, stakeholder

²⁹⁷See Sternberg, *supra* note 283, at 6-9; see also ELAINE STERNBERG, *THE STAKEHOLDER CONCEPT: A MISTAKEN DOCTRINE* (1999).

²⁹⁸Jensen, *supra* note 1, at 300-01.

²⁹⁹*Id.* at 301-04. For a similar analysis, see Anant K. Sundaram & Andrew C. Inkpen, *The Corporate Objective Revisited*, 15 *ORGANIZATION SCI.* 350 (2004).

³⁰⁰Jensen, *supra* note 1, at 305 ("Because stakeholder theory provides no definition of better, it leaves managers and directors unaccountable for their stewardship of the firm's resources [S]takeholder theory plays into the hands of self-interested managers allowing them to pursue their own self-interest").

theory politicizes the corporation.³⁰¹ Finally, and most importantly, Jensen makes a psychological argument. Stakeholder theory is deficient under this argument because it confuses managers, and confusion is bound to handicap the firm.³⁰²

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 lies not in the economic analysis (which is old, as Jensen indeed emphasizes) but rather in the stress he places on the psychological drawbacks of stakeholder theory. Moreover, inspired by Friedrich Hayek's work on the modern market economy,³⁰³ Jensen seems to hold that financial value maximization is 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.³⁰⁴

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

³⁰¹*Id.* at 300.

³⁰²*Id.* at 301. For similar reasons, Jensen also criticizes a management theory called "The Balanced Scorecard." *Id.* at 310-14. 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); ROBERT S. KAPLAN & DAVID P. NORTON, *THE STRATEGY-FOCUSED ORGANIZATION: HOW BALANCED SCORECARD COMPANIES THRIVE IN THE NEW BUSINESS ENVIRONMENT* (2000). According to Jensen:

The 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 maximised. 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.*

Jensen, *supra* note 1, at 310-11 (emphasis added).

³⁰³Jensen, *supra* note 1, at 306-07 (citing Friedrich A. Hayek, *The Fatal Conceit*, in *THE COLLECTED WORKS OF F.A. HAYEK* 14 (W.W. Bartley III ed., 1988)).

³⁰⁴*Id.*

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."³⁰⁵ 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 management a way to assess the tradeoffs that must be made among competing constituencies."³⁰⁶ Exactly how managers should assess this tradeoff when long-term market value may call for sacrificing shareholder value remains unspecified. Managers are left to their own devices.³⁰⁷

C. *Toward a Dynamic Stakeholder Theory*

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 and his colleagues argue that the stakeholder framework cannot readily explain the complex considerations that are involved in giving priorities to competing stakeholder claims.³⁰⁸

Mitchell and his colleagues claim that beyond identifying stakeholders using the standard test of ability to affect and be 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 and his colleagues 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."³⁰⁹ These three attributes together create different levels of stakeholder salience, which indicate to managers whom they should pay attention to.³¹⁰

³⁰⁵*Id.* at 305-10.

³⁰⁶*Id.* at 310.

³⁰⁷Jensen, *supra* note 1, at 308 (likening this task to telling players to score goals in football or soccer without telling them how to win the game).

³⁰⁸Mitchell et al., *supra* note 295, at 854.

³⁰⁹*Id.*

³¹⁰*Id.*

To define "power," Mitchell and his colleagues 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."³¹¹ This is essentially the definition employed by the Restatement on Agency and advanced by Hohfeld earlier in the twentieth century.³¹² 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.³¹³

The attribute of legitimacy in Mitchell and his colleagues' 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.³¹⁴ Mitchell and his colleagues' definition of legitimacy is nearly identical to definition of "social norms" and "culture" in social psychology and other social sciences. This aspect is addressed below. At this point, one may note 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.³¹⁵

Finally, the attribute of urgency reflects the degree to which stakeholders' claims demand 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).

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. "[I]t is the firm's managers who determine which stakeholders are salient and

³¹¹*Id.* at 865 (citing MAX WEBER, THE THEORY OF SOCIAL AND ECONOMIC ORGANIZATION (1947)). Other definitions cited by Mitchell et al. are essentially identical.

³¹²*See supra* note 232.

³¹³*See* Licht, *supra* note 108.

³¹⁴Mitchell et al., *supra* note 295, at 866 (citing Mark C. Suchman, *Managing Legitimacy: Strategic and Institutional Approaches*, 20 ACAD. MGMT. REV. 574 (1995)).

³¹⁵Mitchell et al., *supra* note 295, at 866-67 (noting 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).

therefore will receive management attention," aver Mitchell and his colleagues.³¹⁶ 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 must therefore account for individual qualities of decision makers.

Empirical support for the theory of Mitchell and his colleagues' was provided by a study conducted by Agle, Mitchell, and Sonnenfeld.³¹⁷ 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.³¹⁸ Agle and his colleagues surveyed 70 CEOs out of 650 corporations in the Standard and Poor's 500 list and 150 other large U.S. corporations.³¹⁹ 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.³²⁰ Agle and his colleagues also failed to find evidence for a relationship between stakeholder salience and corporate performance and for a relationship between CEO values and corporate performance.³²¹

³¹⁶*Id.* at 871.

³¹⁷Bradley R. Agle et al. *Who Matters to CEOs? An Investigation of Stakeholder Attributes and Salience, Corporate Performance, and CEO Values*, 42 *ACAD. MGMT. J.* 507 (1999).

³¹⁸*Id.* at 510-11 ("In short, we argue that people perceive as important the things that are somehow connected with their values.").

³¹⁹The 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.

³²⁰Other-regarding CEO values were nonetheless found to significantly moderate the attribute-salience relationship for employees. *Id.* at 520.

³²¹The 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 article notwithstanding its importance. From a theoretical 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 P. 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

D. Assessment

The present theory of values and cognitive style lends itself to assessing the major positions in management studies and to generalizing Mitchell and his colleagues' theory. When one 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 specific other countries.³²² Stakeholder theory is value-free but not value-neutral. 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 can therefore accommodate political positions, but does not imply specific political persuasions.

In contrast, Jensen's position reflects a view of managers as having a specific set of personal traits only. 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 believes 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

Agle et al., *supra* note 317, see also 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); Jeffrey S. Harrison & R. Edward Freeman, *Stakeholders, Social Responsibility, and Performance: Empirical Evidence and Theoretical Perspectives*, 42 ACAD. MGMT. J. 479 (1999); Amy J. Hillman & Gerald D. Keim, *Shareholder Value, Stakeholder Management, and Social Issues: What's the Bottom Line?*, 22 STRATEGIC MGMT. J. 125 (2001); Sandra A. Waddock & Samuel B. Graves, *The Corporate Social Performance-Financial Performance Link*, 18 STRATEGIC MGMT. J. 303 (1997); Gary R. Weaver et al., *Integrated and Decoupled Corporate Social Performance: Management Commitments, External Pressures, and Corporate Ethics Practices*, 42 ACAD. MGMT. J. 539 (1999). For an early theoretical analysis, see Max B.E. Clarkson, *A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance*, 20 ACAD. MGMT. REV. 92 (1995).

³²²Needless to say, the normative interpretation given to Freeman's theory by subsequent scholars is value-laden. Freeman, *supra* note 292. The liberal interpretations of this theory (especially those that rely on Rawls) reflect a blend of Autonomy and Egalitarianism cultural orientations.

value dimensions. There is no denying the fact that communitarian commentators support the multiple constituency version of corporate governance.³²³ 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.³²⁴ Stated otherwise, stakeholderism can be as modern as shareholder primacy is.

Mitchell and his colleagues' stakeholder identification and salience model makes 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, whether executive managers or controlling shareholders. Thus, the theory encompasses both societal and individual levels of analysis—a quality that virtually all the analyses in the legal literature seem to lack. In addition, Mitchell and his colleagues' theory implies that at the individual level, several factors may operate, including managers' personal values and 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 constituencies. They would tend to prefer a simple, single-maximand accountability regime to one that features multiple maximands.³²⁵

Finally, the present theory points to a possible reason for Agle and his colleagues' 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 and his colleagues used a limited set of value items, which they culled from Rokeach's value inventory.³²⁶ These items all reflect values that belong to the Self-enhancement/Self-transcendence dimension.³²⁷ Agle and his colleagues failed to consider the

³²³See *supra* text accompanying note 249.

³²⁴See *infra* text accompanying notes 346-49.

³²⁵The notion of salience, however, may encompass additional factors that bear on perception and other aspects of cognition not dealt with in the present scope.

³²⁶See *supra* text accompanying note 16.

³²⁷Specifically, 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 317, 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.

Openness to change/Conservation dimension, which seems highly relevant for managing multiple stakeholders and is related to the need for cognitive closure.³²⁸ Thus, the value dimension framework 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 stronger 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, and Japan represent wider groupings of corporate governance regimes. This Part demonstrates the usefulness of the value dimension framework in comparative analyses. Section A begins with a comparative review of corporate governance groupings. This is followed by an overview of the convergence dynamics in regards to 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.³²⁹ 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 for historical reasons). Shareholder primacy is the predominant norm in these countries.³³⁰ Subject to the legal

³²⁸Note that this omission is similar to the one committed by Blair and Stout. *See supra* note 268.

³²⁹To be sure, differences do exist between corporate governance systems in various English-speaking countries, but they pale in comparison to other countries. For such comparisons, see Kerry Shannon Burke, *Regulating Corporate Governance Through the Market: Comparing the Approaches of the United States, Canada and the United Kingdom*, 27 J. CORP. L. 341 (2002); Brian R. Cheffins, *Putting Britain on the Roe Map: The Emergence of the Berle-Means Corporation in the United Kingdom*, in CORPORATE GOVERNANCE REGIMES—CONVERGENCE AND DIVERSITY (Joseph McCahery et al. eds., 2002); Brian R. Cheffins, *Corporate Governance Convergence: Lessons from Australia*, 16 TRANSNAT'L LAW. 13 (2002); Ruth O. Kuras, *Corporate Social Responsibility: A Canada-U.S. Comparative Analysis*, 28 MANITOBA L.J. 303 (2002); Janis Sarra, *Corporate Governance in Global Capital Markets, Canadian and International Developments*, 76 TUL. L. REV. 1691 (2002); Paul von Nessen, *The Americanization of Australian Corporate Law*, 26 SYRACUSE J. INT'L L. & COM. 239 (1999).

³³⁰*See, e.g.,* Bradley et al., *supra* note 250, at 37-38, 48.

doctrine of separate corporate personality, shareholders are assumed to be the indirect owners of the corporation and only they have voting rights in the election of the board of directors.³³¹ Public companies in the U.S. and U.K., in particular, tend to be internationally unique in that they have a widely dispersed shareholder body.³³² Finally, The United Kingdom has its own version of a *Dodge*-like precedent.³³³ This decision was followed by a legislative amendment somewhat akin to American other-constituency statutes.³³⁴

In Western Europe, German corporate governance is a prime example of a stakeholder-oriented system.³³⁵ German corporate law directs

³³¹For 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. 39 (2000).

³³²See Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999). 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 (2001).

³³³*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," the *Parke* court held that the intended payments would go forward and that the proceeds of the sale should be distributed to shareholders. *Id.* at 952 (citing *Hutton v. West Cork Ry. Co.* (1883) 23 Ch.D. 654, 673, C.A.).

³³⁴Section 309 of the Companies Act 1985 was enacted in 1980 (then 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. Under section 309, however, only the company (possibly through its shareholders), not the employees, can challenge the decisions of the directors. 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 Len S. Sealy, *Directors' "Wider" Responsibilities—Problems Conceptual, Practical and Procedural*, 13 MONASH 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").

³³⁵The 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, *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 Thomas J. André, Jr. *Cultural Hegemony: The Exportation of Anglo-Saxon Corporate Governance Ideologies to Germany*, 73 TUL. L. REV. 69 (1998); Hwa-Jin Kim, *Markets, Financial Institutions, and Corporate Governance: Perspectives from Germany*, 26 LAW & POLY INT'L BUS. 371 (1995). See also FRANKLIN ALLEN & DOUGLAS GALE, *COMPARING*

managers' fiduciary duties to a diverse group of multiple constituencies, including shareholder, employees, and society as a whole.³³⁶ 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 be elected 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.³³⁷ In France, Ireland, Portugal, and other EU Member States, the law includes aspects of employee participation in corporate governance.³³⁸ It should be emphasized that membership in the

FINANCIAL SYSTEMS (2000); Mark J. Roe, *Some Differences In Corporate Structure In Germany, Japan, and the United States*, 102 YALE L.J. 1927 (1993) (stating that senior managers share power with active intermediaries within large German and Japanese corporations); *but see* Michael 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).

³³⁶Gerard Hertig & Joseph A. McCahery, *Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?* (ECGI Working Paper 2003) (citing Heribert Hirte, *Verteidigung gegen Übernahmeangebote und Rechtsschutz des Aktionärs gegen die Verteidigung*, 31 ZEITSCHRIFT FÜR UNTERNEHMENS-UND GESELLSCHAFTSRECHT 623, 643 (2002)). Other commentators are like-minded. *See* Bradley et al., *supra* note 250, at 52 ("[C]orporate 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.").

³³⁷Luca 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)).

³³⁸*See* Uwe Blaurock, *Steps Toward a Uniform Corporate Law in the European Union*, 31 CORNELL INT'L L.J. 377, 390 (1998); Karel Lannoo, *A European Perspective on Corporate Governance*, 37 J. COMMON MARKET STUD. 269 (1999); Antoine Reberioux, *European Style*

supervisory board does not give employees formal decision power. Nonetheless, the structural involvement of non-shareholder constituencies in the governance of firms 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 German-inspired civil and commercial codes and American-inspired corporate law. Both countries have nonetheless developed corporate governance systems that differ markedly from the German and American models, from one another,³³⁹ and from other Asian countries.³⁴⁰ 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 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.³⁴¹ These Asian systems are

Corporate Governance at the Crossroads: The Role of Worker Involvement, 40 J. COMMON MARKET STUD. 111 (2002).

³³⁹For recent discussion of Japan, see, e.g., Hideki Kanda, *Japan*, in THE LEGAL BASIS OF CORPORATE GOVERNANCE IN PUBLICLY HELD CORPORATIONS 111 (Arthur R. Pinto & Gustavo Visentini eds., 1998); 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); Yoshiro Miwa, *Corporate Social Responsibility: Dangerous and Harmful, Though Maybe Not Irrelevant*, 84 CORNELL L. REV. 1227 (1999); Zenichi Shishido, *Japanese Corporate Governance: The Hidden Problems of Corporate Law and Their Solutions*, 25 DEL. J. CORP. L. 189 (2000). On Korea, see, e.g., Bernard Black, *Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness*, 26 J. CORP. L. 537 (2001); Hwa-Jin Kim, *Toward the "Best Practice" Model in a Globalizing Market: Recent Developments in Korean Corporate Governance*, in 5 Y.B. L. & LEGAL PRAC. IN E. ASIA 1 (2001); 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); Jill Solomon et al., *A Conceptual Framework for Corporate Governance Reform in South Korea*, 10 CORP. GOVERNANCE: INT'L REV. 29 (2002).

³⁴⁰See, e.g., Douglas M. Branson, *The Very Uncertain Prospect of "Global" Convergence in Corporate Governance*, 34 CORNELL INT'L L.J. 321, 345-46 (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).

³⁴¹For 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 et al., *Cross Shareholding and Corporate Financial Policy: The Case of Korea* (Working Paper 2002).

generally perceived as stakeholder-oriented.³⁴² Commentators routinely make references to Asian cultures (especially to Confucianism with regard to Korea and Japan) as the bedrock of corporate governance practices.³⁴³

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. This discussion will focus on the English-speaking versus Western European regions.³⁴⁴ Although countries in these two groups are usually lumped together as "Western," Schwartz and Ros find that Western European nations and English-speaking nations constitute culturally different regions that cannot simply be characterized as "individualistic."³⁴⁵ In a global comparison, countries in both regions attribute high importance to the two Autonomy orientations, with West European countries scoring particularly high on Intellectual Autonomy. These regions differ, however, in their locations on the other two dimensions. Western 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 of these countries in regards to the maximands of corporate governance. Western 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

³⁴²See Ronald J. Gilson & Mark J. Roe, *Lifetime Employment: Labor Peace and the Evolution of Japanese Corporate Governance*, 99 COLUM. L. REV. 508, 538 (1999); Shishido, *supra* note 339, at 201 ("[M]any will agree that Japanese corporate practice is employee-oriented rather than pro-shareholder."); Solomon et al., *supra* note 339, at 30-31 (same, with regard to Korea).

³⁴³See, e.g., Branson, *supra* note 340, at 344-45; Sarra, *supra* note 329, at 1728-29; Meredith Woo-Cumings, *Diverse Paths Toward "the Right Institutions": Law, the State, and Economic Reform in East Asia* (ADB Institute Working Paper No. 18, 2001).

³⁴⁴In 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 115. Japan presents an exception to the 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 124, at 424 n.6.

³⁴⁵See 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).

may therefore expect that both regions will develop accountability regimes, but that the Western 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.³⁴⁶ Such tolerance reflects acceptance of the pursuit of wealth and power for the benefit of a single constituency or even a 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 more hostile takeovers also conveys a societal taste for Mastery, an orientation that connotes exploitation. This and other typically American norms³⁴⁷ share an attitude of legitimacy—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 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 development, welfare socialism did not take root."³⁴⁸ This conjecture links culture and politics and supports Mark Roe's political theory of comparative corporate governance.³⁴⁹ 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.³⁵⁰ The failure of social democracy to take root in the United

³⁴⁶See 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).

³⁴⁷Other characteristic norms of American corporate governance include high levels of executive compensation and deference to managerial discretion, as reflected in the (legal) norm of the business judgment rule. See, respectively, Edward B. Rock & Michael L. Wachter, *Norms & Corporate Law*, 149 U. PA. L. REV. 1607 (2001); Randall S. Thomas & Kenneth J. Martin, *The Effect of Shareholder Proposals on Executive Compensation*, 67 U. CIN. L. REV. 1021, 1025-30 (1999).

³⁴⁸Schwartz & Ros, *supra* note 345, at 114.

³⁴⁹See Mark J. Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539 (2000) [hereinafter Roe, *Political Preconditions*]; 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 ROE, *supra* note 332; Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 32-37 (1991).

³⁵⁰Roe, *Political Preconditions*, *supra* note 349, at 543.

State enabled the rise of widely dispersed shareholding and the adherence to shareholder wealth maximization.³⁵¹

B. *Seeming Convergence Trends*

Major economic and geo-political processes 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" such as South Korea, that were considered poster children of economic growth.

These events first engendered interest in non-American corporate governance systems with a view toward the adoption of successful features of foreign corporate governance in the United States. Hence, comparative corporate governance was born as an academic field of interest.³⁵² At first, mostly lawyers were writing on these issues; but, in the mid-1990s economists started to show interest in comparative corporate governance as well.³⁵³ Corporate governance has drawn tremendous attention in light of

³⁵¹*Id.* ("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.").

³⁵²See 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.

³⁵³The pioneering works were produced by La Porta, Lopez-de-Silanes, Shleifer, and Vishny. See Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998); Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997). These studies prompted a flurry of studies that are too numerous to cite here. For a recent review, see Marco Becht et al., *Corporate Governance and Control* (ECGI Working Paper No. 2/2002, 2002).

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 had lost favor and the Anglo-American model was seen as superior.³⁵⁴ 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.³⁵⁵ Motivated by evidence that corporate governance is necessary for economic performance, international bodies began to endorse corporate governance reform that draws on American features as a standard prescription for transition economies. International aid for distressed economies is conditioned on the implementation of such reforms. Again, Korea is a prominent example.³⁵⁶

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 versus stakeholder interest as the desirable maximands of corporate governance. During the 1990s, corporate governance analysis entered a new phase in which 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.³⁵⁷ The Report marked a conceptual change with regard to corporate governance reform as it called for "soft regulation"—namely, the

³⁵⁴Beyond the obvious success of the American economy in the second half of the 1990s, this perception was to a large extent due to the works of La Porta et al., *supra* note 353, 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 La Porta et al., *supra* note 332; Simon Johnson et al., *Tunneling*, 90 AM. ECON. REV. PAPERS & PROC. 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 outside 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).

³⁵⁵See André, *supra* note 335; Roger W. Mills & Bill Weinstein, *Beyond Shareholder Value—Reconciling the Shareholder and Stakeholder Perspectives*, 25 J. GEN. MGMT. 79 (2000).

³⁵⁶Hwa-Jin Kim, *Toward the "Best Practice" Model in a Globalizing Market: Recent Developments in Korean Corporate Governance*, 2 J. CORP. L. STUD. 345 (2002). On the alleged role of corporate governance in the Korean crisis, see Tomás J.T. Baliño & 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. & DEV. (1999), available at <http://www.imf.org/external/pubs/ft/fandd/1999/03/iskander.htm>.

³⁵⁷REPORT 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.

use non-binding rules and practices—and underscored the importance of private, market-driven improvements in corporate governance.³⁵⁸

The Cadbury Report was followed by similar initiatives in many European countries³⁵⁹ and in other parts of the world, including Asia and Latin America.³⁶⁰ A large majority of these documents have been promulgated since 1999. To understand the 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 adopted an "active" investment policy, focusing on corporate governance in their portfolio companies, and sought to improve it.³⁶¹ These investors also drafted documents on optimal corporate governance that dovetailed the Cadbury Report and its progeny. These two policies combined 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 on the bandwagon and contributed their own documents.³⁶² 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.³⁶³

³⁵⁸*Id.*

³⁵⁹The 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.

³⁶⁰The order of promulgation of these initiatives in these regions include: (1) Asia: Japan and Korea and (2) Latin America: Brazil, Mexico, and Peru.

³⁶¹For a review and critical analysis of institutional investor activism, see Bernard 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 E. Crutchley et al., *The Shareholder Wealth Effects of CalPERS' Activism*, 7 *FIN. SERVICES REV.* 1 (1998).

³⁶²The European Corporate Governance Institute (ECGI) keeps track of corporate governance codes around the world. As of the end of 2004, the ECGI had recorded over 140 such documents, promulgated by 49 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.

³⁶³The new rating agencies derive lists of features that companies should have in their articles of association, the structure of the board and its committees, and so forth from the codes of best principles (or from similar documents). 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 et al., *Globalization and Similarities in Corporate Governance: A Cross-Country Analysis* (Harvard University Strategy Unit Working Paper No. 02-041 2002).

The second factor to promote the corporate governance code movement is the Principles of Corporate Governance adopted by the OECD Ministers in 1999 and revised in 2004.³⁶⁴ 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 after their adoption, the OECD and the World Bank signed a Memorandum of Understanding.³⁶⁵ The signatory parties agreed to adopt the OECD Principles as the point of reference in their corporate governance reform initiatives in both transition economies and developing countries.³⁶⁶ The parties also established the Global Corporate Governance Forum with a similar mission statement.³⁶⁷ Moreover, CalPERS and other institutional investors adopted the OECD Principles as guidance for their corporate governance agenda for foreign portfolio companies.³⁶⁸ 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 2004 more than 140.³⁶⁹

The upshot of the code of principles movement is that due to either moral suasion or pressure from markets and financial institutions, similar codes of principles are 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,³⁷⁰ 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. Still, it is debatable how

³⁶⁴See *supra* note 105. 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 20, at 154 n.8 (citation omitted) (describing adoption of OECD PRINCIPLES).

³⁶⁵MEMORANDUM OF UNDERSTANDING BETWEEN THE OECD AND THE WORLD BANK (1999), available at <http://www.gcgf.org/aboutus/munderstanding.htm>.

³⁶⁶*Id.*

³⁶⁷See GLOBAL CORPORATE GOVERNANCE FORUM, CORPORATE GOVERNANCE: AN ISSUE OF INTERNATIONAL CONCERN (2003), available at <http://www.gcgf.org/about.htm#initiative>; THE WORLD BANK, CORPORATE GOVERNANCE: A FRAMEWORK FOR IMPLEMENTATION 22-24 (2001), available at <http://www.worldbank.org/html/fpd/privatesector/cg/docs/gcgfbooklet.pdf>.

³⁶⁸Licht, *supra* note 20, at 153-57.

³⁶⁹See *supra* note 360.

³⁷⁰Becht et al., *supra* note 353, at 67.

much of an impact this (apparent) budding consensus might have on the issue of stockholder vs. stakeholder interests.³⁷¹

The OECD Principles consider corporate stakeholders only vaguely and half-heartedly. 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."³⁷² When it comes to implementation, however, the Principles adopt a complete deference approach by calling for the recognition rights of stakeholders, but limit the latter only to rights established by law. When law protects such rights, the Principles call for respecting them, albeit weakly, primarily through effective disclosure (transparency).³⁷³ The difficult job of

³⁷¹More 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 (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 Social Responsibility*, GLOBAL COUNSEL, Mar. 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.

³⁷²OECD 2004 PRINCIPLES, *supra* note 105, at 12. OECD 1999 PRINCIPLES, *supra* note 105, at 3, used identical language.

³⁷³Principle IV of the OECD PRINCIPLES, titled "The Role of Stakeholders in Corporate Governance," reads as follows:

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 employee 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.

reconciling conflicting interests of various stakeholders is relegated to the board of directors.³⁷⁴ It should be obvious at this point that in discharging this duty, directors will be affected by their personal values and cognitive styles.

Notwithstanding the OECD Principles, a comparative study of corporate governance codes, relevant to the European Union and commissioned by the European Commission, finds differences in the legal status of stakeholders across Europe, in line with the above review.³⁷⁵ The traditional differences between British and continental European corporate governance, in regards to non-shareholder constituencies, remain intact notwithstanding calls in the U.K. for assessing risks and opportunities for these constituencies.³⁷⁶ This study also points to national culture as underlying these differences.³⁷⁷ 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 considerably abated. 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 stakeholders on a voluntary basis."³⁷⁸

A sober analysis of the code of principles movement leads to the conclusion that it has so far had a negligible effect on the stockholder-stakeholder issue. To paraphrase a critique of the English (supposedly) pro-employee legislation the stakeholder-related provisions in the OECD Principles and the codes that follow them may be considered cynical or incompetent.³⁷⁹ 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

Id. at 12. The language of the OECD 1999 PRINCIPLES was largely similar.

³⁷⁴See Nestor Stilson, INTERNATIONAL EFFORTS TO IMPROVE CORPORATE GOVERNANCE: WHY AND HOW (2001), available at <http://www.oecd.org/dataoecd/61/1/1932028.pdf> ("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.") (Stilson was Head of Corporate Affairs Division at the OECD).

³⁷⁵EUROPEAN 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/news/corp-gov-codes-rpt_en.htm.

³⁷⁶*Id.*

³⁷⁷*Id.* at 29.

³⁷⁸Several 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.

³⁷⁹See Sealy, *supra* note 334.

international codes, fully defer to them. 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.

VI. CONCLUSION

This article has sought to broaden understanding of the *raison d'être* of corporations as 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 more recently policy makers, around the world face the maximands problem regularly.

This article 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 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. It aims to extend, rather than replace, economic analyses of the maximands issue. Overall, the 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 supports this theory.