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Shareholders vs Stakeholders Capitalism

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Abstract

With the growth of the economies worldwide the debate between shareholder and stakeholder capitalism has never been more intense than nowadays. Each country though incorporates this debate differently in its interior market since its corporate governance's structures present distinguished characteristics. Thus, by brining into this debate countries like Germany and the USA, the distinction between shareholders and stakeholders' interests becomes clearer. Countries based on the Anglo-Saxon business model like the USA are in favor of a "shareholder primacy" based system setting as their optimal goal the maximization of shareholder value. On the other hand, countries like Germany seem to have a stronger preference for a stakeholder based system. Both countries though throughout the years have been tested to incorporate into their corporate governance structure models stemming from the opposite side.

Thus, the USA despite its stable preference for satisfying fiercely its shareholders' interests have recently started to embrace views stemming from satisfying stakeholder value, adopting notions such as codetermination and public benefit corporation. At the same time, Germany despite its rigid stakeholder preference, for improving its position in the global business arena has been proposed to become more tolerant versus shareholders' needs. Finally, in both countries efforts are made to satisfy both shareholders and stakeholders' interests. However, the percentage of this satisfaction defers based on the needs of the corporations of each country.

Key words: Shareholder value, stakeholder value, corporate governance, Germany, USA, shareholder capitalism, management.

1. Introduction

The following paper is about the topic “Shareholder vs. Stakeholder Capitalism”. This paper is part of the seminar “Comparative Corporate Governance”. One of the most important questions in the field of corporate governance is the question about an overall goal for business. The two most famous models in this regard are the shareholder and stakeholder approach. Even though both terms lack one clear definition since they have a lot of sub-theories, which differ in accentuation and other details, they both stipulate a certain philosophy how to run business and in particular big corporations.

This paper will take a look at the influence these theories have on corporate governance in the USA and in Germany. The paper is divided in four sections. Section 2. will explain shareholder and stakeholder capitalism and explore the origin of them. Afterwards Section 3. will try to find indications in the German (corporate) law, which point to impacts of either one of the approaches. Section 4. will do the same for the US law. Section 5. then will be the main comparative part.

2. The Theories

This first part will explain what share- and stakeholder capitalism is and will explore the origin of these philosophies.

2.1. What is shareholder capitalism?

The term shareholder theory or also shareholder value approach can refer to different ideas. The term shareholder value approach is a term out of the field of business economics and refers to a particular way of dynamic investment calculation.[1] It was invented by *Rappaport* who searched for a new as precise as possible method of measuring the value created by corporations.[2] Shareholder value is oriented towards an average diversified shareholder who wants maximum profit from his investment in shares.[3] Still in other fields than business economics the term shareholder theory usually means something different, namely a guiding

[1] *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 130.
[2] *Rappaport*, Creating Shareholder Value.
[3] *Kuhner*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 2004, 33 (2), 244, 262.

principle for operating a business, which gives the interests of shareholders the highest priority.[4] Therefore the objective is to maximize the value of the corporation's shares because that is obviously the main interest of shareholders.[5]

This concept of the shareholder approach is mainly concerned with the principal-agent-relationship between shareholders and management.[6] The standard argument for the need to prioritize the shareholder interests is the fact that investors (shareholders) are not protected by contracts like all other corporate units dealing with the corporation.[7] For the purposes of this paper the term shareholder capitalism or approach will refer to a system, which gives the interests of shareholders the highest priority and will therefore first and foremost try to create maximum value for them.

2.2. What is stakeholder capitalism?

Even more than the term shareholder approach the term of stakeholder approach is highly ambiguous, if not controversial.[8] There are multiple „theories"and concepts involving the term stakeholder, which come to different conclusions and have accentuations.[9] The term surely is multi-dimensional and can be described as having descriptive, instrumental and at core normative levels[10].

The fundamental idea of the stakeholder approach is to consider interests of corporate groups other than just those of shareholders.[11] These interests do not need to be considered for the sake of the shareholders but for their own sake. They have an own intrinsic value.[12] For that reason stakeholder capitalism judges the performance of a corporation by a broad spectrum of parameters, [13] and not only by the performance of the shares. The subsequent question which interests need to be considered, ergo who the stakeholders are is answered inconsistently. *Freeman* defined stakeholders very broadly as "any group or individual who can affect or is

[4] *Werder*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1998, 27 (1), 69, 74.
[5] *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 131 f..
[6] *Werder*, Führungsorganisation, 8.
[7] *Werder*, in: Hommelhoff/Hopt/Werder (Publ.), Handbuch Corporate Governance, 3, 8.
[8] *Miles*, Journal of Business Ethics 2012, 108 (3), 285, 295, concluding that the concept is actually contested.
[9] *Scherer/Patzer*, in: Phillips (Publ.), Shareholder Theory. Impact and Prospects, 140, 141 f..
[10] *Donaldson/Preston*, Academy of Management Review 1995, 20 (1), 65, 66 f..
[11] *Werder*, in: Hommelhoff/Hopt/Werder (Publ.), Handbuch Corporate Governance, 3, 8.
[12] *Donaldson/Preston*, Academy of Management Review 1995, 20 (1), 65, S. 67.
[13] *Mayer*, Journal of Institutional and Theoretical Economics 1998, 154 (1), 144, 146.

affected by the achievements of the firm's objectives".[14] It is with no doubt still necessary to further differentiate between different stakeholders since their interests and influence can vary heavily.[15]

In spite of the multi-interest considerations the stakeholder approach is not necessarily dealing with social issues. Broad social concerns and stakeholder considerations do not have to be the same[16] and stakeholder theory is actually not an underlying concept of Corporate Social Responsibility (CSR).[17] The stakeholder approach is thought to be a strategic approach to business making. So it is not about taking the interests of the whole society into consideration and assuming a responsibility towards it, but about understanding and using the relationships between the corporation and the groups that have a stake in it so that the best possible economic result can be reached.

So the stakeholder approach at core requires decision makers to identify the legitimate stakeholder and their interests first, then weigh and balance the latter against each other and finally make their choice on that basis.[18] How to finally make those choices is up to the decision makers. There also is no overall agreement on what the overall goal of stakeholder theory is. One idea is to make long term value maximization the goal[19] since only by means of pursuing maximization of value created all corporate units and society as a whole can benefit.[20]

Another idea puts the balancing of stakeholder interest in the center and makes the coordination of those interests the objective of the corporation.[21] For the purposes of this paper stakeholder capitalism will refer to the strategic multi-interest consideration for the sake of corporations and not to an idea how to bring ethical values into business. So in short it will refer to the broad idea that a firm can and will be run more efficiently if not only the interests

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[14] *Freeman*, Strategic Management, 25.
[15] *Cohen*, Business & Professional Ethics Journal 1996, 15 (2), 3, 5; also *Mitchell/Agle/Wood*, Academy of Management Review 1997, 22 (4), 853, 882.
[16] *Clarkson*, Academy of Management Review 1995, 20 (1), 92, 100.
[17] *Elms/Johnson-Cramer/Berman*, in: Phillips (Publ.), Shareholder Theory. Impact and Prospects, 1, 1 f..; *Hansen/Bode/Moosmayer*, Zeitschrift für Wirtschafts- und Unternehmensethik 2004, 5 (3), 242, 251, think CSR surpasses stakeholder theory.
[18] *Goodpaster*, Business Ethics Quarterly, 1 (1), 53, 56.
[19] See *Jensen*, Journal of Applied Corporate Finance 2001, 14 (3), 8, 9, who calls this "enlightened stakeholder theory".
[20] *Jensen*, Journal of Applied Corporate Finance 2001, 14 (3), 8, 11 f..
[21] *Evan/Freeman*, in: Beauchamp/Bowie (Publ.), Ethical Theory and Business, 97, 103.

of its shareholders but also of other parties which have a legitimate interest in the corporation are taken into consideration. No interest is predetermined to be more important than another. The decisions are based on a complete consideration of all interests or rather stakes, what includes identification, analysis and making the necessary trade-offs.

2.3. Origin and development of the theories

Like with most concepts and theories is it hard to clearly identify the real origin of those theories. Nonetheless it is important to at least have a rough idea where they come from to really understand them. Emphasis will be laid on the development of these concepts in the USA and in Germany.

The origin of the underlying problem, which interests need to be considered in corporate decision-making (at all or primarily), can be dated back to the 1930s. After identifying a dispersed ownership structure of US corporations,[22] *Berle and Means* provided the cornerstone for this in their book "The Modern Corporation and Private Property"[23] by stating that ownership and control of corporations are separated. The book focused on the relationship between management and shareholders. They identified a very strong management and weak shareholders with small influence.[24] To keep the managers from self-interested conduct, they proposed that managers be obliged with fiduciary duties for the benefit of the shareholders. Even though they did not use a term like shareholder theory, approach or capitalism this can be seen as a starting point for shareholder capitalism in the US.[25]

The origin of the stakeholder approach in the US can also be dated back to the 1930s. The forerunner of the stakeholder approach was *Merrick Dodd*.[26] As a reaction to the trust law analogy by *Berle and Means* in which the managers are fiduciaries to the corporation's shareholders, *Dodd* opposed that managers are trustees to the whole institution of the firm

[22] *Means*, The Quarterly Journal of Economics 1930, 44 (4), 561, 591.
[23] *Berle/Means*, The Modern Corporation and Private Property.
[24] *Berle/Means*, The Modern Corporation and Private Property, 277.
[25] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 650 f..
[26] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 666; See also *Dodd*, Harvard Law Review 1932, 45 (7), 1145, 1154.

rather than just to the shareholders.[27] In Germany a similar understanding of the corporation as an autonomous unit already existed at the beginning of the nineteenth century.[28] This institutional view of the corporation suits the stakeholder approach better than for example the contractarian theory since it establishes a unit whose interest the management has to respect and shareholders are a non-exclusive part of that unit.[29]

However these were still far away from using the term stakeholder and the more mature stakeholder approach ideas of today. An important forerunner for the stakeholder approach in Germany then was *Walther Rathenau*.[30] He was very skeptical about a strong influence of shareholders,[31] in particular of speculative investors.[32] Thus the idea was to keep the shareholders out of the decision-making as much as possible.

The rationale behind this would be: the freer the managers are from any undue influence (especially from shareholders) when it comes to making business decision, the better the final decisions for the corporation. This is basically the complete opposite position to *Berle and Means* who wanted to bind the managers with fiduciary duties to the shareholders of the corporation.[33] So their idea was to give the managers less discretion and freedom in making corporate decisions by means of giving the shareholders more power and establishing fiduciary duties whereas the idea of *Rathenau* was to give managers more discretion by strengthening the management. Conclusions deriving from that fact will be made at the end of this section.

Both streams of thought continued to develop over the course of the twentieth century. The stakeholder idea remained the leading approach to corporate governance in Germany not least because of the enactment of the old § 70 German Stock Corporation Act in 1937 and the developing concept of the „Unternehmensinteresse“,[34] which was very much in line with Institutional theories of the corporation.

[27] *Dodd*, Harvard Law Review 1932, 45 (7), 1145, 1160.
[28] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 665.
[29] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 667.
[30] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 680-683.
[31] *Rathenau*, Vom Aktienwesen, 26 f..
[32] *Rathenau*, Vom Aktienwesen, 27 f..
[33] See *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 683 and 688.
[34] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 695.

The actual terms and concepts of stakeholder approach and shareholder value management like we know them today came up or rather gained popularity not before the 1980s. During that time the market for hostile corporate takeovers was evolving in the US and managing in the interest of shareholders was re-emphasized.[35] In addition the significance of the capital market and institutional investors increased in the US but Germany as well.[36] During that time span *Rappaport* developed the business economic idea of creating shareholder value as mentioned above, which some years later also became popular in Germany.[37] In 1984 *Edward Freeman* published a book about the "stakeholder approach" from a business strategic perspective.[38] The term stakeholder was popularized by *Freeman's* book[39], even though it was invented earlier[40] and used in different ways before 1984.

Again the terms continued to develop further on and can even be called ambiguous today because of different ideas and theories that did or did not and even might or might not end up changing the overall understanding of the two overarching approaches to governance.
After all there are some valuable conclusion that can be drawn from this exploration of the origin of the two governance approaches.

These conclusions become most apparent looking at the initial ideas of *Berle and Means* on one hand and *Rathenau* on the other. As already stated before the idea of *Berle and Means* was to protect the corporation of the powerful managers dealing in self-interest whereas *Rathenau* intended to empower the management to protect the corporation of its shareholders. In result it can be concluded that the shareholder approach tends to constrain managers and the stakeholder approach on the other side tends to empower them.[41] Looking at this and the different ownership structures in the US and in Germany back then (and in big parts still today) the conclusion that can also be drawn is that the local shareholder influence had a major effect on how people thought about the relation between management and shareholders.

As already mentioned above the ownership of big corporations in the US was and is dispersed. The influence the shareholders can have is therefore severely limited. Germany on

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[35] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 651 f..
[36] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 698.
[37] *Werder*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1998, 27 (1), 69, 69.
[38] *Freeman*, Strategic Management.
[39] *Freeman*, Strategic Management, 31-43 describing different uses until 1984.
[40] And first used in the Stanford Research Institue, *Freeman*, Strategic Management, 31 f..
[41] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 678.

the other hand was characterized by block-holders, meaning shareholders who own a huge amount of shares of a corporation. Because of this concentration the influence on the management can and will be more drastic.[42]

It then becomes a task of balancing power. If shareholders are too weak the corporation is susceptible for managers dealing in self-interest. If the shareholders are too strong all non-shareholder corporate groups are susceptible for "hold-up"-problems[43]. To balance power in the first case of too weak shareholders, management has to be constrained in some way. For example by binding the management to work as fiduciaries for the shareholders. The goal then is to maximize value for the corporation's stockholders (this would be the shareholder approach).

In the other case of too strong shareholders, corporate decision makers need to have enough power to be able to act independently from the shareholders. So the solution to balance the power in this case is to give managers the right to consider and prioritize interests of non-shareholder corporate units (this would be the stakeholder approach).[44] This conclusion also suggests that there might not be a perfect approach to corporate governance but just different "local optima" adapted to the respective surroundings.[45] It also suggests that both approaches are in reality just ways to find the balance of power between the different corporate units that is best for the corporation.

However it is certain that the approaches are not just some idea of individual persons but rather the results of different surroundings and problems which changed and by that means also changed the ideas how to best approach corporate governance.

[42] *Gelter*, Harvard International Law Review 2009, 50 (1), 129, 133.

[43] Meaning the problem that one party can take advantage of a relationship or a contract due to overpowering influence of one party combined with little protection of the other. See in that regard *Goldberg*, American Behavioral Scientist 1980, 23 (3), 337, 339-341, explaining the "hold-up" situation.

[44] *Gelter*, Harvard International Law Review 2009, 50 (1), 129, 144-168 explains that line of thought in depth.

[45] *Gelter*, Harvard International Law Review 2009, 50 (1), 129, 177 (See Table 1 regarding the differing "local optima").

Comparative Table between Germany and USA regarding share- and stakeholder capitalism

Categories	**Germany**	**USA**
Shareholders	Arguably most important group of stakeholders; trend towards increased focus on creation of shareholder value.	"*Shareholder primacy*" All the modern American corporate Governance thought is based on this notion.
Stakeholders	Protected through a stakeholder friendly legal framework.	Under US Securities Law there is not any explicit obligation to consider non-shareholder interests. Stakeholders' interests not really protected.
Management	(Two-tier Corporate Governance Structure): Broad discretion in terms of overall orientation.	(One-tier Corporate Governance Structure): Board has discretion in terms of overall orientation. Maximization of Shareholder value.
Social Responsibility of Corporations	No general duty; in the discretion of management.	No general duty, in the discretion of management. Recently creation of "Benefit Corporations".
Role of the legislator	Sets legal framework → responsible for stakeholder considerations. National corporate law.	US Securities Law deals with Federal issues (shareholders' interests). Otherwise, each state law diversifies itself. Delaware law-most important state law for corporations.
Codetermination	Worker codetermination very extensive: almost parity on boards of big corporations	Worker codetermination not taken into account. No worker representatives on boards.
Role of Banks	Intervene directly in corporation's management.	Commercial banks are forbidden to intervene in corporation's management.

3. German Part

This Part will explore the German (corporate) legal system in search of indications for a share- or stakeholder capitalistic system.

As explained in depth before shareholder capitalism will in that regard refer to a system that gives the interest of the shareholders, thus the maximization of the share value, the highest priority. Whereas stakeholder capitalism will mean a system in which the interests of all corporate groups will be considered (equally).

Since German law is said to traditionally be very stakeholder capitalistic, this part will start by taking a look at the German development of both orientations and the stakeholder orientation in particular, will then continue to examine different relevant laws and conclude with a quick look on future trends in regard to the overall approach.

3.1. Development and local circumstances in Germany

Even though the German legal scholar *Otto v. Gierke* was one of the first to develop a theory of a (in the broadest sense) corporation as an entity that is to a certain degree independent from its members in the 19th century,[46] the actual development of something like the stakeholder approach in Germany started with *Walther Rathenau*.[47]

Until that time the understanding of the corporation was very shareholder-centric, with the shareholder meeting as the most important body in terms of choosing corporate direction.[48] As mentioned above, *Rathenau* was worried about too much shareholder influence and wanted to protect the corporation from this, in his view detrimental, influence.[49] At the same time he was one of the first to draw a connection between the corporation and public issues,[50] due to the size of some of the corporations and their influence on the national economy.

Even though these ideas did not have an extensive influence on the legal scholars during that time and were even criticized,[51] they might have influenced the development of the enterprise

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[46] *Gierke*, Das deutsche Genossenschaftsrecht.
[47] See Section 2.3.
[48] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 680; also *Langenbucher*, Aktien- u. Kapitalmarktrecht, § 1, Para. 3.
[49] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 683.
[50] *Rathenau*, Vom Aktienwesen, S. 38.
[51] *Haussmann*, Vom Aktienwesen und vom Aktienrecht, S. 26, criticising that *Rathenau* is taking the rather dispersed ownership structure of the corporation which he knows as the general one, while in fact a more concentrated ownership structure is more common.

in itself ("Unternehmen an sich")-concept about a decade later.[52] Thus one core idea of that concept was that the business or the enterprise is an entity separate from its owners and that their influence on corporate decision-making needed to be limited.[53] The courts during that time had a similar understanding in that regard. They allowed shareholders to act in their own interest as long as this does not go at the expense of the corporation or the minority shareholders without a corporate need for such behavior.[54]

A big step towards a more explicit stakeholder capitalistic system was the enactment of § 70 German Stock Corporation Act in 1937.[55] Management was explicitly obliged to manage not only in the interest of the shareholders but instead to manage in the interest of the enterprise its retinue and the common weal of folk and realm. Most of the vocabulary was obviously filled with Nazi ideology,[56] but the article still showed a strong stakeholder oriented idea of business at the time. Due to a lack of control mechanisms, the management had a huge amount of power in corporate decision-making during that time.[57]

After World War II the concept of the interest of the enterprise ("Unternehmensinteresse") evolving from § 70 German Stock Corporation Act (1937) became more of a focus in terms of guiding principles for business.[58] Clearly not disfavoring this was the enactment of a new § 76 German Stock Corporation Act in 1965, which is still in place today.[59] Even though the wording of § 76 is obviously completely different from the one of § 70, it still left the management with a lot of room in decision-making,[60] especially since this amendment was

[52] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 687.
[53] Id.
[54] *Horrwitz*, Juristische Wochenschrift 1930, 59 (2), 2637, 2638.
[55] § 70 of the German Stock Corporation Act as of January 30th 1937, RGBl. 1937, 107: „Der Vorstand hat unter eigener Verantwortung die Gesellschaft so zu leiten, wie das Wohl des Betriebs und seiner Gefolgschaft und der gemeine Nutzen von Volk und Reich es fordern." – „The managing board is, on its own responsibility, to manage the corporation as the good of the enterprise and its retinue and the common weal of folk and realm demand."
[56] *Vagts*, Hardvard Law Review 1966, 80 (1), 23, 40.
[57] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 689 f..
[58] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 695.
[59] § 76 Para. 1 of the German Stock Corporation Act as of December 22nd 2015, BGBl. 1965, 1089: „Der Vorstand hat unter eigener Verantwortung die Gesellschaft zu leiten." – „The Management shall have direct responsibility for the management of the company."
[60] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 696.

not supposed to change the legal situation in 1965.[61] The corporation was still supposed to be governed by multi-interest considerations instead of a prioritization of shareholder interest.[62]

The enactment of the Codetermination Act in 1976[63] further strengthened the stakeholder orientation in Germany since workers now had a way to make their voice heard on the supervisory boards of big corporations.[64] Asked by shareholders about the constitutionality of this act, the German Constitutional Court decided it was constitutional and justified this with a social aspect of the (share-)property of the shareholders,[65] which was even more of a confirmation of a stakeholder orientation in Germany.

The corporation was seen as a conglomerate of different interests.[66] Management had very broad discretion and thus was allowed to take a broad spectrum of interests into consideration in their decision-making.[67] It was stated that pursuing a sustainable maximum profit does not even have to be the corporate objective,[68] as long as the corporation still maintained its profitability because without this it would not be able to sustain its functional capability over time.[69] So the idea of the corporate goal was to consider the interests of the various corporate groups, meet them and their demands as far as possible, while just maintaining the functionality of the corporation.

What the reason for the development of that very strong stakeholder orientation exactly was cannot be said with certainty. As already mentioned above, one reason might be the local optima relation,[70] meaning that a strong management with a lot of discretion to consider stakeholder interest is necessary to keep the strong (block-)shareholders in check.[71] In addition to that another factor contributing to the strongly stakeholder oriented system in

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[61] *Meyer-Landrut*, in: AktG Großkomm, § 76, Para. 9.
[62] *Hopt*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1993, 22 (4), 534, 536; summarizing the continued legal validity situation shortly is *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 147 f..
[63] German Codetermination Act BGBl. 1976, 1153.
[64] The German codetermination system and what deeper conclusions it allows in regard to a stakeholder capitalism, will be explained further in Section 3.3.1.
[65] BVerfG March 1st 1979, BVerfGE 50, 290, 315 f..
[66] *Goette*, FS fünfzigjähr. Best. BGH, BAnwsch. u. RA BGH, 123, 127.
[67] *Mertens*, in: Kölner Komm AktG, § 76, Para. 11.
[68] Id.
[69] *Mertens*, in: Kölner Komm AktG, § 76, Para. 22.
[70] Again *Gelter*, Harvard International Law Review 2009, 50 (1), 129, 177 (See Table 1 regarding the differing "local optima").
[71] See Section 2.3. pag. 6 f.; also see again *Goldberg*, American Behavioral Scientist 1980, 23 (3), 337, 339-341, explaining the "hold-up" threat for stakeholders.

Germany might have been the traditional bank financing of German corporations instead of capital market financing.[72] As a result there never really was a need to consider the interests of shareholders, which is creating maximum share value, all too much whereby the shareholder approach might have had a tougher stand in Germany.

From the 1990s onwards the shareholder value concept gained more and more popularity and support in Germany through US legal scholarship, increased importance of institutional investors and capital markets in general and therefore increased pressure to meet the shareholder's demands of value creation in their favor, ergo considering the shareholder value.[73] At the latest around 2000 the idea of the shareholder value was established in Germany[74] and is now playing a legit role in the question for the right overall orientation.

What system is dominating the German corporate governance today and what future trends are already foreseeable or likely to happen, will be explored in the next sections.

3.2. Management of the corporation

In basically any corporation, the management is the one of the most, usually even the most, important and powerful body. When talking about overall goals for a corporation, one has to talk about goals for management, since this is the corporate organ that actually directs the corporation. Management is the central body especially when it comes to a share- or stakeholder approach to business. The underlying theories of *Rappaport* and *Freeman* were initially supposed to be strategic guidelines for management.[75] Thus any duties and responsibilities the management has can tell a lot about the overall orientation of the system.

3.2.1. Overall goals

The German management is not mandated by the shareholders.[76] Pursuant to § 119 Para. 2 German Stock Corporation Act the shareholder meeting has no saying in management

[72] *Kuhner*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 2004, 33 (2), 244, 247.
[73] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 698.
[74] *Groh*, Der Betrieb 2010, 63 (43), 2153, 2157 f..
[75] Regarding the stakeholder theory *Freeman*, Zeitschrift für Wirtschafts- und Unternehmensethik 2004, 5 (3), 228, 230, in more detail *Donaldson/Preston*, Academy of Management Review 1995, 20 (1), 65, 85-87; regarding shareholder theory *Rappaport*, Creating Shareholder Value, 12 f..
[76] *Weber*, in: Hölters AktG, § 76, Para. 35.

decisions unless explicitly asked. In principle the management is therefore free from shareholder instructions.[77] If you would only consider the pure wording of § 76 German Stock Corporation Act management would be left with almost limitless discretion and could basically do "anything". Therefore the discretion and room for decision-making needs to be limited in some way.[78] At this point setting an objective for management comes into play.

Considering that management is the corporate organ directing the whole company, an overall share- or stakeholder orientation would most likely finds its strongest expression in such a clear goal for the corporation and its management. For that reason the legal concepts of management objectives in Germany and the correlating provisions will be looked at first.

3.2.1.1. Legal provisions

The look at the legal provisions will be limited to the most important legal provisions in regard to an overall orientation and objective for management.

3.2.1.1.1. § 76 Para. 1 German Stock Corporation Act

A very important, if not the most important, section in regard to overall business goals and orientation, at least in the academic debate, is the already mentioned § 76 Para. 1 German Stock Corporation Act. Since Germany does not have one clear statutory provision in corporate law that explicitly states which goals management has to pursue,[79] this section still comes closest to "describe" the managerial responsibilities. Most of the debate about a share- or stakeholder orientation of German corporate law is linked to this provision.

Together with § 93 Para. 1 Sent. 2 German Stock Corporation Act, which can be described as the German version of a Business Judgment Rule[80] and gives the management discretion in how to manage the corporation[81], it sets the basic legal framework for the management board. Still only the wording of those provisions does not give much information in terms of an overall orientation. The concepts of management objectives will give more information.

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[77] *Hüffer*, in: Hüffer AktG, § 76, Para. 25; *Kort*, Die Aktiengesellschaft 2012, 57 (17), 605, 609, also stating that there is no fiduciary relationship between the management and the shareholders.
[78] Also see *Hüffer*, FS Raiser, 163, 168.
[79] *Rittner*, FS Ernst Gessler, 139, 140.
[80] *Windbichler*, GesellschaftsR, § 27, Para. 33.
[81] *Spindler*, in: Münchner Komm AktG, § 76, Para. 35.

3.2.1.1.2. Section 4.1.1 German Corporate Governance Codex

Section 4.1.1[82] and the German Corporate Governance Codex as a whole is significantly more explicit about management's objectives than the entire Stock Corporation Act. Section 4.1.1 states that the management has to manage in the interest of the enterprise, which is managing by taking the interests of shareholders employees and other stakeholders into consideration. The goal is sustainable value creation.

Even though this provision does not give precise instructions it obviously is a (very stakeholder oriented) guideline for management.[83] The problem is that the legislator, namely the German parliament, does not set the German Corporate Governance Codex but rather a commission. Through § 161 German Stock Corporation Act corporations are obliged to "comply or explain" with the Codex but the actual provisions still remain legally unbinding.

Thus Section 4.1.1 gives a very clear indication of an overall orientation but due to a lack of democratic legitimacy[84] it is not able to answer the question of an overall management objective for the whole German corporate law.[85]

3.2.1.2. Concepts of goals for the management

So this leaves German corporate law without a binding clear statutory provision that sets a clear goal for the management. In result there are multiple different concepts of management objectives.

One basic problem of this goal-debate is again terminology. Even though this debate is far from new, legal scholars have not been able to agree on a universal terminology. So the same term can refer to slightly or even completely different ideas, concepts or facts.

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[82] Section 4.1.1 of the German Corporate Governance Codex as of May 5th 2015, available at http://www.dcgk.de/en/code.html: „The Management Board is responsible for independently managing the enterprise in the interest of the enterprise, thus taking into account the interests of the shareholders, its employees and other stakeholders, with the objective of sustainable creation of value."

[83] *Ringleb*, in: DCGK, Para. 561 f..

[84] *Mühlbert*, Die Aktiengesellschaft 2009, 54 (21), 766, 771.

[85] See also *Langenbucher*, Aktien- u. KapitalmarktR, § 4, Para. 110 f..

The first important thing in the debate might be a distinction between corporation (Gesellschaft) and enterprise (Unternehmen),[86] even though the terminology varies[87]. While the corporation is a legal entity and thus can be entitled to rights and subject to obligations,[88] the enterprise is not. The corporation is an association of investors, while the enterprise is not a legal entity, but rather can be described as a unit of everyone and everything that is related to the actual business of the corporation, for example the production of aircrafts.[89] This actual business is called the *object of the enterprise*, and needs to be put down in the articles of incorporation.[90] But the reason why the investors are associated is not necessarily the same.[91] The investors may have no direct connection with the object of the enterprise. Thus the so-called *corporate purpose* describes the reason for their association, which is to make profits.[92] So this distinction also suggests the early conclusion that one common interest, or at least several aligned interests characterize the corporation, whereas the enterprise is characterized by a multitude of different interests.[93]

After distinguishing these, the next step is to take a look at the different concepts for corporate goals respectively goals that the management has to pursue.

3.2.1.2.1. Generating profits

A very popular and in a way simple corporate goal is to generate profits. So the most fundamental version of this argument obliges management only to pursue profitability.[94] The rest is left to the discretion of the management.

The fact that a corporation needs to be profitable to maintain its functionality and therefore to maintain the ability to satisfy all the different interests is unchallenged.[95] The actual difference is that basically all other concepts do not stop at the demand of profitability.

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[86] Early implication already in *Miegel*, Unternehmensbegriff, 153; also clearly rejecting an identification of the corporation and the enterprise is *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 154 f.; see also *Kübler/Assmann*, GesellschaftsR, 34-42.
[87] *Kübler/Assmann*, GesellschaftsR, 4.
[88] *Hüffer*, in: Hüffer AktG, § 1, Para. 4.
[89] *Kübler/Assmann*, GesellschaftsR, 40 f..
[90] § 23 Sect. 3 No. 2 German Stock Corporation Act
[91] See for the difference *Pühler*, in: Happ AktR, Sect. 1.01, Para. 7.
[92] *Schmidt/Spindler*, FG Friedrich Kübler, 515, 535.
[93] *Hefermehl*, AktG, § 76, Para. 21.
[94] *Vedder*, in: Grigoleit AktG, § 76, Para. 14.
[95] *Mertens*, in: Kölner Komm AktG, § 76, Para. 22.

3.2.1.2.2. Maximization of profits

Thus another goal is the maximization instead of just generation of corporate profits.[96]
Even though this might seem like only a slight modification of the first corporate goal, it really is a fundamental change. That is because the discretion of management is reduced drastically.[97] While the management is able to consider the interest of all corporate parties for their own sake if the objective is only making profits, it can only take these interests into consideration as long as they are conducive for the maximization of profits.[98]

3.2.1.2.3. Create shareholder value

The next goal conception for management is the actual shareholder value approach proposed by *Alfred Rappaport*.[99]

Since this concept is based on the economical portfolio theory[100], the actual goal is trying to create maximum value for a theoretical average, ideally diversified investor.[101] Thus this concept does not consider the actual shareholders of a corporation, with whom management might not even be familiar with, but rather the described type of diversified investor.[102]

With this concept it might also seem like there is no big difference to the idea of generating or rather maximizing profits because that can be said to be the main interest of this type of shareholder. But again in fact there are substantial divergences[103] due to the fact that profits of the corporation and value for shareholders do not have to be the same.[104]

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[96] *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 151; same thought even though not with regard to the German situation has *Friedman*, The Social Responsibility of Business is to Increase its Profits (September 13th 1970), URL: http://thinkprayact.us/uploads/The_Social_Responsibility_of_Business_is_to_Increase_its_Profits__by_Milton_Friedman.pdf (last visited on February 15th 2016)
[97] *Mertens*, in: Kölner Komm AktG, § 76, Para. 11.
[98] *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 139, turns this around and points out that its possible that only by considering those interests to some degree the profits can be maximized.
[99] *Rappaport*, Creating Shareholder Value.
[100] Founded by *Markowitz*, The Journal of Finance 1952, 7 (1), 77-91.
[101] *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 137.
[102] *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 156 f..
[103] *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 159-161, explaining the problems of potential conflicts between maximization of profits and creating maximum shareholder value.
[104] *Rappaport*, Creating Shareholder Value, 20-27.

What is similar to the goal of profit maximization is the very narrow scope of this concept.[105] It gives management one clear and arguably very workable objective and only allows all other interest to be considered when they are conducive to that objective.[106]

3.2.1.2.4. No clear goal in German corporate law

The idea here is that there simply is no clearly set goal for corporations and ergo for management in German corporate law. The decision makers can manage the corporation in their own discretion and are only limited by other legal requirements.[107] And because of the fact that management can only move inside the legal borders, this conception sort of gives the legislator an even bigger role insofar that he is required to set those borders properly, to ensure the retention of corporate functionality and efficiency.

3.2.1.2.5. The interest of the enterprise

Arguably the most influential concept in Germany is the one of the interest of the enterprise.[108] As mentioned above the German Corporate Governance Codex is explicitly committed to this concept.[109]

Despite its influence in German corporate law there is no clear, generally accepted definition of what exactly the interest of the enterprise is. There are several ideas and concepts of it.[110] Basically all of them have a multi-interest consideration in common. What is widely undisputed today, is that the enterprise is not a legal entity and clearly not a natural person and can thus not have any kind of own interest.[111]

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[105] *Janisch*, Das Strategische Anspruchsgruppenmanagement, 103.
[106] *Rappaport*, Creating Shareholder Value, 12 f., sees that other interest groups need to be taken into consideration to reach the objective.
[107] *Großmann*, Unternehmensziele im Aktienrecht, 258 f..
[108] Critical is *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 142.
[109] Second section of the foreword to the German Corporate Governance Codex: "The Code clarifies the obligation of the Management Board and the Supervisory Board to ensure the continued existence of the enterprise and its sustainable creation of value in conformity with the principles of the social market economy (interest of the enterprise)."
[110] *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 142 f..
[111] See Section 3.2.1.2. again.

The predominant idea of the interest of the enterprise is that it is an aggregation of all the interests that are related to the actual enterprise.[112] So this includes all corporate stakeholders, including shareholders. To use the interest of the enterprise as a goal would then mean to make the balancing of those interests (part of the) objective for management.[113]

The concept of the interest of the enterprise certainly was and still is contested and some even doubt the legal validity of it.[114] The explanation of the legal origin of the interest of the enterprise, which is an implicit continued legal validity of § 70 of the German Stock Corporation Act of 1937, as already touched on in Section 3.1, is increasingly contested. So are other explanations,[115] which are for example based on the social obligations of (share-) property[116].

Some are arguing that a stop to such continuation of § 70 must be proved by the enactment of other explicit opposing laws, which has not happened.[117] Others instead argue that there have been laws that clearly show an opposing will of the legislator.[118] Some even doubt that the legislator wanted a continued influence of this provision in the beginning.[119] In result the fact that the interest of the enterprise should play any role in a concept for the objective for corporate management is also disputed.[120]

Nonetheless the interest of the enterprise remains one of the most important concepts in terms of management objectives in German corporate law. Most concepts at least refer to it and a good number actually makes the interest of the enterprise the overall guiding principle.[121]

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[112] For example: *Eckert*, in: Wachter AktG, § 76, Para. 11; *Seibt*, in: Schmidt/Lutter AktG, § 76, Para. 12; *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 142 f.; *Schilling*, Betriebs-Berater 1997, 52 (8), 373, 379.
[113] See *Spindler*, in: Münchner Komm AktG, § 76, Para. 69; also *Spindler*, Unternehmensinteresse als Leitlinie des Vorstandshandelns – Berücksichtigung von Arbeitnehmerinteressen und Shareholder Value, 9 (October 12th 2008), URL: http://www.boeckler.de/pdf/mbf_gutachten_spindler_2008.pdf (last visited on February 15th 2016); also *Werder*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1998, 27 (1), 69, 90.
[114] Kuhner, Zeitschrift für Unternehmens- und Gesellschaftsrecht 2004, 33 (2), 244, 249; *Mühlbert*, Die Aktiengesellschaft 2009, 54 (21), 766, 772.
[115] *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 147-155.
[116] See *Spindler*, in: Münchner Komm AktG, § 76, Para. 68, who deduces an obligation for management to consider multiple interests by using the social obligation of share property.
[117] *Hüffer*, in: Hüffer AktG, § 76, Para. 30.
[118] *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 147 f., rejecting the idea that there is any continued legal validity of § 70 German Stock Corporation Act (1937).
[119] *Rittner*, FS Ernst Gessler, 139, 142.
[120] *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 156.
[121] *Kuhner*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 2004, 33 (2), 244, 278.

3.1.2.3. Concluding remarks on the goals for management

Due to a lack of room it is not possible to unfold the whole dispute between the different goal conceptions, weigh their arguments against each other and then try to choose the "right" goal. Nonetheless a roundup is necessary to draw basic conclusions for the overall question whether German corporate law is more share- or stakeholder oriented.

The fundamental conflict of a German corporate law between a unified interest of the association of shareholders as the corporation and the multiple interests that meet in the enterprise, which the corporation operates, shows up clearly in these conceptions.[122]

In spite of years of academic debate it still is not possible to give a final answer to what objectives the German management has. None of the listed goal conceptions is uncontested. What still can be concluded with relative certainty is that neither interest group can be totally left out of the consideration for decision-making.[123] Whether or not there is any prioritization of interests and if yes, which interests have a priority edge is answered inconsistently.[124] No one denies the need for corporate profitability.[125]

The German Corporate Governance Codex can be a good indicator of the legal situation, even though it technically is not a binding law.[126] And due to the fact that this codex shows the interest of the enterprise as the overall guiding principle it might point to a preponderance of a multi-interest concept, which in turn points to a strong stakeholder orientation in Germany.[127] What needs to be stressed at the end is that the German corporate management has very broad

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[122] *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 141-156, solving this problem in favor of the corporate purpose.

[123] See OLG Frankfurt August 17th 2011, Die Aktiengesellschaft 2011, 56 (24), 918, 918; *Spindler*, in: Münchner Komm AktG, § 76, Para. 82 f.; *Fleischer*, in: Handb. VorstandR, § 1, Para. 31; *Kuhner*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 2004, 33 (2), 244, 278; *Kort*, Die Aktiengesellschaft 2012, 57 (17), 605, 609.

[124] *Werder*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1998, 27 (1), 69, 79 and 89 f., in favor of shareholder interests and also concluding that the objective should be competitiveness on different fronts; similar *Spindler*, Unternehmensinteresse als Leitlinie des Vorstandshandelns – Berücksichtigung von Arbeitnehmerinteressen und Shareholder Value, 14 f. (October 12th 2008), URL: http://www.boeckler.de/pdf/mbf_gutachten_spindler_2008.pdf (last visited on February 15th 2016); *Kort*, Die Aktiengesellschaft 2012, 57 (17), 605, 606-610, tends to no priorization of any interest, or if anything a priorization of stakeholder interests; also *Müller*, FS Johannes Semler, 195, 209; clearly seeing the pursuit of the interest of the enterprise as the main goal is *Baums*, American Journal of Comparative Law 2005, 53 (1), 31, 32.

[125] *Mertens*, in: Kölner Komm AktG, § 76, Para. 22; *Schilling*, Betriebs-Berater 1997, 52 (8), 373, 377.

[126] *Mühlbert*, Die Aktiengesellschaft 2009, 54 (21), 766, 771, stating that it only shows the comission's understanding of the legal situation; *Mathieu*, Brooklyn Journal of International Law 2013, 38 (2), 579, 607, says the codex sets the corporate governance tone in Germany.

[127] *Ringleb*, in: DCGK, Para. 562 and 565.

discretion in how to manage the corporation and the enterprise also in terms of overall objectives.[128]

At the same time the question of an overall orientation of the laws regarding management is of little practical impact.[129] This is on the one hand due to the fact that the interests and thus also the responsibility of the management to consider them have a relation of practical concordance,[130] which means that long term all interests need to be considered to some degree to get the best result for all in the end. And on the other hand no court has ever rejected any management decisions, because of over- or under-considering the interest of share- or stakeholders.[131] It is also not likely that this ever will happen, since courts are not meant to make those types of (business) decisions.[132] In fact that is what a management is there for, i.e. to decide the overall business direction of the company. And if there is no overall binding law that explicitly obliges management to follow a share- or stakeholder orientation,[133] then it is only right to give management a very broad discretion in terms of decision-making.

3.2.2. Social conduct of management

Up next is the question if management is allowed to act in (purely) social interest and if it is where the limits to such conduct are. A duty for purely social conduct of management can only exist in cases of explicit statutory provisions.[134]

The social conduct of management, which is also discussed under the Corporate Social Responsibility (CSR) topic or terminology, gained more and more popularity and relevance in the last years, due to an increased usage and presence in the media of such behavior.[135] So did the question about the legitimacy and limits of such social conduct. Thus the most important justifications for social behavior of management will now be examined.

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[128] Again *Kuhner*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 2004, 33 (2), 244, 271.
[129] *Fleischer*, in: Handb. VorstandR, § 1, Para. 35.
[130] *Mertens*, in: Kölner Komm AktG, § 76, Para. 19.
[131] *Kuhner*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 2004, 33 (2), 244, 271.
[132] Regarding the problem of legal control of business decisions see also *Brinkmann,* Unternehmensinteresse und Unternehmensrechtsstruktur, 303.
[133] Also in favor of a clear regulation *Spindler*, Unternehmensinteresse als Leitlinie des Vorstandshandelns – Berücksichtigung von Arbeitnehmerinteressen und Shareholder Value, 20-22 (October 12th 2008), URL: http://www.boeckler.de/pdf/mbf_gutachten_spindler_2008.pdf (last visited on February 15th 2016)
[134] *Langenbucher,* Aktien- u. KapitalmarktR, § 1, Para. 15a; similar *Hefermehl*, AktG, § 76, Para. 21.
[135] *Mühlbert,* Die Aktiengesellschaft 2009, 54 (21), 766, 766 f..

3.2.2.1. Basic problem

The basic problem is that management is using money of the corporation for a type of activity that usually does not or only indirectly aim at profitability. Because of that, such activities need further justification.

If any social actions promise profits there really is no debate, as long as it does not violate any other rules. The so-called business case for CSR[136] will for that reason not be further explored since it does not need any further justification than its profitability and can in result not deliver any additional information regarding an overall share- or stakeholder orientation. A similar situation exists if the articles of incorporation specify the corporate purpose in that way.[137] Then management obviously is obliged to consider this in their decision-making.

3.2.2.2. Responsibility of a good corporate citizen?

A first way to justify social activities of corporation or rather its management evolves from the status of the corporation as a legal entity. The idea is that like any other good citizen with rights, corporations also have a responsibility towards society.[138] So they need to be allowed to act socially responsible, ergo so must be the management.[139]

The issue with this justification is mainly that the analogy between the corporation and the responsible citizen is misleading. Corporations only exist and only are legal entities to enable them to function as a vehicle for conducting business. So the purpose usually is business and not social conduct.[140] And if it is social conduct in exceptional cases, this will need to be put down in the articles of incorporation anyways, which eliminates the need for justification.

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[136] *Schreck*, in: Schneider/Schmidpeter (Publ.), Corporate Social Responsiblity, 67, 67.
[137] *Mühlbert*, Die Aktiengesellschaft 2009, 54 (21), 766, 772.
[138] *Fleischer*, Die Aktiengesellschaft 2001, 46 (4), 171, 174, explaining that thought, even though denying it as a justification for social conduct of management finally.
[139] *Mühlbert*, Die Aktiengesellschaft 2009, 54 (21), 766, 769, in the end also rejecting this justification.
[140] Id.

3.2.2.3. Article 14 Para. 2 German Constitution

The next line of justification is based on article 14 Para. 2 of the German Constitution.[141] Because (share-)property is also supposed to serve the public good,[142] the idea is that a corporation needs at least be able to, if not is required to, act socially responsible.[143]

There are a couple of problems with this idea of justification for social conduct of management. The issue with article 14 Para. 2 is that is does not contain any instructions to non-state actors but rather an instruction to the legislator to regulate.[144] In general the German Constitution does not give any instructions in terms of an overall economic system[145] and can thus never be used to justify any economic decision of the management[146]. So a possible justification would have to derive from any laws set by the legislator and not from the article itself.

3.2.2.4. Management's discretion

A way to actually justify social conduct of management is the managerial discretion.[147]
In general the German management has broad discretion how to manage the corporation and the enterprise.[148] That also goes for managerial social conduct.[149] So management is allowed to act socially responsible in the borders that § 93 Para. 1 Sent. 2 German Stock Corporation Act sets.[150] Social conduct can even be allowed if there are no direct profits to hope for.[151]

The problem remains control of this, due to the fact that actual cause-effect relationships are hard to judge in the case of social conduct. § 93 forbids actions that are detrimental to the

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[141] Art. 14 Para. 2 of the Basic Law for the Federal Republic of Germany as of December 23rd 2014, BGBl. 1949, 1: „Property entails obligations. Its use shall also serve the public good."
[142] See BVerfG March 1st 1979, BVerfGE 50, 290, 315 f..
[143] *Mühlbert*, Die Aktiengesellschaft 2009, 54 (21), 766, 769, describing this line of justification but also rejecting it afterwards; more in line with this justification is *Spindler*, in: Münchner Komm AktG, § 76, Para. 68.
[144] *Jarass*, in: Jarass GG, Art. 14, Para. 50; also *Papier*, in: Maunz/Dürig GG, Art. 14, Para. 305 f.; different *Wieland*, in: Dreier GG, Art. 14, Para. 107 f..
[145] BVerfG July 20th 1954, BVerfGE 4, 7, 17 f.; *Hofmann*, in: Schmidt-Bleibtreu/Hofmann/Henneke GG, Art. 14 Para. 6.
[146] *Fleischer*, Die Aktiengesellschaft 2001, 46 (4), 171, 175.
[147] *Bürgers/Israel*, in: Bürgers/Körber AktG, § 76, Para. 16.
[148] *Kuhner*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 2004, 33 (2), 244, 271.
[149] *Mertens*, in: Kölner Komm AktG, § 76, Para. 33.
[150] *Mühlbert*, Die Aktiengesellschaft 2009, 54 (21), 766, 772-774, examining such a justification in the borders of § 93.
[151] *Eckert*, in: Wachter AktG, § 76, Para. 14.

benefit of the company. But usually management will be able to justify social conduct in some way, even if it is just by saying the social esteem will be raised.[152] As a result there is no clear line[153] and whether or not a social action is justified needs to be examined from case to case[154]. Parameter for such an examination is the situation of the corporation in the broadest sense.[155] This includes the size of the corporation, its financial situation and so on.

At the end of the day it can be concluded that social conduct of management can be allowed depending on the individual case. Management has broad discretion in that regard but the limit is a business-related reasonableness.[156]

3.3. Other indicators of a share- or stakeholder orientation in German law

After examining the central indicator of an overall share- or stakeholder orientation of the German system, which is the legal situation of the corporate management, other laws will now also be checked for indications to such an orientation.

3.3.1. Codetermination

Another key indicator of an overall orientation is the German codetermination. This part will take a look at corporate codetermination and not operational codetermination that also exists in Germany and proceeds mainly in the form of works councils.[157]

3.3.1.1. How does it work?

German corporate codetermination is in large parts based on three acts. These are the German Codetermination Act[158], which applies to companies with more than 2000 employees, the German One-Third Participation Act[159], which applies to companies with less than 2000 but more than 500 employees and the German Coal, Iron and Steel Codetermination Act[160]. Even

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[152] *Mühlbert*, Die Aktiengesellschaft 2009, 54 (21), 766, 768.
[153] *Bürgers/Israel*, in: Bürgers/Körber AktG, § 76, Para. 16.
[154] *Fleischer*, Die Aktiengesellschaft 2001, 46 (4), 171, 175.
[155] *Mertens*, in: Kölner Komm AktG, § 76, Para. 33.
[156] *Seibt*, in: Schmidt/Lutter AktG, § 76, Para. 13.
[157] *Saenger*, GesellschaftsR, 1058.
[158] German Codetermination Act as of April 24th 2015, BGBl. 1976, 1153.
[159] German One-Third Participation Act as of April 24th 2015, BGBl. 2004, 974.
[160] German Coal, Iron and Steel Codetermination Act as of April 24th 2015, BGBl. 1951, 347.

though the procedure differs in detail, all of those acts require the respective corporations to let employees participate in a supervisory body.

According to the Codetermination Act one half of the supervisory board needs to be worker representatives whereas the other half needs to be shareholder representatives, resulting in parity on the board. This equality only has one exception. § 27 Para. 2 of the act allows the shareholders to elect the chairman, if the two-thirds majority for this election required by § 27 Para. 1 is not reached. And pursuant to § 29 Para. 2 the chairman has the decisive vote in the case of a tied vote in regular voting procedures.

The One-Third Participation Act obviously gives the worker representatives one-third of the supervisory board's seats, whereas the Coal, Iron and Steel Codetermination Act establishes parity on the board.

3.3.1.2. What does it imply?

Codetermination is a means to not only make the management consider stakeholder interests, but a rather direct way to make the worker interests felt in the decision-making process, due to the control function of the boards and the rights[161] that come with it. Thus it is a procedural way to involve the worker's interests in the consideration of the management[162] instead of requiring the management to do so by some legal rule in the material law.

In terms of an overall orientation the mere existence of such worker participation in a supervisory body shows a very clear stakeholder oriented system, even if the shareholders might have a tiny little bit more influence[163] in big corporations (meaning those with more than 2000 employees). Considering the fact that workers are certainly the most important and influential stakeholders and that there basically is parity on the supervisory boards of big corporations the stakeholder philosophy could merely be stated more explicit.

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[161] There is a wide range of rights from the appointment of managers (§ 84 German Stock Corporation Act) to setting executive compensation (§ 87 German Stock Corporation Act).
[162] See *Brinkmann*, Unternehmensinteresse und Unternehmensrechtsstruktur, 233.
[163] *Mühlbert*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 129, 153.

Additionally the initial debate about codetermination in Germany, in particular about the constitutionality of the Codetermination act, is pretty much over these days.[164] In its already mentioned decision regarding this constitutionality, the German Federal Constitutional Court stated social obligations of share property, due to the fact that this type of property has only limited influence on the private sphere of individuals.[165] Considering this decision and the virtually ended debate, this also points to a broad acceptance not only of the codetermination but also of a however described stakeholder idea in general.[166]

3.3.2. Executive compensation

A quick look at executive compensation can give additional information about the orientation of the German system.

The last major legislative change was the enactment of the Act on the appropriateness of the Management Board Remuneration in 2009.[167] Objectives of this act were to improve the control of the supervisory board, increase transparency of the compensation and make corporate management pursue sustainable economic growth through specific compensation packages.[168]

Today the key provision in terms of executive compensation in Germany is § 87 of the Stock Corporation Act. Together with part 4.2 of the Corporate Governance Codex it provides the regulatory framework for executive compensation in Germany.

In very short they state the standards that the supervisory board has to consider in regard to setting executive compensation. So for example the compensation must be reasonable in different respects and aimed at sustainable development of the business.[169]

The long-term sustainable growth goal and the prominent role of the supervisory board again point to a broader consideration of interests. In that regard executive compensation is even a very good example how codetermination ensures stakeholder participation, meaning through

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164 *Hopt*, International Review of Law and Economics 1994, 14 (2), 203, 205 f..

165 BVerfG March 1st 1979, BVerfGE 50, 290, 315 f..

166 *Hansen/Bode/Moosmayer*, Zeitschrift für Wirtschafts- und Unternehmensethik 2004, 5 (3), 242, 248, think that stakeholder involvement is just a given thing and that this is why the explicit strategic stakeholder theory is not as important in Germany.

167 Act on the appropriateness of the Management Board Remuneration BGBl. 2009, 2479.

168 *Mathieu*, Brooklyn Journal of International Law 2013, 38 (2), 579, 615 f..

169 *Langenbucher*, Aktien- u. KaptialmarktR, § 4, Para 30 f..

extensive controlling rights of the supervisory board, which is partly filled with stakeholder (worker) representatives.

Still a fair amount of the compensation can also be performance-based, variable compensation e.g. based on stock option programs. One reason for that obviously is to set incentives for the management, but it also clearly aligns management's with shareholder's interests.[170] Thus the German executive compensation system also significantly considers shareholder interest.[171]

3.3.3. Non-corporate law

Outside of the corporate (and capital market) law basically no indications for a shareholder orientation can be found, whereas indications for a broader consideration of interest on the other hand can be found all over the German law, e.g. environmental protection regulation, over protective provisions in contract law, to a (arguably) worker friendly labor law.

Due to limited room the specific provisions cannot be examined here, but it is still possible to identify a very stakeholder friendly overall picture. The German legal system does not only (maybe not even primarily) protect the stakeholders through corporate law regulation, but rather through other specific laws.[172]

3.4. Share- or Stakeholder capitalism in Germany?

The German (corporate) legal system can clearly not be described as shareholder centric. Neither is the management obliged to follow some kind of shareholder primacy rule, nor does the other legal framework ensure such primacy.

What characterizes the German system is not any explicit rule that requires management to follow the strategic stakeholder approach in the sense of *Freeman*[173],[174] but rather other

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170 *Ulmer*, Archiv für die civilistische Praxis 2002, 202 (2), 143, 158 f..
171 *Höpner*, Wer beherrscht die Unternehmen?, 55
172 See *Busse v. Colbe*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 1997, 26 (2), 271, 289; *Ulmer*, Archiv für die civilistische Praxis 2002, 202 (2), 143, 158; also *Fifka*, UmweltWirtschaftsForum 2013, 21 (1), 113, 117, who stresses the role of the legislator in Germanys stakeholder orientation.
173 *Freeman*, Strategic Management.
174 *Spindler*, Unternehmensinteresse als Leitlinie des Vorstandshandelns – Berücksichtigung von Arbeitnehmerinteressen und Shareholder Value, 20-22 (October 12th 2008), URL: http://www.boeckler.de/pdf/mbf_gutachten_spindler_2008.pdf (last visited on February 15th 2016), sees this as

regulation that makes sure the stakeholder interests are considered in some way, with codetermination being the clearest example for this. Management is only able to manage the corporation with consensus of the other influential stakeholder groups.[175] I.e. regulation ensures that management cannot make substantial decision unilateral, so essentially power within the corporation is split up.[176] Because other regulation plays such a huge role in the German stakeholder orientation, the system is also characterized by more state intervention.[177] In Germany it is broadly accepted that there is more to a corporation than just a legal entity owned by the shareholders, otherwise the concept of the interest of the enterprise would not be so omnipresent.[178]

To conclude: the German legal system is not shareholder capitalistic. It must be described as stakeholder capitalistic, which does not mean that the managerial stakeholder theory characterizes the system, but rather that a literal multi-interest consideration does, which is mainly implemented by broad regulation ensuring the consideration of stakeholder interests.

3.5. Outlook

The most important trends that will most likely influence the orientation of the German system in the future are progressive internationalization of national capital markets, [179] the increased importance of such markets and institutional investors.

Corporations are not primarily relying on bank financing anymore, but are rather making a move towards the (international) capital markets.[180] Still the costs of capital are relatively high in Germany[181] at least partially due to a lack of focus on creating shareholder value. Thus this increased competition for investors puts pressure on German corporations to meet their demands[182] and focus more on the creation of shareholder value.[183]

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the reason why a clear guideline would be necessary if the legislator wanted to ensure that management explicitly has to consider stakeholder interest in everyday decision-making, besides the rest of the stakeholder friendly regulation.

[175] *Cheffins*, American Journal of Comparative Law 2001, 49 (3), 497, 501.
[176] *Vitols*, Competition & Change 2004, 8 (4), 357, 359.
[177] *Cheffins*, American Journal of Comparative Law 2001, 49 (3), 497, 501.
[178] *Hansen/Bode/Moosmayer*, Zeitschrift für Wirtschafts- und Unternehmensethik 2004, 5 (3), 242, 248; also see the diagram in *Allen/Carletti/Marques*, ECGI - Finance Working Paper No. 190/2007, 35.
[179] *Ernst/Seibert/Stuckert*, KonTraG KapAEG StückAG EuroEG, 1.
[180] *Cheffins*, American Journal of Comparative Law 2001, 49 (3), 497, 501.
[181] *Lewis*, Steigerung d. Unternehmenswertes, 15 f..
[182] *Cheffins*, American Journal of Comparative Law 2001, 49 (3), 497, 505.
[183] *Kuhner*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 2004, 33 (2), 244, 273.

Still the block holding has not changed much[184] and there are also no major changes on the most important elements of the German stakeholder oriented system, such as codetermination, foreseeable in the near future. Therefore it is highly unlikely that the stakeholder orientation will be completely dropped any time soon. Nonetheless corporations, and in this regard this means the management and also all the stakeholders,[185] will have to focus more on the shareholder needs to not fall behind in the competition for investors. [186]

[184] *Gelter*, NYU Journal of Law & Business 2011, 7 (2), 641, 727.
[185] *Vitols*, Competition & Change 2004, 8 (4), 357, 368, calls this negotiated shareholder value due to the fact, that the management has to negotiate an increased shareholder orientation with the powerful stakeholder, instead of just shifting the focus from above.
[186] *Vitols*, Competition & Change 2004, 8 (4), 357, 372.

4. Shareholder v stakeholder capitalism in the US

4.1. Introduction

This Part discusses the American (corporate) legal system and it will shed more light on one of the most important debates in modern corporate governance; in particular, it will examine the debatable relationship between shareholders and stockholders' interests in the corporate arena.

Nowadays, there are many principles, concepts and terms shaping the management of organizations[187]. Examining the success of the companies and their governance, its interpretation is based on terms of profit like shareholder value and return on equity. These two parts constitute some of the most basic elements on which shareholder capitalism is based on. In addition, since the introduction of business ethics into the managerial scene, firms have set as their goals the satisfaction of the relationship between corporate social responsibility and shareholder value. Stemming from the latter goal though, stakeholder value approach makes its appearance giving rise to many questions regarding the priorities that management should set. That is the main reason why uncertainty in most of corporate managers' decisions making exists making it even harder for them to decide. Despite their efforts to reach to a successful and viable decision, social sciences did not succeed to find an answer to the current uncertainty and the debate between shareholders and stakeholders' capitalism is at the center of attention for many years now in many European counties as well as in the US.

In particular, the analysis of the differences between shareholders and stakeholders' rights in the USA helps to distinguish these two conflicting groups adopting these ideas. On the one hand, there are those who share normative doubts regarding shareholder value, and argue in favor of stakeholder value, according to which there should be a balance of stakeholder's interests before any decision is made by the managers[188]. On the other hand, those who advocate in favor of shareholder value, argue that in a free market economy and entrepreneurship, shareholder value is the key for the successful growth of the firm. What really intriguers though academics' attention is the potential impact of shareholder democracy

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[187] *See* Martin Gelter, *The Dark Side of Shareholder Influence*, 50 HARV. INT'L L.J. 129, 129 (2009).
[187] *See, e.g.*, Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795 (1993).
[188] *Id*.

on corporate stakeholders such as creditors, the environment, the employees and the local communities[189].

In order to further understand USA's position on the debate between shareholders and stakeholders' interests, Part 4.2 of the paper first discusses the two approaches clarifying the important elements of these two theories. Then, Part 4.3. sheds more light on shareholders' influence in practice, under the prism of directors' behavior towards the stakeholders, aiming to clarify stakeholder's notion under American corporate law. Later on, Part 4.4.initially discusses the managerial role of the board under American law in cases where a) a manager is insulated; b) there is a large ownership and control, setting the foundations for the understanding of directors' constituencies taking a decision. Finally Part 4.5. discusses whether American law could accept stakeholders in its current corporations' needs by examining codetermination matters as well as the newly introduced notion of "*benefit corporations*".

4.2. Development of shareholder's and stakeholder's approaches in the US

4.2.1. Evolution of shareholder approach

Aiming to the further development of the "a firm's theory", shareholders' approach seems to be the predominant one in the USA. In particular, this approach is based initially on the concept of private property. As J. Locke argued[190], shareholder approach constitutes the starting point of the socially defined property rights from where the theory of the firm is further developed. At the same time, under the prism of contract theory, *Speckbacher*[191] argues that shareholder approach makes its appearance under the assumption that a complete social contract does exist defining the responsibilities of the property rights. That can be interpreted in a way according to which this approach prioritizes property rights' owners and their willingness to make use of their assets. Owning the asset means that they can use it however they want; for instance, they could invest it in a firm. This is a common approach, where many people tend to decide to invest in a single firm known as a model of pooling private property. Under this approach, many owners decide to put their rights commonly in a

[189] *Id*.
[190] *See* Locke, J, , *Zwei Abhandlungen über die Regierung* (2002).
[191] *See* Speckbacher, G, *Shareholder-Value und Stakeholder Ansatz*, Die etriebswirtschaft 57, 630–639 (1997).

place of resources, everything being placed under central control, as it is described in the certificate of incorporation of the company[192].

Nevertheless, the theory of the firm brought to the surface several questions and especially the assumption inspired by private property rights which results in a number of implications. The most important one though aims at defining even more shareholders' approach. Shareholder approach focuses more on the interaction and the relations created between the individual owners and the assets. However, as long as the assets are gathered in the firm, there are a couple of questions, such as: "under which principle should the assets be gathered?" and "who will be in total control of all the gathered assets?" The most dominant approach is that investors remain still the owners of the gathered assets having as a result their common ownership of these assets. Nothing really obliges under the private property rights the owners of these assets to restrict their decision making power and be guided only by the satisfaction of their personal interests. Thus, the firm tends to adopt specific tactics according to which, the assembled assets of the company are used (as it is specified by the law), in a way that the interests of its owners are truly satisfied, in other words, the interests of its shareholders[193].

4.2.1.1. Separation of ownership and effects on shareholders' approach

Nowadays though, many corporations are managed by professional managers hired by their owners and no longer by the owners themselves. As Berle and Means[194] argued, a clear separation of ownership and control has started to establish itself. Since private property started to lose its prolonged acceptance throughout the years, new problems have started to concern corporations though. The interests of the corporations' managers and the interests of their shareholders have started to diverge systematically. Starting from the analysis made by classical economists like Adam Smith[195] to the ones made by modern scholars, this situation is identified as a principal agent problem[196]. Today, this can be justified under the prism of three systematic reasons: a) management is better informed whenever a successful business

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[192] *See* Coleman, J.S., Foundations of Social Theory (Cambridge) (1990).

[193] *See* Anant K. Sundaram & Andrew C. Inkpen, *The Corporate Objective Revisited,* IS ORG. SCI.·350, 353 (2004).

[194] *See* John H. Matheson & Brent A. Olson, *Corporate Law and the Long term Shareholder Model o f Corporate Governance*, 76 MINN. L. REv. 1313, 1326 (1992).

[195] *See* Smith, Adam. *Wealth of Nations,* edited by C. J. Bullock. Vol. X. The Harvard Classics. New York: P.F. Collier & Son, 1909–14.

[196] *See* Jensen, M.C. and W.H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structures", Journal of Financial Economics 3, (1976) at 305–360.

strategy plan is implemented (hidden information problem); b) shareholders' actions can be hidden (partly) by management (hidden action problem) and c) managers are given great flexibility in order to decide in a continuous modified environment, a very beneficial decision for the firm[197]. Under contract theory's perspective, the agent-principal contract between the manager and the owners is not complete[198]. This openness of the contracts could result in shifting corporation's focus on from satisfying the interests of its stakeholders to the interests of its shareholders. Thus, among shareholders' goals could be to establish institutional arrangements based on which managers' and their own interest harmonize.

4.2.2. Evolution of stakeholder approach

The role of stakeholders has always been a debatable topic in the US and especially whenever it was contrasted against shareholder's interests. *Bainbridge* has been one of those who took a position against a more shareholders' controlling position, arguing that is not absolutely essential to adopt a position where shareholders and stakeholders' will be evaluated in a heterogeneous way. Similar decision making does not always lead to a better management[199]. Therefore, any expansion of shareholder influence over corporate decision-makers and decision making is not the optimal solution since that would affect the discretion of the board negatively.

4.2.2.1. Directors accountable to everyone?

There are also other voices criticizing shareholders' tolerance to accept the importance of satisfying stakeholders' interests first, arguing that this could encourage the directors to defend only a certain amount of shareholders' or stakeholders' interests instead of the whole class of shareholders[200]. Analyzing that situation it becomes clear that if directors are considered as being accountable to everyone, that would affect their managerial and supervisory efficiency[201]. In particular, directors would be distracted and instead of satisfying

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[197] *See* Williamson, O.E.: 1963, "Managerial Discretion and Business Behavior", American Economic Review 53, 1032–1057.
[198] *Id*.
[199] *See* Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006).
[200] *See* Martin Lipton & Steven A. Rosenblum, *Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come*, 59 BUS. LAW. 67 (2003).
[201] *See* Stephen M. Bainbridge *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 576 (2003) at 608-615.

shareholders' wealth would end up defending stakeholders' rights. However, to the extent that institutional investors are understood to use their influence in order to promote their own interests, sometimes even to the detriment of the beneficiaries, directors' intervention is considered more than necessary. The economic value of the company is preserved and any depreciation or investors' evaluation is avoided[202]. Therefore, someone can argue that when stakeholders' interests are set at the centre of attention then instead of advancing company and shareholders' profits, only the opposite to the desired results are achieved.

4.2.2.2. Why should shareholders not be given absolute power?

Towards the same direction, those being skeptical about shareholders' absolute power, advocate in favor of a more stakeholders' oriented behavior. However, they notice that both officers and directors are well equipped with the necessary legal tools to supervise the stakeholders efficiently under the current legal regime[203]. Hence, stakeholders' position is encouraged to be supported by shareholders as well. Moreover, it is argued that in cases where management is insulated from shareholder control, that could be beneficial to shareholders ex ante. These decisions could encourage stakeholders to invest in the firm without having any second thoughts or fearing that shareholders will have company's value transferred ex post[204]. Nevertheless, these opportunities can be only made available to the stakeholders, if shareholders are not in full control over the management. As Mitchell argues, the role of the board should be focusing on safeguarding corporation's interests as a whole. Moreover, he notes that shareholders' continuous dominant position in the management of the company could result in weakening management's attention over the employers of the company and the rest of the stakeholders[205]. Briefly, if the company overpowers its shareholders' profit oriented value that would have inevitably negative effects on stakeholders' interests, ending up on hurting even the company's future.

4.2.2.3. Risks of giving excessive powers to investors

[202] *See* Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601 (2006).
[203] *See* Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of the Corporation,* 85 VA. L. REV. 247, 310–12 (1999).
[204] *See* Margaret Blair & Lynn Stout, *A Team Production Theory of Corporate Law,* 85 VA. L. REV. 247 (1999) at 304–05.
[205] *See, e.g.*, Lawrence Mitchell, *The Board as a Path to Corporate Social Responsibility*, *in* THE NEW CORPORATE ACCOUNTABILITY 207, 283 (Doreen McBarnet et al., eds. 2007).

At the same time, other voices point out different risks and dangers whenever investors are given excessive power. Powerful investors tend to use their power in order to impose their interests either by directing company's value toward opportunistic shareholders coalitions or by manipulating corporate constituencies or by aligning with managerial boards holding unfavorable position against non-shareholders[206]. In the 1990s many criticisms related to public pension funds were raised noting that many pension funds used their influence affecting negatively corporation's and shareholders' interests[207].

Overall, the management of a firm can be viewed as a trustee of all stakeholders that does not present opposed interests to those of the shareholders but is committed to balance the interests of the stakeholders in their decisions. Various reforms have been suggested by social institutions so as to accomplish some of the following goals: stakeholders' participation in a company's decision, promotion of dialogs among the stakeholders and the board, proposal of legislation that could strengthen stakeholders' position in the company etc[208]. Nevertheless, shareholders' primacy in the US is still the dominant notion.

4.3. Shareholders primacy in the USA (the traditional view)

4.3.1. Understanding of the norm of "shareholder primacy"

Shareholders' primacy's concept is the notion that mainly describes corporate governance in the USA. The origin of the norm can be found back in the 1930's and especially in the classic debate between Adolf Berle and Merrick Dodd. In particular, Berle's[209] argument was based on the conception of shareholders as owners of the corporation and thus, directors owned their fidelity to the shareholders of the company. The main purpose of this view is to show that the main goal of the corporation is the maximization of shareholders' wealth. On the other hand, Merle's[210] argument was based on the idea that managers should expand their obligations to a wider set of beneficiaries. Overall, both Dodd and Berle, through their arguments, clarified managers' obligations to their shareholders, separating them from those to the other

[206] *See* Martin Gelter, *The Dark Side of Shareholder Influence*, 50 HARV. INT'L L.J. 129, 129 (2009).
[207] *See* Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795 (1993).
[208] *Id.*
[209] *See* Adolf Berle, *Corporate.Powers as Powers in Trust,44* HARV. L. REv. 1049, 1074 (1931).
[210] Merrick Dodd, *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REv. 1145, 1156 (1932).

stakeholders, acknowledging at the same time the importance of considering other stakeholder interests as well[211].

4.3.1.1. Shareholder's primacy: shareholders at the center of attention

Initially though, based on Friedman's theory, business' only social responsibility is to increase its earnings as long as this is happening in a free and open competition, without any fraud and deception[212]. In its strongest form, the interpretation of shareholder's supremacy on non-shareholders, and especially when focusing on social philanthropy or any other similar activities ends up in reducing shareholders' profitability, a situation that cannot be considered as permissible. Such activities do not promote company's ability to further increase its profitability and thus instead of maximizing shareholders' earnings, they reduce them. Under US perspective, these activities could only be considered as "*big good investments*" to the extent that in the long run they generate profit for the shareholders[213].

That does not mean though that stakeholders do not participate at all in a world where shareholder primacy is praised that much. Based on the law and economics argument, social welfare is better achieved whenever the managers of the corporation adopt a policy which holds them responsible only while trying to secure shareholders' interests[214]. Towards the same direction someone could argue that by trying to satisfy shareholders' interests and thus maximize their wealth that could result in a better satisfaction of the public. Not only the payment of the taxes is better achieved but also goods and services are better provided and more employees are hired[215].

By accepting shareholder influence, someone can argue that it is the direct or implicit influence that shareholders have on management's decision making roles within legitimate business judgment. Shareholder influence though should not be misunderstood and perceived as shareholders' protection against illicit activities. Whenever illicit actions are committed either by controlling shareholders or managers these constitute parts of a different subject and

[211] *See* Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 648 (2006).
[212] *See* Milton Friedman, *The Social Responsibility of Business Is to Increase its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 32, 126.
[213] *Id.* 61, at 135.
[214] *See* Henry Hansmaan & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 450, 468 (2001) at 441.
[215] *Id*.

are related more to agency problems in large corporations[216]. This distinction between the above mentioned directors' decisions refers roughly to the division between the duties of care and duties of loyalty[217] under US corporate law[218] under which directors are subject to[219].

4.3.1.2. Shareholder's primacy: the norm started to differentiate

As it was discussed just above in the *development of shareholder's approach*, directors and managers focus mainly on the idea that their goal is the maximization of shareholders value[220]. Nevertheless, *shareholder primacy norm* has really started to be questioned about its effectiveness. For instance, based on Gordon Smith's approach the very well known argument of shareholder primacy used in *Dodge v. Ford Motor Co.*[221] and even in previous case law, that argument was not really used in order to clarify stakeholder-shareholders conflicts but its main use was to stabilize any conflicting interests between minority investors and controlling shareholders[222].

Most of the States in the USA have adopted constituency statutes based on which directors are allowed or required to take seriously into consideration employees' interests, especially as a an answer to hostile takeovers[223]. In some states, and mainly in Delaware, takeover case law has introduced the idea that others' interests and not only of the shareholders' should be taken into account by the directors. In particular, customers, various creditors, employees and sometimes even the community in generally do have an impact on corporations' constituencies[224].

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[216] *See* Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *The Law and Economics of Self-Dealing,* 88 J, FIN. ECON. 430 (2008).
[217] *See* Melvin A. Eisenberg, *The Duty of Good Faith in American Corporate Law,* 3 EUR. COMPANY & FIN. L. REV. 1, 14 (2006); *See* Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403, 427 (2001).
[218] In particular, the duty of loyalty, it is more related to self-dealing transactions at its core, and demands that a director acts towards the corporation fairly whenever he is self interested. Going a little bit further, this duty could also apply to controlling shareholders as well (Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)). As a general rule, the duty of loyalty is used mainly by the courts in cases where corporate assets are misappropriated by large shareholders, directors or managers for the satisfaction of the owner's benefit.
[219] *See* William T. Allen, Reinier Kraakman & Guhan Subramanian, Commentaries and Cases on the Law and of Business Organizations 241 (2d ed. 2007).
[220] Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919).
[221] *Id*.
[222] *See* D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277 (1998).
[223] Jonathan D. Springer, *Corporate Constituency Statutes: Hollow Hopes and High Fears,* 1999 ANN. SuRv. Am. L. 85, 125-28 (1999).
[224] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985); *See* Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 VA. L. & Bus. REv. 163 (2008).

Briefly, as long as managers' actions are not based on unlawful decisions, they can act and make decisions with great discretion on business related questions[225]. Top management is responsible for taking fundamental decisions of the firm as well as daily based ones, although for the most significant ones shareholders' approval is strongly desired[226].

4.3.1.3. Implicit and explicit shareholder influence

Within what is considered business judgment, shareholder influence can be produced in various ways. Nevertheless, there are two big categories under which shareholder influence can be interpreted. On the one hand there is the implicit shareholder influence and on the other, the explicit one. In particular, implicit shareholder influence is based on the institutional framework that may provoke managers to decide as if the business was directed by the shareholders. This could be the result of market driven mechanisms that implicitly push managers to satisfy shareholders' interests[227]. Implicit influence is viewed as being more important in dispersed ownership. In this case, shareholder influence focuses more on analyzing those institutional factors that determine whether managers were incentivized or forced to satisfy shareholder interests within the allowances described by corporate law[228]. Explicit influence exists when the shareholders directly intervene into management. This kind of influence is strongly met not only by controlling shareholders but also by large shareholders who could eventually influence dramatically company's business decisions. Concentrated ownership reflects mainly the ways that this influence is used.

4.3.2. "Stakeholders" interests in US corporate law

As it has been discussed above, the interests of corporate stakeholders sometimes are aligned and sometimes not with those of the shareholders'. In many corporate decisions, someone could notice a significant conflict between the interests of various stakeholders and at the end a decision that would benefit certain shareholders would certainly harm the interests of the others.

[225] *See* Mark J. Roe, *On Sacrificing Profits in the Public Interest, in* ENVIRONMENTAL PROTECTION AND THE SOCIAL RESPONSIBILITY OF FIRMS 88, 88, 90-91
[226] *Id.*
[227] *See* Dirk A. Zetzsche, *An Ethical Theory of Corporate Governance History* 23 (Ctr. for Bus. & Corp. Law, Working Paper No. 0026, 2007), at 17-21.
[228] *See* John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1, 3 (2001).

Empirical research has showed that many existing corporate rules have already focused on giving an answer to intra-corporations' structure conflicts. Starting from takeover regulation, to officer liability, scope of director, executive compensation and board structure, all these areas have pointed out a possible effect on wealth transfer, between stakeholders. Nevertheless, the decision to reach to a fair evaluation of these roles under the prism of shareholder wealth asks for normative justification. In particular, a justification that could really argue the importance of working in favor of shareholder interests to the detriment of other stakeholders[229].

A huge dilemma confronting management is its identification of the appropriate constituency to choose between either adopting anti-takeover devices or start evaluating a tender offer[230]. In a corporate control context, directors find themselves facing their traditional fiduciary duty to their shareholders to maximize the shareholder value[231]. Nevertheless, directors cannot focus only on satisfying shareholders' interests since they have a duty to the corporation as a whole, in other words, to the "stakeholders", considering that their lives are directly influenced by the corporation.

The theory of "stakeholder" interests in a company is not a new concept for US case law. For instance, in Revlon[232]the Delaware Supreme Court held that in the context of a tender offer, a board of directors might be warranted to take into account the interests in addition to those of the stakeholder; in other words, the interests of the note holders[233]. Even though, someone would argue that the language in Revlon was dicta by the court and nothing else had ever been noted in another Delaware Supreme Court case, an investor was given the chance to file a certificate of incorporation now in Delaware which would adopt a "beneficial" purpose and the Secretary of State's Office would not deny that filing. Nevertheless, since Delaware never adopted a "constituency" statute, someone would very simply ask: "what duties would be owed to the creditors, the environment, the employees and the community?

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[229] See Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 648 (2006).
[230] *See* Feinberg, *The Directors' New Dilemma in the Takeover Crisis: A Special Report*, INSTITTIONAL INVESTOR,June, (1987), at 30.
[231] *See, e.g.,* Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).
[232] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182-84 (Del. 1986).
[233] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

Under common Delaware law, it would be clear that this certificate would not be able to create any fiduciary duties but only to the shareholders. The real question is whether the purpose clause has such a broad character in order to proceed in the creation of further beneficiary rights (third-party beneficiary rights) in the "constituencies" found therein. An additional issue would have been the actual application of the business judgment rule[234] to the decisions made by Delaware directors, since the certificate has broadened the scope of stakeholders.

4.4. Management of the company and directors' constituencies

4.4.1. Directors' influence on decision making process

Neither directors nor managers are obliged to satisfy the interests of employees and of the other stakeholders, since their interests most of the times do not coincide with these groups[235]. Nevertheless, supporters' of production theory argued that it is directors' obligation to satisfy any corporate constituents successfully as a trade in order to safeguard their jobs[236]. At the same time any social norms which are further enforced by legislation, manage to further persuade both managers and directors not to engage in self dealing but to strive for loyalty and fairness protecting company's constituents[237]. At this point someone would argue that directors often decide being driven by a narrow interpretation of the economical rational especially whenever they have to build relationships of trustworthiness with stakeholders wanting to enhance the common objectives of the corporate coalition[238].

However, the social norms argument does seem to be an ambiguous reality. Sometimes positions which would be in favor of a social norm for short term stockholder value could be found responsible for a corporate scandal. This is actually the case since there is not any

[234] The crucial delineation defining the duty of care is the business judgment rule (hereinafter "*BJR*"). Under this rule, directors are given enough flexibility in order to make all the daily decisions as long as: a) before they decide they gather all the necessary information, b) they act in good faith and c) they keep a distance from self-interest decisions. According to section 102(b)(7) of the Delaware General Corporation Law (hereinafter "DGCL") firms are even allowed to preclude liability whenever the duty of care is violated; as a result most of the corporations in Delaware adopted this provision.

[235] *See* Lucian A. Bebchuk, *The Myth of the Shareholder Franchise,* 93 VA. L. REV. 675 (2007). at 909-11.

[236] *See* Margaret Blair & Lynn Stout, *A Team Production Theory of Corporate Law,* 85 VA. L. REV. 247 (1999) at 315.

[237] *Id.* at 315-16.

[238] *See* Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403, 427 (2001). at 438-41.

uniformity regarding the quality of the social norms that prevail at the end[239]. Nevertheless, for some this could be only the result of the non compatibility of a team production and an implicit shareholder influence approach[240]. According to the results of recent studies, entrenched management has been related to lower shareholder wealth whereas takeovers are associated with lower in variables decreases in wages[241]. While antitakeover statutes seem to be related with higher payments[242], takeover defenses tend to be associated with lower cost of debt; hence, creditors are found in an advantageous position[243]. Other recent studies have proven as well that worker satisfaction and enhanced corporate social performance are closely connected to managerial entrenchment[244].

Based on behavioral theory's results, someone could argue that when managers are not under pressure, then their decisions do not really focus on maximizing profits. Their attention is attracted more by their willingness to determine the best payoff methods that the providers of equity would accept[245]. It is a general rule that outside shareholders cannot verify corporation's profits. Thus, this information is attempted to be fully disclosed to the shareholders[246]. Since managers have a strong preference not to provoke their shareholders by choosing the non-disclosure of plant closings, that results in benefiting employees' interests[247].

A strong preference for continuation of firm's operations without any substantial modifications could also make indirectly reference to union competition and avoidance of job cuts. Under certain occasions though, during a hostile takeover for instance, top management and employees end up to be on the opposite sites[248]. One can argue though that by insulating the managers, the agency problem related to shareholders is exacerbated. Except from the

[239] *See* William W. Bratton, *Enron and the Dark Side of Shareholder Value,* 76 TL. L. REV. 1275, 1357 (2002).
[240] *See* Firey Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers,* 69 U. CHI. L. REV. 973, 1013-16 (2002). at 99-100.
[241] *See* Frank R. Lichtenberg & Donald Siegel, *The Effect of Ownership Changes on the Employment and Wages of Central Office and Other Personnel,* 33 J. L. & ECON. 383 (1990).
[242] *See* Marianne Bertrand & Sendhil Mullainathan, *Enjoying the Quiet Life? Corporate Governance and Managerial Preferences,* 111 J. POL. ECON. 1043 (2003).
[243] *See* Martin Gelter, *The Dark Side of Shareholder Influence*, 50 HARV. INT'L L.J. 129, 129 (2009) 153.
[244] *See* Jordi Surroca & Josep A. Trib6, *Managerial Entrenchment and Corporate Social Performance,* 36 J. Bus. FIN. & ACCT. 748 (2008).
[245] *See* JESSE H. CHOPER, JOHN C. COFFEE, JR. & RONALD J. GILSON, CASES AND MATERIALS ON CORPORATIONS 30-31 (7th ed. 2004).
[246] *See* M. Pagano & P.F. Volpin, *Managers, Workers, and Corporate Control,* 60 J. FIN. 841, 842 (2005).
[247] *See* Martin Gelter, *The Dark Side of Shareholder Influence*, 50 HARV. INT'L L.J. 129, 129 (2009).
[248] *See* Martin Hellwig, *On the Economics and Politics of Corporate Finance and Corporate Control, in* CORPORATE GOVERNANCE: THEORETICAL AND EMPIRICAL PERSPECTIVES 95, 122-25.

managers themselves, nobody else is benefited from illicit managerial self-dealing. Conducts like these are typically within the duty of loyalty. Moreover, another potential problem which makes its appearance quite often is the employees and managers' insufficient effort. Thus, any efforts aiming at creating an optimal corporate governance regime are supposed to be viewed as an attempt of achieving the right balance between the minimization of any holdup costs and agency costs.

4.4.2. Large ownership and control

Many researchers have shown that large shareholders facilitate holdups of non shareholders constituencies[249]. On the other hand, others may argue, and especially in Europe, that in long-term periods, specific investments agreed by managers or any implicit contractual relationships can be facilitated by big financial investors or by various other shareholder constituencies[250].

The argument that large shareholders can really contribute to the alleviation of holdup problems seems to be quite doubtful. At the same time, it is widely accepted that in control oriented financial markets, large shareholders tend to keep for a significant period of time their shares[251], the fact that a large shareholder exist does not really facilitate any specific investment. Although, that would create the assumption that there is always a threat of hostile takeovers, however, that is not the case today in the USA. It is known that employees, stakeholders and managers are protected by hostile takeovers by big shareholders under concentrated ownership. Nevertheless, many would argue that there are two main reasons according to which a holdup occurs. First, financial benefits can be offered to large shareholders themselves. Second, large shareholders who do not show any interest in ex post opportunistic sales to third parties, even in cases where they not willing to keep stakeholders themselves waiting.

Regarding managers, economic theory explains that specific investment is not encouraged in cases of concentrated ownership since managers only keep their place in the corporation at the

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[249] *See* Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737, 758 (1997) at 758.
[250] *See* Julian Franks & Colin Mayer, *Ownership and Control in Europe,* in 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 722, 728-29.
[251] *See* William W. Bratron & Joseph A. McCahery, *Comparative Corporate Governance and Barriers to Global Cross Reference,* in CORPORATE GOVERNANCE REGIMES 23, 27 (Joseph A. McCahery et at. eds., 2002). at 26.

whim of the dominant coalition or shareholder. Burkart, Gromb & Panuzi explain the tradeoff that exists between managerial initiative, which is initiated by block holders, on the one hand and on the other hand, reduction of agency cost proposed by large shareholders, simply by monitoring it. It becomes obvious then that managerial initiative, viewed initially as directly invested, is not chosen ex ante by the managers, if they do not get any guarantee that they will be able to keep the control of the company ex post regardless the existence of a block holder[252].

The same reasoning goes to employees as well, where in case there is a controlling or a large shareholder, they cannot resist not to be part of a holdup[253]. In order to further understand that position, someone should think of a controlling shareholder with absolute control of corporation's business decisions and a fully entrenched director who is not subject to implicit or explicit shareholder influence, both having in mind to increase profits by threatening employees[254].

From what it was discussed above, the established manager's interest may to some degree coincide with the interests of the employees. The same conditions may apply to the controlling shareholder of the corporation if that person truly has under his control the management of the firm. Nevertheless, although an established manager does have personal benefit from any existing holdup in the firm, the controlling shareholder is the one that is really benefited[255]. Therefore, someone could argue that a controlling shareholder would be more willing to expropriate non-shareholder constituencies rather than a non-controlling one. Most of the incentives as a result of the implicit shareholder influence manager's incentives are different[256].

Moreover, the difficulty of selling in a firm publicly held a large share is one of the main reasons why specific investment may be facilitated by concentrated ownership[257].Analyzing

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[252] *See* Mike Burkart, Denis Gromb & Fausto Panunzi, *Large Shareholders, Monitoring, and the Value of the Firm*, 112 Q. J. Econ. 693, 693-94 (1997).
[253] *See* Mike Burkart, Denis Gromb & Fausto Panunzi, *Large Shareholders, Monitoring, and the Value of the Firm*, 112 Q. J. EcoN. 693, 693-94 (1997) at 702.
[254] *Id.*
[255] *See* Martin Gelter, *The Dark Side of Shareholder Influence*, 50 HARV. INT'L L.J. 129, 129 (2009) 166.
[256] That is the case mainly when there is the threat of a hostile takeover where the shareholders' interests may align with managerial incentives.
[257] *See* Ruth V. Aguilera & Gregory Jackson, *The Cross-National Diversity of Corporate Governance: Dimensions and Determinants*, 28 ACAD. MGMT. REV. 447, (2003) at 451.

shareholders' behavior showing fear for holdup, the counterpart is a voluntary sale of control action to hostile takeover in a controlled corporation[258]. Contrary to what is happening in hostile takeovers, managers under concentrated ownership find themselves under a continuous control under dominant shareholders and thus sales are unlikely to change[259]. Nevertheless, matters concerning specific investment, stakeholders' incentives may be influenced[260]. Overall, the protection of stakeholders is examined under the prism on whether the dominant shareholder is: a) not made by a third party, a lucrative offer and b) both unwilling and unable to proceed in the expropriation of non-shareholder constituencies on its own. For the first condition to be satisfied, it is necessary for the controlling shareholder to focus on non-pecuniary private benefits[261].

It is the identity of the shareholder though that determines whether non-pecuniary benefits will appear or not. In particular, there are three occasions where non-pecuniary benefits could rise: a) the controlling shareholder may be a government entity aiming at saving taxpayers' money; b) in family ownerships. Although that is not met very often in the US, it is a general phenomenon in smaller European countries[262]. That affects the entrepreneurial skills of the firm since the interest is lost, leading to the sale of the firm under very disadvantageous prices;[263] and finally c) in cases where controlling shareholders agree to enter in a transaction with not very favorable terms. That affects though minority shareholders' interests, and thus under corporate law that tactic has started to eclipse more and more[264].

Concentrated ownership cannot be seen as a commitment mechanism which facilitates stakeholders' specific investments. Even in cases where a delay is not considered as potential threat, it could provoke a deterrent against specific investment as it would be the case of a hostile takeover. Thus, for very concentrated capital does not even exist any doubt why labor involvement (as stakeholders) should be considered as important constituencies. \

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[258] *See* John Armour, Simon Deakin & Suzanne J. Konzelmann, *Shareholder Primacy and the Trajectory of UK Corporate Governance*, 41 BRIT. J. INDUS. REL. 531, (2003) at 543-45.
[259] *See* Klaus Gugler & B. Burcin Yurtoglu, *The Effects of Mergers on Company Employment in the USA and Europe*, 22 INT'L J. INDUS. ORG. 481, 497 (2004).
[260] *See* John C. Coates IV, *Measuring the Domain of Mediating Hierarchy: How Contestable Are U.S. Public Corporations?*, 24 J. CORP. L. 837 (1999) at 858-59.
[261] *See* Gilson, Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Corporate Taxonomy*, **119** HARV. L. REV. 1641 at 1663-64.
[262] *See* Mike Burkart et al., *Family Firms*, 58 J. FIN. 2167, 2168 (2003)
[263] *See* Sandy Klasa, *Why Do Controlling Families of Public Firms SellT heir Remaining Stake?*, 42 J. FIN. & QUANTITATIVE ANALYSIS 339 (2007).
[264] *See* Martin Gelter, *The Dark Side of Shareholder Influence*, 50 HARV. INT'L L.J. 129, 129 (2009).

4.4.3. Director's constituencies

Debates over constituency directors in the USA have been at the center of American corporate law from the 1970's. In particular, there were some proposals about having a board member to represent labor or environmental interests on the board. These proposals though did not really flourish in the US since existing corporate governance structures never let them enough space to grow[265].

A different concept though has arisen more recently with hedge fund representatives on boards. Compared to those representatives who would defend labor or environmental interests on the board, hedge funds representatives tend to be more "aggressive" aiming more at satisfying short-term profit goals. That position has provoked boards' attention, in particular in cases where the majority of the board does not seem willing to obey to the minority's interests (hedge funds' representatives[266]) leading to internal conflicts of interests harming sometimes even for the existence of the corporation itself. Nevertheless, someone would argue that in both cases, constituency directors challenge the theme about whether the board should consider disparate interests or a single goal and, relatedly, the question which is eventually born is: "how the board should be structured to serve that objective?"[267]

From a theoretical point of view, corporate law's perspective approach seems to contradict with all the possible desirable constituency interest representation of the board. Arguments made in favor of a more non-uniform positon tend to be more convincing and persuasive than those that defend a more uniform duties position.

Nevertheless, limitations that may be imposed by corporate law are not always taken into consideration. In other words, even in cases where it is given specific preference to the standard duty standard, that does not affect the fairness. But, why is that? What is really

[265] However, as it will be examined later on, issues regarding codetermination and B-corporations started to have some acceptance in the US (the former not a really strong presence in the business world; whereas the later on, it has started to become widely accepted).
[266] Hedge fund activism is a big issue nowdays in the USA and it has started to attract corporations' attention in a global scale.
[267] *See* Buchanan, John and Chai, Dominic Heesang and Deakin, Simon, Agency Theory in Practice: A Qualitative Study of Hedge Fund Activism in Japan (February 2013) at 1-3. European Corporate Governance Institute (ECGI) - Law Working Paper No. 237/2014; University of Cambridge Faculty of Law Research Paper No. 14/2014. Available at SSRN: http://ssrn.com/abstract=2394698 or http://dx.doi.org/10.2139/ssrn.2394698

questioned at this point, is it really the reality of the regulated situation or there is something else? Corporate law finds itself facing a dual reality: the pragmatic nature of the corporate actors who are willing to compromise in the constraints they are asked to undertake in order to help the company to evolve and develop. Moreover, towards the same direction, corporate directors do not hesitate to select rules enforcing them in a more diligent way than others would. At this point, the duty of confidentiality, found to be on the legal books in a quite strict format, makes clear that its transformation from a mandatory duty for directors into a default rule, would be widely accepted since that would facilitate active interactions between firms and venture capitalists when they want to invest[268].

Furthermore, most of the disagreements and the conflicts of interest that may rise between all the various constituencies that are represented by the different directors are not likely to be examined thoroughly by the courts. For instance, the shareholder primacy rule (as it has been discussed before) is not considered to be vigorously enforced all the time. Robert Clark argues in the *Dodge v. Ford* case that Ford's mistake was not his decision itself to act as he did but to have his decision based on social motivation.[269] Most decisions which are redistributed among workers and shareholders, such as whether a factory will be closed, or what are the benefits provided to the employees of the corporation, or how a bargain is going to be performed with the union, are all most of the types protected by the business judgement rule[270]. Someone could argue the same, in case where there is a conflict of interest between creditors and shareholders, trying to specify what the appropriate risk is for the company (in general, higher risk is redistributed to the shareholders from the creditors) .

Todd Henderson and Douglas Baird argue that the board has the power to take decisions that can benefit the creditors to the detriment of the shareholders, under the condition that this decision is based on facts, well thought, decided in good faith, and without conflicting any of the majority of the directors' personal interests[271]. However, it becomes more difficult to determine these situations in cases where there is a conflict of interest between not different

[268] *See* Gelter, Martin and Helleringer, Geneviève, Constituency Directors and Corporate Fiduciary Duties (October 17, 2013). Forthcoming: The Philosophical Foundations of Fiduciary Law (Andrew Gold & Paul Miller eds., Oxford University Press, 2014); Fordham Law Legal Studies Research Paper No. 2341660. Available at SSRN: http://ssrn.com/abstract=2341660 or http://dx.doi.org/10.2139/ssrn.2341660

[269] *See* Robert C. Clark, CORPORATE LAW 603 (1986); *see also* Jonathan R. Macey, *A Close Read of an Excellent Commentary on* Dodge v. Ford, 3 VA. L. & BUS. REV. 177, 182 (2008).

[270] Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governanc*e, 97 NW. U. L. EV. 547, 582 (2003).

[271] *See* Douglas G. Baird & M. Todd Henderson, *Other People's Money,* 60 STAN. L. REV. 1309, 1322 (2008).

directors but between different groups of shareholders. For instance, under Delaware law, a director who is representing a venture capital, in a transaction with that shareholder, would not be considered as disinterested by the courts. That is actually the reason why a decision on a self-dealing transaction where this director would participate, he would be subject to entire fairness review[272]. In case where a transaction would confer a benefit to the sponsoring shareholders, the nominee directors do not even find themselves capable of promoting their sponsor's interests. At the same time, any corporate goal that asks from directors to promote "the interest of the corporation" or setting it to a broader sense to its corporate constituencies, that would make courts' enforceability of any specific action even more difficult[273].

The fact that there is any not efficient enforcement of a corporate objective, that gives adequate flexibility to the decision-making process to be considered "flexibly" by directors. The way that directors are appointed and nominated determines the outcome of board deliberations. Considering that an enforceable and clear objective is not provided by corporate law, someone can reach to the conclusion that the "interest of the corporation" can be more interpreted procedurally than substantively. In other words, those duties which are imposed to directors stemming from corporate objectives tend to be outcome of the process of board deliberation[274]. Thus, directors end up to formulate the corporate objective through their deliberations, a way which helps them to define the duty of loyalty[275].

Inspired by the German supervisory board having members participating efficiently from the labor and capital benches[276], that understanding shows that the interest of the corporation becomes suitable for all the various situations of "nominee" and "constituency" directors. Nevertheless, the interest of the corporation defined here is primarily determined by board deliberation. By permitting a certain type of director on the board, the purpose is to integrate the interests related to its constituency into the specification of corporate policies. Apparently, if a board of directors is composed of different directors, that will develop a thoroughly

[272] *Id.*
[273] *See* Mariana Pargendler, *State Ownership and Corporate Governance,* 80 FORDHAM L. REV. 2917, 2935 (2012).
[274] *See* Andrew S. Gold, *A Decision Theory Approach to the Business Judgment Rule: Reflections on* Disney, *Good Faith, and Judicial Uncertainty,* 66 MD. L. REV. 398, 436 (2007).
[275] *See* Sean J. Griffith, *Good Faith Business Judgment:A Theory of Rhetoric in Corporate Law Jurisprudence,* 55 DUKE L. J. 1, 19-21 (2005).
[276] *See* Friedrich Kübler, Dual Loyalty of Labor Representatives, in CORPORATE GOVERNANCE AND DIRECTORS'LIABILITIES 429, 439 (Klaus J. Hopt & Gunther Teubner eds., 1985).

different"interest of the corporation" in the relevant case always taking into account the constituencies represented at this point.

4.5. Stakeholders' interests at the center of attention under US law?

4.5.1. Co-determination in the US

The US has been one of the countries (compared to what can be viewed in Europe)[277] that does not have much experience with employee representation on corporate boards except from the case where there is a small employee owned company[278]. Only a few boards that have been elected would have as their goal to satisfy public's or consumers' interests[279]. These board members though, despite their flexibility, always have to answer back to the shareholders while not having any particular defined constituency[280]. In the US the participation of an employee in the board has not been regarded as an advantageous position for the benefits of the corporation, since the shareholder primacy rests dominant dealing with some apparent problems that could rise otherwise.

In the employee side apparent problems to codetermination do not constitute real problems. Even though employees' groups are distinguished for their divergence, constituencies are defined and election districts are specified representing the most important interests and categories. In addition despite the possible disagreements that may arise in the areas of collective bargaining and codetermination, in practice these two conditions can coexist and produce very significant result to the operations of the firm. It has been proven actually that codetermination can really contribute to improvement and strengthening of collective bargaining[281].

Nevertheless, the tough problems are the less distinctive ones. For instance, how for those employees that here is not any representation in collective bargaining their interests are represented on the board? Since these groups do not have any particular structure that means

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277 *See* Combined Section (comparison between USA and Germany).

278 *See* Clyde W. SUMMERS, *Codetermination in the United States: A projection of Problems and Potential*, Journal of Comparative Corporate Law and Securities Regulation 4 (1982) 155-191 155 North-Holland Publishing Company.

279 However, many corporations have made tremendous efforts to include minorities and women's rights.

280 *See* SUMMERS, *supra note* 278.

281 *See* Eisenberg, *Legal Models of Management Structure in the Modern Corporation: Officers, Directors, and Accountants.* 63 Calif. L. Rev. 375 (1975) at 415-16.

that their representation in the election process is really limited. Codetermination does require the active participation of the implicated members of the firm in order to offer to those employees that are not part of any collective agreements organizational functions beyond electing powers only. These functions should be reflected both in the employees' resources and functions. Opportunities like these can be offered satisfying various purposes which should not be only restricted in the context of codetermination[282].

Among the tough problems, the problem of conflict of interest between the employee's representatives on the board is among the most distinguished ones. Nevertheless, its seriousness cannot be really compared to the differences between the interests of the outside and the inside directors of the company. In this case, the interests of the inside directors, who are highly paid executives and take the business decisions can be much more influential[283].

Towards the same direction, another problem that can be indentified is the problem of confidentiality. Employee directors are supposed to have full access to information regarding the management and the strategical decisions of the company. However, someone could argue that this would not be achieved very easily since their interests rarely coincide with the interests of the managing directors. On the other hand, there are voices arguing that with modest reinforcing measures this gap could be filled. Nevertheless, under US law, there is not any particular provision that could really safeguard corporation's interests (or in other words, shareholders' rights) while at the same time provide the same satisfaction to its stakeholders (in our case the employees) the same satisfaction[284].

Despite the above mentioned dominant opinion, codetermination could be used as a tool, benefiting board of directors' position no matter its significant implications on corporation's concept. For some, codetermination could be seen as an answer to narrow down shareholders' primacy. But would the US be ever ready to change its well established corporate decisional structure towards such a direction? That is a hard answer to be given, however, codetermination could be seen as a common shelter for both employees and shareholders' interests[285].

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[282] *See* SUMMERS, *supra* note 278.
[283] *See* Blumberg, *Implications of Representation Trends for U.S. Corporations.* Harv. Bus. Rev. (Jan.-Feb. 1977) at 46.
[284] *Id.*
[285] *Id.*

One very significant issue that needs to be avoided though is the confrontation between frustrating codetermination and attitude of collective bargaining. To this matter, there is not any specific answer yet in the USA; however, what could be really done is the establishment of a specific procedure and form for codetermination in the country. At the same time the advancement of safeguards is more than necessary aiming at limiting the consequences of any conflict while ensuring for those who participate any opportunities. At this point, someone could argue that codetermination can only perform its function whenever parties agree to recognize the existence of common interests that need to be satisfied. However, in cases where parties treat each other as adversaries, codetermination can still provide to the parties the chance to discuss their differences and reach to mutually beneficial agreements[286]. For those who are in favor of introducing codetermination in the US, they argue that no further modifications are required for the further establishment of that concept since it is built upon the premise that the management of the company which is based on the board of directors[287].

Despite all the efforts made to start consider stakeholders' interests by proposals made like using codetermination as part of management's policy, there still issues that need to be covered so as to change the whole shareholders' satisfaction philosophy.

4.5.2. Benefit corporations

Some of the most important questions that corporations need to answer nowadays focus really on the issue: Why shouldn't be promoted the change of nature of some corporations in order to ask from the directly to address all stakeholders' interests?

Although in the US stakeholders' interests are not considered by regulation, during the last years a couple of states have decided to supplement their corporation law. Nowadays, many states have included in their law provisions which consider this matter. In particular, their laws accommodate now benefit corporations (hereinafter, "B corporations"). These entities are non-profit and are required to take into account stakeholders' interests and aim at

[286] *See* SUMMERS, *supra note* 278.
[287] *Id.*

satisfying specific target(s) that yield benefits for the public based on their constituent documentation (for example, articles of incorporation)[288].

Jurisdictions in the USA from November 2013 made their first steps in order to include benefit corporation law in their state. The statute which has been recently enacted in Delaware State gives another perspective in terms of treating stakeholders. Delaware defines "public benefit" as "*a positive effect (or reduction of negative effects) on one or more categories of persons, entities, communities or interests (other than stockholders in their capacities as stockholders)*[289]". In its certificate of incorporation a Delaware B corporation is obliged to identify at least one of the benefits that it intends to promote.

According to the requirements of Delaware law, a Delaware B corporation demands from its directors to manage the affairs and the business of the company in a sustainable and responsible way, pursuing always to achieve a balance between the following: a) stockholders' pecuniary interests, b) those interests that are influenced due to the company's conduct (those of the stakeholders) and c) those public benefits that have been found in the corporation's articles of incorporation[290].

The corporation expects from its directors to satisfy their fiduciary duties while at the same time the new Delaware law is enacted in order to protect directors from any potential lawsuits by those investors who would argue that directors do not maximize shareholder value while pursuing public benefits[291]. Nevertheless, that law offers directors latitude that exceeds "business judgment rule's" protection which already protects quite efficiently directors from shareholder lawsuits[292].

But are there any concerns about B corporations? At this point, someone would argue that since a Delaware B corporation is intended to balance stakeholder's interests, only those who hold bigger blocks of stocks would be able to sue so as to enforce directors' duties. Thus, by

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[288] *See* Conaway, Ann E., The Global Use of the Delaware Limited Liability Company for Socially Driven Purposes (February 13, 2012). William Mitchell Law Review, Vol. 38, p. 772, 2012 at 797; Widener Law School Legal Studies Research Paper No. 11-03. Available at SSRN: http://ssrn.com/abstract=2004651
[289] *See* Del. Code Ann. tit. 8, 362(b).
[290] *See* Conaway, Ann E., supra note 275, at 799.
[291] *Id.*
[292] *See* Del. Code Ann. tit. 8, 361 - 362.

enacting this law, management and directors are allowed to be less responsive to criticism and complacent, considering their accountability to stakeholders[293].

Moreover, another issue that could arise with a B corporation concerns its ability to attract equity capital. Since Corporation B is viewed more as an investment that would attract to "socially responsible" investors, others may have been less willing to invest expecting any returns as an exchange for offering some good public chances.

4.6. Conclusion

To conclude, American corporate directors and officers are known to have enjoyed broad discretion so as to consider stakeholder interests. The notion of shareholder primacy though examined under the prism of some of Delaware Court' decisions, still remains the dominant view, overshadowing stakeholders' interests in many occasions.

Nevertheless, that has led empowered shareholders to satisfy their own interests and under certain conditions achieve that to the detriment of the stakeholders. So far, it has been very common for the board of directors to adopt a behavior which was aiming solely to the maximization of shareholder value. Powerful or controlled shareholders may force management to swift value to certain shareholders from other shareholders but this has started not to be the optimal option. Some argue in favor of stakeholders' interests but this still remains the voice of the minority. Moving a little bit further, directors' constituencies have started to be examined in more depth, trying to satisfy the goals of the corporation as a whole this time.

Towards a pro-stakeholder appreciation and of their interests under US corporate law, both the notion of codetermination as well as of the newly enacted B-Corporation seem to bring promising "innovations" under US and on stakeholders' interests in general.

However, nobody can argue that the optimal solution for US would be a total rejection of its existing "beliefs"; the answer could be surely a determined opening to stakeholders' interests keeping at the same time the satisfaction of shareholder value to its maximum.

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[293] *See Understand Legal* B CORPORATION, http://www.bcorporation.net/become/legal (last visited Oct. 11, 2011).

5. Comparative Section[294]

5.1. Shareholder Versus Stakeholder approach

This section will take a closer look at problems and possible advantages that both approaches to corporate governance have in general or compared to the other. It is obviously very hard to do such an evaluation since both approaches have a lot of sub-theories and different accentuations as mentioned above. Therefore, this look at issues of the approaches will be limited to the usual, very general points of criticism which are applicable to overarching shareholder and stakeholder capitalism as defined in sections 2.1. and 2.2.

One apparent issue that both approaches have likewise is that they could overpower one party if the act of balancing goes wrong. Hence if one party gets more power, than actually necessary for the benefit of the corporation it would then result in disadvantages like already mentioned in section 2.3.

In case of the shareholder approach it is possible that shareholders are so powerful that they take advantage of the other corporate units in “hold-up”-situations. For the stakeholder approach the problem could be that managers who get a lot of discretion to also consider stakeholder interests do not have enough control mechanisms whereby they can act in self-interest.

5.1.1. Stakeholder approach: issues & advantages

Following up on this issue, one argument regularly brought up against the stakeholder approach is that it has no clear objective.[295] The approach has the problem that it is vague to a certain degree, due to not specifically stating how to approach the stakeholder relations and therefore the business as a whole.[296]

[294] NOTE: In order to avoid further repetition on the comparative part, many ideas have already been explained in each of the national Parts (Part 3 – German Part and Part 4 – American Part). In these two Parts (found just above), both the national perspective regarding shareholders and stakeholders interests as well as their influence in practice have been described in details. Thus, the comparative outcomes are available to the reader after careful study. However, in Part 5, only those parts which were not covered in details are further examined.
[295] *Jensen*, Journal of Applied Corporate Finance 2001, 14 (3), 8, 9-11; also *Sternberg*, Corporate Governance: An International Review 1997, 5 (1), 3, 4.
[296] See *Friedman/Miles*, Journal of Management Studies 2002, 39 (1), 1, 15, who identify this problem and try to develop a more specific theory.

Multiple interests can and have to be taken into account. By that means the decision makers are accountable to every stakeholder, which finally leaves them with no accountability at all.[297] Again the result is a threat of managerial self-dealings to the detriment of the corporation and all corporate units, shareholders included, other than the managers themselves.

Another famous problem with the stakeholder approach is the so-called "Stakeholder Paradox" found by *Goodpaster*. The paradox evolves from the fiduciary duties the managers have in relation to the shareholders. From his understanding of the stakeholder approach the management is supposed to have a multi-fiduciary position, meaning that managers have fiduciary duties to all the stakeholders of the corporation.[298] And since a fiduciary duty requires one party to act solely in the interest of another it cannot work if the fiduciary has those types of duties to more than one party.[299]

The issue nearly always coming up when it comes to evaluating stakeholder theory is that it does not account for business considerations and realities enough[300] or rather that there is no room for social considerations in business decisions[301]. Those points of criticism are insofar not valid that they have an incomplete if not wrong understanding of the stakeholder approach. The stakeholder approach does have a goal: maximum value creation for the corporation as a whole.[302] It also is not necessarily the idea of the stakeholder approach to take ethical and social considerations into account[303] especially if they run against all economic reasoning because it still is a business approach.

Additionally the argument of too much freedom and discretion for managers does not work. That is because it is not in line with the stakeholder approach to give the managers so much power that they become unaccountable or can deal in their own interest. The idea of the stakeholder theory is to give managers as much room in decision-making, as they need to be

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[297] *Sternberg*, Corporate Governance: An International Review 1997, 5 (1), 3, 5.
[298] *Goodpaster*, Business Ethics Quarterly 1991, 1 (1), 53, 63.
[299] *Kuhner*, Zeitschrift für Unternehmens- und Gesellschaftsrecht 2004, 33 (2), 244, 254.
[300] *Sternberg*, Corporate Governance: An International Review 1997, 5 (1), 3, 4.
[301] *Friedman*, The Social Responsibility of Business is to Increase its Profits (13.9.1970), URL: http://thinkprayact.us/uploads/The_Social_Responsibility_of_Business_is_to_Increase_its_Profits__by_Milton_Friedman.pdf (last visited on 31.1.2016)
[302] *Jensen*, Journal of Applied Corporate Finance 2001, 14 (3), 8, 11, "enlightened stakeholder theory".
[303] *Clarkson*, Academy of Management Review 1995, 20 (1), 92, S. 100.

able to take other interests than those of the shareholders into consideration, but not more. Anything else is not the stakeholder approach and cannot be used to criticize it as a result. The "Stakeholder Paradox" is also not really a problem since stakeholder theory does not adopt the fiduciary duty model of the classic shareholder approach.[304] In conclusion basically no point of critic is sweeping because the stakeholder theory can counter them with different understandings of the underlying ideas. Still the actual problem of ambiguity of the objective and multi-interest considerations remains.

5.1.2. Shareholder approach: issues & advantages

The first and easiest point of criticism concerning the shareholder approach is that it is to narrow. The argument is that due to its focus on creating shareholder value it is not able to consider the relationships with other corporate groups appropriately.[305] So the idea is that a good governed corporation or corporate governance in general must have a broader scope than just the principal-agent-relationship[306] (which then in turn is one of the most important arguments for the stakeholder approach). The other substantial argument against the shareholder approach is that it is said to favor „short-termism".[307] Since shareholders have a good amount of power in a corporation and are even capable of getting managers fired, the management has a very strong incentive to meet the demands and interests of shareholders.[308] But most long-term strategies do not influence the share price immediately or directly.[309] In addition the shareholders do not have the same information the management has and therefore lack the knowledge and in a lot of cases also the skill to put a corporate decision into (long-term) perspective.[310] That is why incomprehension and resentment can grow towards the management in case of making long-term decisions. As a result it is easier and safer for the management to take the route of quick, apparent but also of possibly more risky decisions in hope to create easy gains for the shareholders.[311]

So the argument in short is that corporate management is forced into taking short-term gains in share value over the long-term welfare of the corporation and potentially even society as a

[304] *Freeman*, Zeitschrift für Wirtschafts- und Unternehmensethik 2004, 5 (3), 228, 235.
[305] *Werder*, in: Hommelhoff/Hopt/Werder (Publ.), Handbuch Corporate Governance, 3, 7.
[306] *Janisch*, Das Strategische Anspruchsgruppenmanagement, 103-105.
[307] *Mitchell*, Vanderbilt Law Review 1992, 45 (5), 1263, 1283.
[308] *Mitchell*, Vanderbilt Law Review 1992, 45 (5), 1263, 1286 and 1288.
[309] *Mitchell*, Vanderbilt Law Review 1992, 45 (5), 1263, 1286.
[310] *Mitchell*, Vanderbilt Law Review 1992, 45 (5), 1263, 1287.
[311] *Mitchell*, Vanderbilt Law Review 1992, 45 (5), 1263, 1288 f..

whole. Similar to some of the points of criticism before, the argument that the shareholder approach is too narrow is based on a bit of a misunderstanding. The idea of the shareholder approach is not to ignore all corporate units except for the shareholders but instead to make interests of the shareholders and therefore an increase in the share value the highest priority. The interests of other groups can and even have to be respected and considered but only to foster the actual objective of the corporation, meaning the maximum share value.[312] So the shareholder approach is indeed considering all corporate relations but decides to make the meeting of the demands of shareholders the corporate objective and can in result not really be criticized as too narrow.

The other argument is a legit concern for the shareholder approach. The threat of favoring short-termism and harming corporate welfare long-term is a real thing.[313] In spite of that there are effective ways to prohibit this short-term decision-making. As mentioned above one reason for this short-termism is the lack of information available for shareholders about corporate decision making. Thus one way to eliminate incentives for short-termism is eliminating information deficiencies by providing detailed and understandable information about the reasoning behind the (long-term) decisions to shareholders.[314]

The other means to prohibit short-termism by managers is to give them stronger incentives to create long-term value for the corporation. A way to do this is by making part of their compensation performance-based and long-term oriented.[315]

This together with a functioning information policy can create enough incentives for managers to seek long-term value while also ensuring support from the shareholders for the managerial decisions. Like it was the case for the stakeholder approach, there is also not one overwhelming reason against the shareholder approach.

5.1.3. Conclusion of the evaluation

It has become apparent that it is difficult to evaluate the two approaches. Both approaches have a right to exist. None of the arguments is so convincing that they could take away the

[312] *Rappaport*, Creating Shareholder Value, 12 f..
[313] *Mitchell*, Vanderbilt Law Review 1992, 45 (5), 1263, 1292.
[314] *Mitchell*, Vanderbilt Law Review 1992, 45 (5), 1263, 1287.
[315] See for example the German Corporate Governance Code 4.2.3 para. 2.

foundation of the approach. Just as little as one of the approaches could be called superior. Applied the right way share- and stakeholder capitalism both are conclusive concepts and it mainly comes down to the local realities to decide why approach suits the economy best.[316]

5.2. Codetermination in the US and in Germany

This part will now take a comparative look on the legal situation of codetermination in both countries and try to draw conclusions in regard to an overall orientation.

5.2.1. Legal situation

As shown above the German corporate governance system is mainly characterized by codetermination. Germany does not have an explicit guideline that obliges the management board to manage the corporation in a stakeholder friendly direction, but rather a system of codetermination of the supervisory board that ensures the consideration of stakeholder (more precisely worker) interests in everyday business.[317] The most important German regulation in that regard is the Codetermination act, which basically requires parity of worker and shareholder representatives on corporate boards.

The US system can be said to work the other way around. A very stakeholder considerate legal framework is not existent there. The key corporate organ in the US that is able to consider stakeholder interest significantly is the management.

Corporate law in the US is far away from such a system of parity on corporate boards. In fact there basically is no mandatory (stakeholder) codetermination on US boards at all. Even though a codetermination system has been debated, the US never really came close to enacting one[318].

[316] See again *Gelter*, Harvard International Law Review 2009, 50 (1), 129, 177 regarding differing “local optima”.
[317] See the Section 3.3.1. „Codetermination“ in the German Part of this paper.
[318] *Summers*, Journal of Comparative Corporate Law and Securities Regulation 1982, 4 (2), 155, 155.

5.2.2. Reasons for this difference

This difference is at least partly due to some of the different local circumstances in the US and Germany. For starters codetermination would only make sense if federal law requires it.[319] But in contrast to Germany, the US does not have a unified federal corporate law system. Thus the enactment of something as influential and changing as codetermination would constitute a major problem in terms of practical implementation.

Another important difference is the general situation of labor in the US and in Germany. The major means to represent the interests of workers in the corporation is collective bargaining.[320] In Germany collective agreements are also existent, but are in contrast to the US not the only and arguably not even the main way to represent workers interests.

Germany has works councils and obviously codetermination to ensure consideration of worker interests in the corporation. Still all of those measures have slightly different goals. Whereas collective agreements are using the combined power of all the workers in the union to improve the working situation of a whole industry, both codetermination and the system of work councils[321] is aimed at improving the situation of workers in the specific corporation. The later is for the most part just non-existent in the US.

One possible reason for this is that there simply is less need for such worker protection on the corporate side. This could be based on the weaker, because more dispersed, shareholder influence in the US that was mentioned earlier. In Germany where block holding was traditionally more prevalent shareholders had and might still have a stronger influence and therefore the hold-up threat for workers and other shareholders is bigger.[322]

Still a good amount of workers in the US are not covered by collective agreements and union representation[323] and even if they would not be held-up by shareholder, the risk of hold-up is not eliminated since management can still take advantage of its stronger bargaining position in relation to individual workers. And there is no apparent reason, why management would

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[319] *Summers*, Journal of Comparative Corporate Law and Securities Regulation 1982, 4 (2), 155, 157.
[320] *Summers*, Journal of Comparative Corporate Law and Securities Regulation 1982, 4 (2), 155, 158.
[321] While these two can again be subdivided into operational codetermination and corporate codetermination, which is the topic of this section.
[322] See *Gelter* Harvard International Law Review 2009, 50 (1), 129, 193.
[323] *Summers*, Journal of Comparative Corporate Law and Securities Regulation 1982, 4 (2), 155, 159.

not do that, since directors could either benefit themselves or the shareholders which in turn would give the corporation an edge in competing for investors on the capital markets. On the other hand it must also be considered that management is arguably more closely supervised in the US than in Germany because of potential managerial self-benefitting due to weaker share- and stakeholders. This would take some of the mentioned hold-up risk away.

An important reason against the enactment of codetermination in the US and even a still prevalent point of criticism in Germany is the risk that codetermination slows down and in the worst-case even blocks the management in its decision-making and day-to-day business.[324]

Furthermore, even though the German supervisory board has broad rights to influence the actual business making conducted by the management board the two are still separated. The US on the other hand does not have such a two-tier system. This increases the difficulty of practically implementing codetermination and might additionally raise the risk of delay in day-to-day business. Even though the latter one is highly doubtful, since the one-tier board in the US is working very similar to the German management and supervisory system by having inside (dealing with day-to-day business) and outside (fulfilling supervisory tasks) directors.[325]Thus this might not eliminate the risk of delay, but it also will not increase it further.

As a result, any potential US codetermination system would need to look very different from the German system, due to very different circumstances. But in spite of the mentioned problems it would probably still be possible for the US and most other legal systems in that matter to create some kind of codetermination framework that accounts for the workers, as the most important stakeholders, if there were a broad consensus about the benefits of such a system.[326]

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[324] See *Hopt*, International Review of Law and Economics 1994, 14 (2), 203, 207 f.; also *Summers*, Journal of Comparative Corporate Law and Securities Regulation 1982, 4 (2), 155, 166.

[325] *Summers*, Journal of Comparative Corporate Law and Securities Regulation 1982, 4 (2), 155, 168.

[326] Building a base for this, while finding no obstacles that cannot be overcome and even examining possible benefits of a codetermination system in the US is *Summers*, Journal of Comparative Corporate Law and Securities Regulation 1982, 4 (2), 155-191.

5.2.3. Codetermination conclusions

In the end it can only be stated again that codetermination is a very good indicator of a stakeholder orientation of a legal system. It will not always be possible to install a codetermination system as extensive as in Germany, but it will still be possible to enact some kind system of codetermination, which ensures stakeholder interests are considered as well.

Thus, the mere fact whether or not there is some kind codetermination system can be pretty telling in regard to the overall orientation of a legal system. Additional looks on the specific design of the particular codetermination system and surrounding legal frameworks will provide an even more complete picture. This is shown in the case of the shareholder capitalistic US system without any form of codetermination and the more stakeholder capitalistic German system, with one of the most extensive codetermination frameworks around the world.

5.3. Banks' involvement in executive compensation's matters in the US and in Germany

This part will now shed more light on the existed relationship between executive compensation and the performance of the board and its effects on the shareholders and stakeholders debate in both countries aiming to clarify the current situation.

The differing levels of executive compensation in the countries all over the world have attracted academics and professional's attention recently more than ever before. Although most of the academic literature has focused primary on examining US executive's compensation, Germany has been one of the countries that has equally challenged researchers, since today it constitutes the third largest economy globally.

5.3.1. Legal situation

Before explaining the main differences between USA's and Germany's executive compensation's policies', a brief comparison between the German and American corporate governance's structure is necessary. In particular, there are two main features of German governance structure that differ from those in the USA. The first one is that in Germany large corporations have a two-tiered board structure. On the one hand there is the "*Aufsichtrat*" or

Supervisory Board and on the other hand there is the "*Vorstand*" or Managing Board. In the USA the corporate governance structure is actually a one tier board[327].

Therefore, based on German law, among Supervisory Board's main responsibilities is the oversight of the corporation. This responsibility seems to be similar to that of the American board of Directors. In addition, the Supervisory Board is responsible for appointing the Managing Board and at the same time is asked to set the remuneration of the members of the Managing Board[328]. In the USA the top management is the equivalent of the Managing Board and for the determination of its salaries there did not really any particularly methodology until after Dodd Frank Act's enactment where Executive Compensation has now been set under certain patterns.

Under German law, the Managing Board has also the responsibility to oversight all the daily operations of the corporation. A huge difference though between German law and American law in this perspective is that under German law commercial banks seem to have a tremendous influence on corporate governance compared to the USA. In principle, in the USA commercial banks are prohibited in having under their possession any equity of the corporations.

Moreover, some voices would advocate that this situation is viewed as quite controversial under an American perspective. And a question which is born in this case is: To what extent can actually German universal banks impact the governance of one corporation? Although the existing evidence cannot really give a prominent answer on this question, it is widely believed that the degree of influence of the universal banks over corporate governance's control extends beyond the traditional limitations met between lender-creditor relationship[329]. Taking this into account, someone would argue that this relationship creates a different intervention rights to the banks in the interior management and at this point the bank as a stakeholder could even sometimes influence the board more than the shareholders of the company[330]. Under American law that would not be allowed not only since shareholder primacy is the key

[327] Emmons, William R. and Frank A. Schmid, *Universal Banking, Control Rights, and Corporate Finance in Germany*, Federal Reserve Bank of St. Louis Review No. 4, Vol. 80, July 19 (1998).
[328] *Id.*
[329] Emmons, William R. and Frank A. Schmid, *Universal Banking, Control Rights, and Corporate Finance in Germany*, Federal Reserve Bank of St. Louis Review No. 4, Vol. 80, July 19 (1998).
[330] Edwards, J.S. and K. Fischer, (1994), *The German Financial System*, Cambridge: Cambridge University Press.

answer to the increase of the corporation's wealth but also banks, as stakeholder of the corporation would never be able to be accounted the same as the real invertors (of course, as mentioned just above, banks' intervention in Corporate Governance's matters would not be allowed by the law).

Towards the same direction, trying to understand German banks' behavior, Elston is trying to explain banks' most important ways through which a back influences a corporation. In particular, banks achieve their influence through a) associated voting rights and bank share ownership accrued from proxy votes and ownership, b) bank's representation on the Supervisory Board and c) share underwriting and bank lending. Bank representatives can also play an active role as shareholders according to which they can take part in shareholders' annual meetings, and are regularly represented on the Supervisory Board of the corporation starting from one to more representatives. Based on the above mentioned, the banks manage to have direct influence on the corporation's operations, a situation that surpasses the traditional British-American corporation-creditor relationship[331].

Therefore, although the banks cannot really have a large portion of the voting right in a corporation, by collecting proxy votes[332] can influence significantly the decisions made by the corporation in matters regarding both the remuneration of the Managing Board as well as the Supervisory Board. Examining that situation from an agency problem perspective, taking into account banks' intention to hold the shares of the corporations for a long time, that could be interpreted as banks aiming at engaging actively on the management (monitoring) of the corporation.

To conclude, contrary to what is happening in the USA where the banks have no involvement affecting Managing and Supervisory board salaries, in Germany banks are among the most important factors, which decide these matters. Hence, it more than important for someone to

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[331] *See* Elston, Julie Ann, *Investment, Liquidity Constraints and Bank Relationships: Evidence from German Manufacturing Firms," in Competition and Convergence in Financial Markets: The German and Anglo-Saxon Models,* Advances in Finance, Investment, and Banking and Finance series, Vol. 5, Elsevier Science Publishers (1998).

[332] Under German law proxy voting ("*Depotstimmrecht*") banks manage also to get voting right from shares found in trustee accounts of their customers. In general, in board decisions these votes count including also Managing Board's nominations and the salaries of the Board. In German, someone can find deposited in such bank trustee accounts almost half of the total issued shares. In addition, combining to the votes from direct ownership rights the proxy votes, the votes that are controlled overall by banks in the largest 100 corporations in Germany is almost 36%. However, in the top 10 corporations that percentage is much higher and it can be over 50%.

understand initially the structure of the German style system of the banks before reaching to any conclusion. It becomes, thus obvious that in Germany the banks as stakeholders play a significant role.

6. Final Conclusion

After all it sure can be stated that the approaches to business of the US and Germany are substantially different. Whereas the US is still in large parts characterized by the shareholder primacy rule, a relatively stakeholder-friendly legal framework ensures a consideration of multiple interests in Germany. This is to a high degree due to different local circumstances that shaped the development of today’s legal situation.

But even though both systems are very different from each other, at the end of the day it is clear, that no corporate groups can be totally left out of the picture, when a corporations want to maximize their success. The question on which group the focus should be on is obviously answered different in the US and in Germany, but again due to diverging circumstances and even political ideas, the answer needs to be different to maximize corporate efficiency and success, which is the central objective of a good corporate governance.

If the circumstances change, so might the overall orientation. A good example of that is a progressive shift of focus to more shareholder value creation due to increased market pressure in Germany (and also the in the EU)[333] and in the US there also might be slight changes to a broader consideration of interest, e.g. looking at the public benefit corporation.

So even if both systems will probably stay with their overall orientation in the foreseeable future change is possible and will likely happen as long as this facilitates the overall corporate success.

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[333] *See* Shareholder Directive COM/2014/0213 final - 2014/0121 (COD) http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2014%3A213%3AFIN

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