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THE BEST OF WORLD OPINION

Value or values. Shareholders watch more than the bottom line. PHOTO: EDDIE JIM

Friedman's attack on stakeholderism still holds, despite what boards say now

Governance

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Exactly 50 years ago, economist Milton Friedman argued that corporate boards should focus on maximising shareholder value and not get wrapped up in trying to achieve other objectives. The conventional wisdom in boardrooms today seems to be that Friedman was wrong.

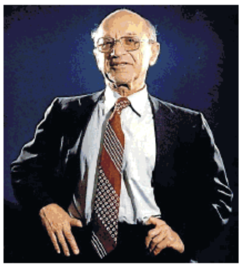
In fact, though, a lot of what he wrote was spot on. Sadly, the current emphasis on "stakeholder value" is one part enlightenment, one part public relations, and one part an attempt by corporate directors to get a freer hand to run companies as they personally see fit.

True, as the ESG (environment, social, governance) movement contends, there are legitimate reasons to take into account the interests of stakeholders other than shareholders. But it takes sophisticated reasoning, not just hand-waving, to address the critique of Milton Friedman, the libertarian icon who won a Nobel memorial prize in economics in 1976.

The title of Friedman's article in *The New York Times Magazine* on September 13, 1970, was *The Social Responsibility of Business Is to Increase Its Profits*. His thesis was as provocative then – the year of the first Earth Day – as it is now.

Echoing arguments he'd made eight years earlier in his book, *Capitalism and Freedom*, Friedman wrote: "What does it mean to say that the corporate executive has a 'social responsibility' in his capacity as businessman? If this statement is not pure rhetoric, it must mean that he is to act in some way that is not in the interest of his employers." That, Friedman argued, is unjustified and nonsensical.

In the past few years corporate directors and chief executive officers have moved sharply away from Friedman's thinking. In August 2019, the Business Roundtable, which had long upheld Friedman's shareholder primacy, put out a pro-stakeholder statement that was signed by CEOs of 181 companies with a combined market capitalisation of more than $US13 trillion ($18 trillion).



Libertarian icon. Milton Friedman's views are still controversial. PHOTO: AP

It said, "While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders." The World Economic Forum issued a Davos Manifesto in December, saying: "The purpose of a company is to engage all its stakeholders in shared and sustained value creation."

The University of Chicago, where Friedman taught for 30 years until his retirement in 1977, is in the middle of taking a closer look at his legacy. On September 10 and 11, the university's Booth School of Business and its Stigler Centre held a virtual conference called *Political Economy of Finance 2020: Should Corporations Have a Social Purpose?* Speakers included Oliver Hart of Harvard, himself a Nobel laureate in economics.

One of the papers presented at the Chicago conference channels Friedman and questions the logic of shareholder capitalism. *The Illusory Promise of Stakeholder Governance* is by Lucian Bebchuk and Roberto Tallarita of Harvard Law School. "Stakeholderism," it says, "would increase the insulation of corporate leaders from shareholders, reduce their accountability, and hurt economic performance."

The weak theory of stakeholderism is that taking into account the interests of employees and so forth is ultimately good for shareholders. But that's so obvious as to be meaningless. Even Friedman said CEOs and directors should take actions that help others if they benefit shareholders in the long run. (And, of course, they should obey the law at all times.)

The strong theory of stakeholderism, which is the only version with enough meat to be interesting, says that CEOs and boards should occasionally take actions that conflict with shareholders' interests. That's the one Bebchuk and Tallarita disagree with.

Boards and managers could use it to justify underperformance by fuzzing up what they're responsible for achieving.

"Indeed, we argue, the support of corporate leaders and their advisers for stakeholderism is motivated, at least in part, by a desire to obtain insulation from hedge fund activists and institutional investors," Bebchuk and Tallarita say. "In other words, they seek to advance managerialism by putting it in stakeholderism clothing."

By the way, opposing stakeholderism doesn't imply throwing stakeholders to the wolves. Bebchuk and Tallarita say they are more reliably protected by laws and regulations than by the whims of corporate leaders. "Some of the adverse effects that companies impose on stakeholders raise serious policy concerns and warrant legal and regulatory intervention," they write.

Luigi Zingales, a professor at Booth who organised the Chicago conference (with Paola Sapienza of Northwestern University's Kellogg School of Management), says that the intellectual basis for stakeholder capitalism can be rescued. He presented part of his argument in an essay called *Friedman's Principle, 50 Years Later* for the journal *ProMarket* introducing the conference, and added some thoughts in a telephone interview.

One pro-stakeholder argument, which Zingales and Harvard's Hart made in a 2017 paper, is that shareholders care about more than just the bottom line, so it's perfectly consistent for boards to focus on maximising shareholders' overall welfare, not just market value.

For example, say one company's shareholders worry about global warming. It's cheaper and easier for the company to reduce its greenhouse gas emissions than for its shareholders through their private actions to reduce their emissions by an equal amount, so the company should be the one to do it.

It would be more efficient for the government to force companies to lower emissions through a tax or cap, but government doesn't always do what's right, so shareholders sometimes need to take matters into their own hands, Zingales says. Another example is when merchants voluntarily curb sales of firearms beyond what state laws require.

Another line of attack on Friedman's shareholder primacy is that it becomes absurd in the extreme. Assuming that campaign contributions are legal, says Zingales, "In principle, if you take Friedman to an extreme, I should sue a CEO who doesn't buy off all the members of Congress."

Zingales' third line of attack on Friedman, and thus a partial justification of stakeholder capitalism, is that companies are not just value-neutral contractual arrangements, but rather have a responsibility to do good for society.

"Historically we know that corporations were born as public institutions with a special privilege granted by the state," Zingales says. "Even today, we do know that the privilege of limited liability, especially with respect to tort claims, is an extraordinary privilege granted by the state. So to what extent does this special privilege bring with it a special responsibility?" R

BLOOMBERG BUSINESSWEEK

The key to living with the virus is less accurate tests

Stopping the spread

Joshua Gans and Richard Holden
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Testing times. There is an alternative to the nasal swab. PHOTO: EDWINA PICKLES

If Australia is to navigate the rest of the pandemic without yo-yoing lockdowns we need to test a lot more and a lot smarter.

One of the key elements of Australia's response to the COVID-19 pandemic has been large-scale and rapid testing. By early May we were testing one person per thousand per day. By July the rate was more than two – high by world standards.

And the type of test we use – a so-called PCR test – is considered by medical professionals to be the gold standard. These tests look for viral RNA remnants in cycles. This process requires a laboratory, reagents and specialised machines, costs about $50-$100 per test, and takes between 24 and 48 hours for results to be returned.

The good news is PCR tests can pick up a tiny amount of the virus causing COVID-19. These tests can find very small needles in large haystacks. The chance of a false negative – that someone tested has the virus but gets a negative test result – is small. So is the chance of a false positive – the chance someone tested doesn't have the virus but gets a positive result. But that's also the bad news. PCR tests – at least the way they are used – are too accurate.

The problem is the PCR tests pick up traces of the coronavirus whether it is active or dead. When it is active, you care. When it is dead, you don't. A dead virus is not contagious, so you don't need to isolate the person involved.

And that's the key: we need a test well matched to the public-health decision we use the results for. That decision has two components: whether to isolate someone, and whether to trace their contacts.

This is where the gold standard, measured by accuracy, turns out to have rather less sparkle as measured by what actually matters. Detecting dead virus in people who are not infectious, but treating them as if they were, is costly. It's not the cost of the test itself (about $50 in Australia) – but the cost of the action taken with the information stemming from the test.

It has always been clear that isolating people for 14 days if they are not infectious is a costly exercise – in both economic and human terms. But we have learnt throughout the pandemic how easily contact tracing systems can become overwhelmed. Sending contact tracers on wild goose chases, tracking down the contacts of people who are not, in fact, infectious, is a huge waste of one of our scarcest resources.

If only there were a better way, one might lament. In fact, there is. So-called LAMP or antigen tests are better matched to the isolate-and-trace decisions required during the pandemic. These tests are not as scientifically impressive as PCR tests. Antigen tests are less precise – meaning that if there are small amounts of the virus in you, they won't pick it up. But you actually don't want a test to do that. That isn't enough to force you into isolation. You want tests that tell you that you have lots of the virus and need to be isolated. In this case, less precise tests are better at telling you when to do what.

But, wait, there's more. They are also much cheaper (about $5 per test), they can use saliva instead of a nasal swab, they return test results in about 15 minutes, and they don't need to be performed in a big laboratory. Everything about them is compelling.

Test strips could be deployed to schools and workplaces, and even to shopping centres, airports, and large cultural events. We could test dramatically more people far more often. And we would end up isolating the people who are actually in danger of infecting others, and tracing their contacts.

Given all that, why don't we have them? The answer is that our regulatory authorities are charged with approving tests to inform on whether to treat someone for COVID-19, not whether to isolate them. Those are different things. You may be infected but not infectious, in which case you need monitoring but not necessarily isolation. Yes, occasionally someone may get through who is infected and then becomes contagious. But when the tests are cheap, we can test more often and so you can catch those cases too. In other words, we need to think about what we can do with tests and not just what a test alone can do.

If Australia is to navigate the rest of the pandemic without resorting to yo-yoing lockdowns, we need to test a whole lot more and a whole lot smarter. We have within our grasp a test that is faster, cheaper and less invasive. It is also better matched to the public-health decisions we need to make with the result of the test.

Widespread adoption and aggressive use of such antigen tests is the best path to managing our way through the pandemic, unless and until a vaccine is widely deployed. It may be the best way we can actually "live with the virus" without needless loss of lives, or at undue economic cost.

We need to remember that the "self-lockdown" in the face of the pandemic accounts for about 90 per cent of the decline in economic activity we have experienced. Smarter, faster, more widespread testing is the surest way to overcome that very natural fear and return our lives to a more normal state. R

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