Looking Back with a Legend: Ira Millstein Reflects on the Impact of Milton Friedman's Views on Corporate Governance

Interview of Ira M. Millstein and Leo E. Strine, Jr. by Eric Talley[*]

In this discussion,[1] corporate governance legend and frequent *The Business Lawyer* contributor Ira M. Millstein reflects on the impact of Milton Friedman and his adherents on our corporate governance system and economy generally, as well as the path forward to an economy that functions better for the many. Millstein takes an historical perspective in conversation with former Chief Justice and Chancellor of Delaware, Leo E. Strine, Jr., moderated by Professor Eric Talley of Columbia Law School. Millstein situates the evolution of our corporate governance system, including the effect of Friedman and the Chicago school on it, within the political dynamics of the last fifty years since the *New York Times* published the essay, "A Friedman Doctrine—The Social Responsibility Of Business Is to Increase Its Profits."

Talley: What is the purpose of a corporation? To make money for its shareholders, right? That is what economist Milton Friedman famously wrote in his 1970 *New York Times* essay. In the fifty years since, his argument has become central to the way we think about corporations in society. The goal of maximizing shareholder value is now baked into mountains of legal precedents and regulatory mandates. However, even before this year's pandemic, the so-called Friedman Doctrine had begun attracting pointed criticism amid growing concerns that include climate change, corporate political influence, wage stagnation, and wealth and income inequality. In fact, just last year, over 200 of the country's top CEOs signed onto an

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* Mr. Millstein is a Senior Partner at the international law firm of Weil, Gotshal & Manges LLP, Founding Chair of the Millstein Center, an elected Fellow of the American Academy of Arts & Sciences and author of *The Activist Director: Lessons from the Boardroom and the Future of the Corporation*. Mr. Strine is a former Chief Justice and Chancellor of Delaware. He is presently Of Counsel in the corporate department of Wachtell, Lipton, Rosen & Katz, and serves as the Ira M. Millstein Distinguished Senior Fellow at the Millstein Center and the Michael L. Wachter Distinguished Fellow in Law and Policy at the University of Pennsylvania Carey Law School. Professor Talley is the Sulzbacher Professor at Columbia Law School, Co-Director of the Millstein Center, and host of *Beyond Unprecedented*.

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unprecedented declaration by the Business Roundtable stating that the purpose of a corporation is not solely to maximize shareholder welfare, but also to enhance the welfare of other stakeholders, such as employees, customers, suppliers, creditors, and surrounding communities. A year later, we now find ourselves hip-deep in a global crisis that is even more far-reaching. While shareholder primacy still has its champions, the COVID-19 pandemic and the national racial justice movement have only increased pressures on corporate actors, not just to talk the talk, but to walk the walk of stakeholder capitalism by adopting concrete measures to safeguard environmental sustainability, social responsibility, and governance—popularly known as ESG. In short, the events of 2020 have raised the stakes in what was already a pivotal moment for how we think about corporations and how they think about themselves. What is behind this new focus on ESG and stakeholder capitalism? Is it merely optics or pretext, or have positions genuinely changed on these issues? How has the current deluge of crises affected the debate? Looking forward, would stakeholder capitalism make corporations more resilient, more responsive, and more responsible citizens in the next crisis? I am excited to dive into these topics and more with Ira Millstein and Leo Strine, two of the country's leading gurus on corporate law and governance.

Let's kick things off with the present day. Ira, if you were a CEO today thinking about corporate governance—or, more aptly, an advisor to CEOs thinking about corporate governance—what would keep you up at night?

Millstein: Well, what would keep me up at night is whether the CEO would listen to me, because I would be telling that CEO: "Hey, look, shareholder and stakeholder interests are now coming together, and you had better pay attention. The future of your corporation and the future of your relationship with shareholders is on the line." Too many CEOs may be harking back to the good old days when they ran the show and did not have to worry about anybody else. That is not the case anymore. They have to worry about everybody else—not just shareholders, but stakeholders. Why? Because there is tremendous pressure on them to do so. What I worry about most is that they are not listening. That is why I have turned, and I hope lawyers will turn their attention, to something called moral psychology, because I think somehow we have to get through to CEOs that this is real.

Talley: Leo, I want to pivot to you on this. I have been teaching corporate law for at least a quarter of a century now, and I have never before witnessed such a moment of inflection. There have always been skeptics of the Friedman Doctrine, even before ESG was a "thing." But those skeptics now have grown in ranks, and they have been joined by their traditional adversaries, such as the Business Roundtable. Why are people like Senator Elizabeth Warren seemingly locking elbows with the Business Roundtable and management on stakeholder responsibility?

Strine: The social compact has gone beyond being frayed to being torn. The results we saw in the 2016 election are a reflection of economic insecurity. We see throughout some of the West an increasing recognition that, unless you deal with the new power dynamics within corporate governance itself, you cannot address this malady. To put a point on it, the driving issue is the profound change in gainsharing between workers and stockholders in the making of corporate profits. There has been plenty of new pie. People will argue that productivity has not grown as much as it should have. It can always grow faster. (The reality is that inventions like the refrigerator, automobiles, and air conditioning are truly transformational. The latest generations of the iPod are neat, but they are not going to grow the economy quite as fast as some of the previous innovations.) But there has been a lot of growth. The difference is that the share of productivity growth that has been distributed to workers and their pay have gone far down in comparison to the share that has gone in the pockets of top management and shareholders. Another difference is in who the shareholders are. They are intermediaries who have other people's money. What we are observing from the Business Roundtable is a recognition that business leaders need to make the system work for everybody. They are under pressure to balance interests in a way that is very difficult for them when they are getting significant pressure from one constituency and there is not enough protection for others. So there is a convergence around rebalancing our system, and that is where you see some of these forces coming together.

Millstein: Things went really wrong with the free market. It didn't work. It was a good idea to start with, but it swung too far in the wrong direction. The fact of the matter is, if you look at where we are presently as a country, we have gone way down the list in terms of livability. We have gone way down the list in terms of productivity, quality of life, and global competitiveness. That is a bad thing. Then come along the inequalities that you both cited. These inequalities—in wealth, education, ability to climb the ladder—are very real. And a whole host of people are just damn unhappy. That is why there is a marriage between the very far left and the Business Roundtable. Nobody can deny where we are. We are in a mess and we have to get out of it. The challenge in corporate governance is: What can the private sector do about it? What does corporate governance have to do with it? Both Leo and I think that corporate governance has a lot to do with it. How corporations are run and behave become paramount factors, and that is the crux of corporate governance. If we need changes in corporate governance, so be it. We will change it.

Talley: We have mentioned the ongoing multiple crises in the real economy, the racial justice movement, and political life. This stakeholder debate was already on a mid-level boil before any of these crises hit. Has the current set of crises amplified attention to these issues, adding a greater sense of

urgency? Or have these crises pushed off the importance of the stakeholder model until we get through them?

Millstein: It is just worse. Period. The virus has landed on people who were already in trouble. I do not blame them for being angry and upset. I would be, too, because they have a lack of access to healthcare and employment. The virus has been a major multiplier factor in bringing about unhappiness. You can see it in the current election and people who are on both sides of these issues. People are angry.

Talley: Leo, let me get your take on this as well. Has the virus turned up the heat on this already boiling pot?

Strine: I think it has, and it would be a real mistake if we lost sight of the underlying causes and only addressed the symptoms. For example, lack of corporate resiliency. If you think about it, companies should have been at their strongest in confronting the pandemic. We had ten years of economic recovery. The federal government gave a huge corporate tax cut. But we had companies that had to lay off workers in the first month. We are stiffing landlords. Why? Because institutional investors had pushed companies to run on fumes with minimal reserves. Additionally, as Ira mentioned, there are the distributional effects. It turns out that the workers most essential to our economy—the people who keep us up and running—were making much less than average. That class of workers was much more likely to be comprised of Black people. Black people were much more likely to be in the essential worker class with direct exposure to the virus and lower pay. They were also more likely to be unemployed. So Black people again took it on the chin and working-class and lower-middle-class people did, too. They were left more vulnerable to inequity, including because the changes in gainsharing have impaired workers' ability to build wealth. One piece of context we have overlooked is that Friedman wrote at a very ironic time. Europe, the United States, and our allies were experiencing unprecedented, widespread prosperity. Black people in the United States were making strides toward economic equality because they had only been given labor rights in '64, '65. We Reaganized the economy, and since then, wages have stagnated. By the way, there is a big canard we have to address. American workers have never been more educated, more skilled, more capable of retraining. If you look at the educational standards imposed upon professionals in society—for example, for nurses and therapists—they far exceed what would have been in place forty years ago. And their real pay has gone down. So it is just total bunk that the share workers are getting is because they are less skilled or less educated. It is that the take at the top has grown. As Ira said, that is unsustainable. Unless we address those power dynamics within corporate governance, we are going to be back at the same place. Also, I think we have to talk about the stockholder class and how profoundly different it is now from 1970. There is a new

segment of power in our economy: institutional investors, who have not been regulated in ways to channel their influence in a more socially productive way. We are either going to regulate institutional investors in the near term or we are going to be having this conversation again in five or six years.

Millstein: I agree with that, Leo. Let's focus on the need to bring people up. We have to start doing that, and I don't think the corporate community is doing its share. What did the corporate community do with the handouts it got? They bought back stock. They did not invest in the future. That was one of the more outrageous things that transpired. As I just said, this is what keeps me up at night. I don't see the private sector yet pitching in the way it should.

Strine: Do you think most of the CEOs really wanted to use that money for buybacks? Or did they have to do so to keep investors at bay, and it's all a precarious balancing act? That is what I wonder. Is it really that CEOs and managers have changed so much? Or is it that the dynamics within which they are operating are fundamentally different?

Millstein: We know very well that one of the dynamics here is the pressure that the public markets put on CEOs and boards. You still have a great deal of difficulty diverting your profits to growth and losing two points on the stock market. The pressure to keep up the value of your stock in the market is tremendous. This balancing that you and I are talking about is necessary. But the pressure coming from the top, from people who want returns in order to keep the stock up, is intense. Let's recognize also the way the compensation system works, because many corporations have tied executive compensation to stock price. So you have a vicious cycle here. There is pressure from shareholders to keep the price up and a willingness to keep the price up in the executive suite because it pays them to do so. How do people accumulate a hundred million dollars or more? I believe it is because of this vicious cycle. You are right. That is another thing we have to deal with. Heaven knows how we do that.

Strine: It is the workers who get the shaft, Ira, because the CEOs seek to please the stock market. It is much more pleasing to Wall Street to focus on immediate returns and investing in R&D, while shrinking pay to workers. The question is: How do you rebalance that to afford more discretion to managers? One of the pushes has been for institutions to start to say, well, maybe a slug of pay should be tied to EESG (including an extra "E" for employees) factors, as opposed to just total stock return.

Talley: Stock price and stock return have not only been incredibly focal measures of performance, but institutional investors, hedge funds, and other sophisticated investors have been able to figure out how almost to weaponize attention on stock returns as a way to put pressure on boards and CEOs.

Leo is probably correct that if we are going to have a serious capability to break out of this vicious circle, we are going to need to figure out a way to measure various attributes of performance under a stakeholder model. It is not particularly difficult to measure performance under a shareholder primacy approach—look at the stock returns and you have at least a proxy for how things are going. Once we start folding in other constituencies, we have, at the very least, a measurement problem.

Strine: Legal bottom lines provide a framework for fair competition. In terms of outcomes around factors like carbon emissions, having a governmental framework within which everybody must abide is useful. The same is true for labor standards. A living wage is extremely important. It sets a bottom line under all bargaining, and it eliminates arbitrage on the wrong dimensions against labor. Some areas of the world—Scandinavia, Germany—have sectoral bargaining. This allows for competition on real productivity, not on labor arbitrage. In addition to this external framework, we need to address this cacophony of standards being thrown at companies. Rulemaking through the SEC could be very helpful if you broaden the commission's mandate to allow it to consult with the EPA and Department of Labor, and guide the business and investment communities to focus on certain metrics. If everybody focuses on a subset of standards and reporting, we will be able to improve those metrics. For example, we have not focused sufficiently on worker safety, and this has hurt us in the pandemic. Other nations that are more attuned to worker safety have been more resilient. In terms of environmental responsibility, it should not be too difficult to develop metrics around carbon or other emissions. Unless all companies have to compete within a strong framework, we will not escape that vicious cycle, Ira. If you do not pay everybody a living wage, you are not doing what you should for racial inequality. Requiring companies to report on such focal areas will provide some basic, albeit imperfect, accountability.

Millstein: I don't think we are ever going to develop metrics that allow us to say a company is a 1.2 or 1.5, and therefore excellent. I would give up trying to do that. However, I do think that what Leo is suggesting, and what I firmly believe in, is in putting pressure on companies to provide better disclosure on sustainability, including through some of the measures that Leo is describing.

Talley: Even if we had perfect performance measures along all of these different stakeholder metrics, it still would not completely solve the problem. Suppose there is a decision that will make employees better off, but make the environment worse off, or vice versa. How do we know how to make these tradeoffs within a corporate governance environment?

Strine: Metrics will make the tradeoffs more rationally informed. Part of why law matters is that it sets boundaries on those tradeoffs. There are tradeoffs over time, in terms of gainsharing and other splits, but there are also tradeoffs in

terms of impact on stakeholders. That is where the law and good governance come together. The law tends to regulate companies where they rub up against stakeholders, including society. I am for a combination of principles-based disclosure and some basic metrics in each area that allow for company-to-company comparability. We need to turn the dial in a measured way along many dimensions. Then you do not have to do anything radical along any one dimension. However, if we ignore important dimensions—that is why I keep emphasizing institutional investor responsibility—then we will not have a system that works. The standards and metrics have to be part of an overall measure. Ira, I don't know if you agree with this—I also think you cannot have only companies disclosing how they take into account EESG factors. The institutions also need to disclose how these factors figure into their stewardship plans. Unless they really mean what they say, Ira, the pressure dynamics are not what you want them to be, right?

Millstein: I agree with that, Leo. I would like to remind everybody, however, of something that Sir Adrian Cadbury invented a long, long time ago. When we were trying to impose standards of corporate governance, he came up with a catchphrase that I thought was perfect. It was called "comply or explain." It seems to me that we could use the same thing here. If investors put the pressure on with a comply-or-explain regime, and they said, "Here are the things we think you should comply with; and if you're not going to comply, explain why you're not," then everybody has to open up and understand that these are important things to do. The private sector has to do it starting at the top and going all the way down.

Talley: How would you share the load between regulatory mandates to bring the regulatory state into the twenty-first century vs. solutions within corporate governance (also adding the gloss of what is practicably achievable within the political and regulatory sphere)?

Strine: There is no way to get where we need to go without restoring the promise of the New Deal and modernizing it for a twenty-first century economy to protect key stakeholders. Some of this is restoration. In the labor area, we definitely need to revive the promise of the National Labor Relations Act and make it applicable to the twenty-first-century economy. We need to restore a real living wage and we need to deal with the gig economy to make sure people do not exploit the contracted-worker status of workers that they are basically employing full time. In the environmental space, there is very clearly the need for a bottom line. The revival (and I think Ira is an expert on this) of the full promise of antitrust regulation is actually quite important to the business sector itself. In terms of consumer safety, there have been erosions. I do not think we are talking about a radical change, but we are talking about dealing with externalities that we have known existed for a long time, and bringing the regulatory state into the twenty-first

century. It also involves Pigovian approaches to taxation that could be quite helpful—a fractional trading tax. Aligning capital gains taxes with income taxes would provide some pricing friction for longer-term investors, would deter some of the destabilizing effects of high-velocity trading and non-fundamental strategies, and raise money to address climate change. I think that every Democratic legislator and every Republican economist, if put in a room, would support a carbon tax. In many ways we are just talking about bringing the regulatory state into the twenty-first century after forty years of not attending to it. We are not talking about anything radical, but a restoration of fair rules of the game to bring back into alignment the balance we formerly had.

Millstein: The menu Leo has laid out is unquestionably a great menu. All the legislative changes and regulatory changes he cited are necessary. I do not believe that the dysfunction in government is going away soon. Some changes in the political system to get us to a place where we can pass laws again may be necessary to take some of the steps that Leo is recommending. Of course, he knows we cannot do them all at once, but we could do some of them. In my view, we need some of them. We need government. We need legislation. We need everything. So what I have done, simply, from my old-fashioned view, is look back at a time when the private sector knew what to do. In 1931, the Business Roundtable knew exactly what to do, and they laid out a guide for themselves as to what they had to do to get back on track. Somehow, between '31 and now they lost their way. All I am saying is that, for heaven's sake, we knew how to do this once upon a time without people hitting us over the head. The only people I know I can talk to who might be able to do something toward this end are corporations and the private sector. They have the ability to change things if they want to. I do not see government as having the ability to do the things that Leo wants.

Strine: The private sector did not cure the Depression. They did not cure the dysfunctions of the nineteenth century economy that was lingering into the twentieth century. It was a partnership with government. It was a New Deal. It was a president who respected the free market forces, but channeled them. Many of the great business stories of the twentieth century and the twenty-first century are results of government inventions and government investments. We would not have Silicon Valley without the technological developments fueled by federal government research. You cannot even wash a chip in Silicon Valley without government—you would not have water to do it. You would not have the pharmaceuticals, the transportation infrastructure that facilitated growth, the social-fabric structure around economic security that took some of the load off the private sector. Social Security, programs like that, made it a lot easier for private sector businesses to thrive in their space. We have let go of some of what helped us in a win-win approach. I have a little more optimism than Ira does that

we can get some of this done in a meaningful way. However, I have total skepticism that the private sector alone, without a requirement that everybody pull in the same basic direction, will do it, because if they were so good at this, we would not be in the situation we are in today. I do not think they are bad people. The reality is that incentive systems matter, the rules of the game matter, and we have a chance next year to put the shared prosperity and economic security of the American people first and to set an example that will serve us well in international markets. Will it happen? I like to think so. Much will depend on what happens in the next two weeks at the presidential level and in the U.S. Senate. If the U.S. Senate turns Democratic, we can expect to see many Republicans in states where people care about economic security very attracted to a President Biden agenda that focuses on investing in infrastructure, supporting working people, and helping the private sector to train their workers. And that focuses the corporate governance system on being fair to all stakeholders. That will be attractive across party lines, Ira. So while I am not typically seen as an optimist, I do think now is a time of promise.

Millstein: I also agree that in the long run we will need a higher degree of government than we have now in such areas as antitrust, climate, environment, and workers' rights. However, I think that anything approaching Leo's idea of a new New Deal is not possible in this current dysfunction and is, unfortunately, wishful thinking. As much as I would like to endorse this dream, I remain a doer and I think we haven't got time for the long run. The short run is too unbalanced to put up with at this point. The only place I know to push a button is in the private sector through better corporate governance. I cannot make what I am facing as a government do anything, but Leo and I can talk to the private sector and say stop talking and do something. If you can change the government, fine, try. But even if you can't, there is a great deal you can do at this juncture as the private sector, and I think most CEOs know that and simply need a push.

Talley: Let me just pose one last question. What did we miss talking about? What topic central to this debate should we be spotlighting within this conversation?

Millstein: We have to focus on how to get this into the heads of people who count. We have to find the compromises. We have to get people to understand that to get along, we have to get along. We are not going to move forward by acting individually anymore. How do we get that across? Everything I am writing and saying is intended to indicate to people, "Get into your head: we are at a tipping point and it is very dangerous. It could go very wrong if we do not get it right." Period.

Strine: My addition is simple, but it is the most challenging of all. The New Deal in many ways was the creation of an effective regulatory state in the U.S. government to govern the scope of the whole U.S. economy, and people

forget that. Part of what has happened with the EU is the creation of a framework to govern that economy. We really need to knit together as a globe around common values to address issues like climate change and fair worker protection. The one topic we did not discuss is the international dynamic and how convergence around shared values, applying upward pressure for stakeholders, upward standards of living for workers in regionally appropriate ways so that we can include the developing world without arbitrage against workers, is a really important topic. Unfortunately, the last four years have worked a lot of injury to important international institutions that we have to revitalize and depend upon to address these issues, because the forces of the economy are much larger than any single nation—even the United States—can control. We all need to pull together. That fits with Ira's theme of cooperation. It cannot be just a U.S. cooperative effort. It has to be a set of shared values across nations, extending them internationally to make sure that we all have economies that we can be proud of and that are focused on sustaining our ability to survive as a species.

Talley: Great points. Although I could continue discussing this all day, I think we have to stop it here. Ira, Leo, thanks so much for speaking with me today.

Strine: It has been an honor, Eric. Thank you very much.

Millstein: I enjoyed it. Thank you.