

## Reflecting on CONSUMER PRIMACY

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Reflecting on Professor Summer Kim's paper "Consumer Primacy," I can summarize the findings in her excellent research paper for discussion as follows:

(i) While the shareholder-oriented model of corporations has served and will continue to serve an essential role in corporate law, this shareholder primacy regime involves two sources of inefficiency: first are principal costs, which stem from shareholders, as principals, behaving in self-interested ways that reduce overall firm value, and second are agency costs, which stem from managers, as agents, behaving in self-interested ways that reduce overall firm value;

(ii) Due to growing evidence of the inefficiencies above in (i), this Article provides consumer-focused metric, as an alternative, to expand the role of consumers in corporate governance for the purpose of mitigating some of the principal and agency cost that arises in shareholder-oriented model;

(iii) this paper categorizes the firms into three (3) subsets – "high consumer input" (**HCI**) firms, "high consumer output" (**HCO**) firms and "high consumer vulnerability" (**HCV**) firm considering the characteristics of the firms;

(iv) HCI firms are firms in which consumers provide critical inputs, such as ideas and investments (e.g., crowd-funded firms), and the interventions for expanding the role of consumers to treat them as principals of these firms, includes consumer voting system for board members and for fundamental consumer matters, and the formation of a consumer advisory committee;

(v) HCO firms are firms for which consumer satisfaction is a direct and reliable measure of a firm's output (e.g., the airline industry), and the interventions for expanding the metrics used to measure firm performance to include consumer satisfaction, involves offering an additional metric to assess managerial performance in these firms, and a new form of disclosure system with new formula; and

(vi) HCV firms are firms in which consumers are the primary victims of the market failures to which corporate law protections offer the most effective shield (e.g., Facebook or ICOs), and the interventions involves redesigning the scope of corporate law protections – fiduciary duties to the consumers as the ultimate beneficiaries - to extend to consumers in these firms.

The important role of consumers is rarely asked by corporate law professors in Korea as well. This paper provides fascinating counterarguments and refinements to protect the consumer primacy through analysis on a couple of challenges to implementation of new proposals, but none of which seems ineffective and insurmountable.

For sharing purpose, I would like to mention the recent big change in debate of stakeholder theory happened in the U.S. On August 19, 2019, Business Roundtable announced the release

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of a new Statement on the Purpose of a Corporation signed by 181 CEOs who commit to lead their companies “*for the benefit of all stakeholders – customers, employees, suppliers, communities and shareholders.*”<sup>2</sup> Since 1978, Business Roundtable has periodically issued Principles of Corporate Governance and each version of the document issued since 1997 has endorsed principles of shareholder primacy (that corporations exist principally to serve shareholders). With this announcement, the new Statement supersedes previous statements and outlines a modern standard for corporate responsibility (See the details of the new Statement in the *Attachment*).

While many in the legal profession, academia and various “moral” or “conscious” capitalism groups have articulated various forms of the stakeholder argument for a long time, the vast majority of investors, board members and executives of public companies have aligned with the “shareholder primacy” philosophy for the last 30-40 years.<sup>3</sup> Similarly, several legislations to reform the Korean Commercial Code (“KCC”) - which involves the Korean corporate law-, have aligned with the traditional shareholder primacy philosophy for the recent 20 years since the foreign currency crisis of 1998 in Korea and subsequently, acceptance of the IMF bailout package by the Korean government.

I am not in the protectionist mode of traditional view of the corporate law – i.e. shareholder primacy-, with belief of the shareholder-oriented model being errorless. I would stress and, also agree upon Professor Kim’s argument for redesigning the corporate law to improve the firm performance and protecting a class of consumers depending on categorized types of the firms. The consumer primacy regime may be considered as the strongest alternative among other stakeholder theories on the failure of shareholder primacy.

Nonetheless, as the shareholder primacy norm has had profound implications as pointed out by this paper, its cost-based framework is still a very useful tool to understand the corporate law in general.

The corporate governance does still matter with many controversial issues. The failure of board system is the best example of the big problems of corporate governance issue meanwhile. In fact, board of directors fails to give meaningful advices to management and/or to monitor important corporate decisions to be rendered by management due to lack of times and information.<sup>4</sup> For example, all shareholders’ equal power to vote on the selection of directors is the core of corporate governance. In Korea, like the United States, in the presence of high information and coordination costs, it has been more common practice to let the corporate

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<sup>2</sup> <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans>

<sup>3</sup> Don Delves, Ryan Resch and Willis Towers Watson, *Stakeholder Capitalism and Executive Compensation*, Harvard Law School Forum on Corporate Governance and Financial Regulation on October 2, 2019. (Italic emphasis added by the discussant)

<sup>4</sup> Taejin Kim, *What exactly do we want directors to do? - Discussion of Corporate Directors as an Alternative Measure on Failure of Board System*, Journal of Business Administration and Law Vol. 25 No. 4 (Korean Academic Society of Business Administration and Law, July, 2015) p123.

management perform the search function that precedes nomination of candidates, and have the shareholders simply vote on them after getting through approval of board meeting, acting through its outside directors.<sup>5</sup> Now, we can see another failure of corporate governance system based on shareholder primacy coupled with some serious legal problems (e.g., tunneling issues in Korea).

Traditional view recognizes three (3) generic agency problems arise in business firm. The corporate governance system principally supports the interests of shareholders as a single class according to the traditional view. Corporate law also reflects the agency conflicts jeopardizing the interests of minority shareholders and non-shareholder contractual constituents.<sup>6</sup> The first involves the conflict between the firm's owners and its hired managers. The problem lies in assuring that the managers are responsive to the owners' interest rather than pursuing their own personal interests.<sup>7</sup> The second agency problem involves the conflict between owners who hold the majority or controlling interest in the firm, on one hand, and the minority or non-controlling owners, on the other hand. The controlling shareholders can control corporate decision beneficial to themselves pursuing their own personal interests rather than the interest of the whole class of shareholders.<sup>8</sup> The third agency problem involves conflict between the firm itself (including its owners) and the other parties with whom the firm contracts such as creditors, employees, suppliers and customers.<sup>9</sup> The non-contractual constituents lack any contractual leverage over the firm in general. In addition to these agency problems, which are viewed as fundamentally voluntary in nature, another difficulty lies on externalities. Externalities means the situations where a firm imposes the costs on parties who do not contract with the firm. Dr. Kim's view about consumer primacy will help us solve this externality problem by consumer participation system reflecting her proposals.

As for legal strategies for reducing overall agency costs, some scholars categorize it into two subsets, regulatory strategies and governance strategies functionally as follows: (i) regulatory strategies are prescriptive: they dictate substantive terms that govern the content of the principal-agent relationship, tending to constrain the agents' behavior directly; and (ii) governance strategies seek to facilitate the principals' control over their agents' behavior.<sup>10</sup> This paper is reviewing regulatory strategies and governance strategies, both. For example, the suggested intervention for HCV firms would be to expand corporate law protections such

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<sup>5</sup> R. Kraakman, et al. *THE ANATOMY OF CORPORATE LAW – A COMPARATIVE AND FUNCTIONAL APPROACH* (3rd ed. Oxford University Press, 2017), p53.

<sup>6</sup> *Id.* p79.

<sup>7</sup> *Id.* pp29-30.

<sup>8</sup> *Id.* p30 (Similar problems can arise between ordinary and preference shareholders and between senior and junior creditors in bankruptcy).

<sup>9</sup> *Id.* p30. (The expression of "suppliers" is added.)

<sup>10</sup> *Id.* pp31-32.

as fiduciary duties to permit consumers to assert breach of fiduciary duty claims against corporate directors and officers.

Korea is an example showing preference of regulatory strategies. Even though the Korean corporate law has been reformed several times for decades, the numerous reform bills for amendment to the KCC had been still submitted to the National Assembly for its approval of the legislation (but currently hang in limbo). Some bill contains to specially empower representatives of employees (if there is an employees' union, the union)<sup>11</sup> and minority shareholder(s)<sup>12</sup> to nominate the candidates for election of outside directors and consequently, the company should be obliged to warrant the candidates to be corporate directors in the case of the public corporation. The fundamental idea is called as direct worker voting participation system, which is the very beginning step to consider the stakeholders' interest, although these proposals are grounded on consideration of employees' interest into the corporation.

In terms of consumer primacy, however, we may think about some situation where there are multiple principals and especially so where they have diverging interests, or heterogeneous preferences. If the firm produced one single product or provided one unified service to the consumer, the consumers is likely to be homogeneous. However, in real business world, the firm could produce multiple products or provides a variety of services involving lots of factors. Multiple layers of consumers will face more complicated information and coordination costs, which will inhibit their ability to engage in collective action to the firm.<sup>13</sup> Also there might be conflict between each fiduciary duty owed for each layer of consumers. With the foregoing difficulties of coordinating between principals, the principals will delegate more of their decision-making to agents. The more difficult it is for multiple layers of consumers (as principals) to coordinate on a single set of goals, such as selection of a consumer representative for a number of board seats, the harder it is to ensure that the firm (as an agent) does the "right" thing.<sup>14</sup> This signaling may lead the firm to intentionally ignore the voices of the consumers and legal rights of the consumers, if any, could be deemed as a mere formality even if the legislation allowed the consumers voting rights afterwards. In addition, it is unclear how to

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<sup>11</sup> New bill proposal's No. 2002091 proposed by Congressperson Hoechan No (노회찬 의원), et al. to amend the KCC (September, 2, 2016) and see more details at [http://likms.assembly.go.kr/bill/billDetail.do?billId=PRC\\_O1V6W0D9K0K2X1X7D2S9V2K1Y9W8D4](http://likms.assembly.go.kr/bill/billDetail.do?billId=PRC_O1V6W0D9K0K2X1X7D2S9V2K1Y9W8D4)

<sup>12</sup> Also, see another bill proposal's No. 2003516 proposed by Congressperson Ibae, Chae (채이배 의원), et al. to amend the KCC (November, 11, 2016). The minority shareholder referred herein should be required to have more than three(3)% shareholdings and keeps such shareholding at least 6 months and see more details at [http://likms.assembly.go.kr/bill/billDetail.do?billId=PRC\\_V1D6K1Y1N1P1V1X8L2R7B0I1Q0J4P9](http://likms.assembly.go.kr/bill/billDetail.do?billId=PRC_V1D6K1Y1N1P1V1X8L2R7B0I1Q0J4P9)

Similarly, new bill proposal's No. 2009211 proposed by Congressperson Unju Lee (이언주 의원), et al. to amend the KCC (September, 8, 2017) and see more details at [http://likms.assembly.go.kr/bill/billDetail.do?billId=PRC\\_J1T7U0J9S0L8V1G7V3U0I0U1H2G0R9](http://likms.assembly.go.kr/bill/billDetail.do?billId=PRC_J1T7U0J9S0L8V1G7V3U0I0U1H2G0R9)

<sup>13</sup> R. Kraakman, et al, *supra* note 5, p30 (This statement is found in James M. Buchanan and Gordon Tullock, *THE CALCULUS OF CONSENT* 63-116 (1962) and Mancur Olsen, *THE LOGIC OF COLLECTIVE ACTION* 66-7 (1991)).

<sup>14</sup> *Id.* p30.

mitigate the possible conflict between consumer voting and shareholder voting, for board members and for fundamental corporate matters which will affect both interests of consumers and shareholders. Is separating or partitioning one group from the other groups the best way indeed?

The new trend toward stakeholder primacy involves the recent growing concerns<sup>15</sup> about corporate scandals by misconducts of directors and managements and stories of greedy institutional investors pursuing high return and quick exit plan. However, there is doubt that enforcing the pursuit of overall social welfare to the corporation will be commensurate with the original purpose of corporations. Maximizing the value of the firm (stock value) is also important to the firm, honestly. For charity purpose, people do not form the corporate organization. According to shareholder primacy theory, more modestly, could it be impossible to find any feasible way that directors should not be inclined to adopt an excessively high-risk-strategy only for the best interests of stockholders, on one hand, and the institutional investors should not exercise their power in ways that preference of short-term and private benefits over long-term and collective gains of the firm, on the other hand by fiduciary duty framework and the existing legal strategies? We may think about another measures or corrections to the shareholder primacy (e.g., imposing liability to shareholders under certain circumstances by lifting limited liability shields).

Also, I could emphasize the divergence among American, European, Japanese and Korean corporations in terms of corporate governance and business culture or political environment even though business corporations have a fundamentally similar set of legal characteristics, pursuing their intrinsic purpose and face a fundamentally similar problems legally in all jurisdictions. To some extent, therefore, the structure of corporate law in any given country is a consequence of that country's pattern of corporate ownership<sup>16</sup> and business or political culture. Regarding this, we could find any differences from the perspective based on Korean cultures.

Corporate transactions are beneficial not just to the shareholders, but to all parties who deal with the firm. This Article provides the aspirations and conceptual framework of how to redesign corporate law, by expanding the consumers' role into corporate governance. None of us has a crystal ball to foresee and predict the future. However, we all agree that corporate law requires a steady infusion of new energy and fresh perspectives and therefore, this paper does give an infusion of new energy and a fresh perspective, indeed.

Thank you for listening to my words.

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<sup>15</sup> Lenore M. Palladino, Ending Shareholder Primacy in Corporate Governance (Roosevelt Institute Working Paper, 2019).

<sup>16</sup> R. Kraakman, et al, *supra* note 5, p27.

## References

- Taejin Kim, *What exactly do we want directors to do? - Discussion of Corporate Directors as an Alternative Measure on Failure of Board System*, Journal of Business Administration and Law Vol. 25 No. 4 (Korean Academic Society of Business Administration and Law, July, 2015) (Korean Title: “우리는 이사회에게 무엇을 기대할 것인가 – 이사회 실패 현상을 극복하기 위한 대안으로서 법인 이사론을 중심으로 –”).
- Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda, Mariana Pargendler, Wolf-Georg Ringe, Edward Rock (2017). *THE ANATOMY OF CORPORATE LAW – A COMPARATIVE AND FUNCTIONAL APPROACH* (3rd ed. Oxford University Press, 2017).
- Lenore M. Palladino, *Ending Shareholder Primacy in Corporate Governance* (Roosevelt Institute Working Paper, 2019).

*[Attachment]*

## **Statement on the Purpose of a Corporation**

Americans deserve an economy that allows each person to succeed through hard work and creativity and to lead a life of meaning and dignity. We believe the free-market system is the best means of generating good jobs, a strong and sustainable economy, innovation, a healthy environment and economic opportunity for all.

Businesses play a vital role in the economy by creating jobs, fostering innovation and providing essential goods and services. Businesses make and sell consumer products; manufacture equipment and vehicles; support the national defense; grow and produce food; provide health care; generate and deliver energy; and offer financial, communications and other services that underpin economic growth.

While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders.

We commit to:

- Delivering value to our customers. We will further the tradition of American companies leading the way in meeting or exceeding customer expectations.

- Investing in our employees. This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect.

- Dealing fairly and ethically with our suppliers. We are dedicated to serving as good partners to the other companies, large and small, that help us meet our missions.

- Supporting the communities in which we work. We respect the people in our communities and protect the environment by embracing sustainable practices across our businesses.

- Generating long-term value for shareholders, who provide the capital that allows companies to invest, grow and innovate. We are committed to transparency and effective engagement with shareholders.

Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country.

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