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Corporate Political Speech is Bad for Shareholders

By Lucian Bebchuk

The United States Supreme court recently struck down limits on the freedom of companies to spend money on political elections. Large, publicly traded companies in other countries also often face lax limits on their use of corporate resources to influence political outcomes, fueling fears that the interests of shareholders will trump those of other groups, such as consumers and employees. But corporate spending on politics can also hurt the interests of shareholders.

Stock market listed companies control a big share of almost every country's resources, so the free flow of corporate money into politics can have a profound impact on politicians' preferences and choices. In particular, the influence of corporations on politicians and political outcomes can be expected to weaken the rules that protect shareholders and ensure that companies are well-governed.

To understand why, it is important to focus on the individuals who make decisions for companies. When corporations decide which politicians to support, what kind of messages to send, and which political outcomes to seek, their general investors are not consulted. Rather, such decisions are likely to reflect the preferences and objectives of the insiders who manage the companies, ostensibly on shareholders' behalf. And politicians that benefit from corporate spending and access to corporate resources will have an interest in serving the insiders' preferences and objectives.

To be sure, on many issues the interests of corporate insiders overlap with those of investors, and here insiders can be expected to lobby in directions that are consistent with the interests of shareholders. But there are also important issues on which the interests of insiders and outside investors can sharply diverge. This is clearly the case with respect to the rules which govern investor protection and corporate governance.

The purpose of these important rules is to protect outside investors from the opportunism of insiders. When such rules are too lax, insiders face insufficient constraints on their ability to run the firm in ways that serve their private interests at the expense of outside, general investors.

Of course, insiders do not want the rules to be so lax that it becomes impossible for them to raise capital from the public. But, because publicly traded companies usually have a large amount of capital in place, lax rules would enable insiders to use this capital to their advantage. As a result, insiders benefit from, and prefer to have, rules concerning corporate governance and investor protection that are more lax than those that are in the interest of shareholders and society.

The ways in ways in which a country's rules can be expected to be too lax depend on how publicly traded firms are structured and run. In some countries, such as the US, ownership and control are separated, and companies are *de facto* controlled by professional managers. Such managers can be expected to use their influence to obtain and maintain rules that weaken the rights of dispersed shareholders and make it difficult for shareholders to replace them. Thus, in the US, corporate influence makes it difficult to obtain long-needed reforms that would eliminate barriers to takeovers and remove legal impediments to the ability of shareholders to replace company directors.

In many other countries, however, listed companies commonly have a controlling shareholder that dominates the firm's decision-making. In such countries, rules are supposed to limit the controlling shareholders' power to advance their interests at the expense of minority shareholders. But the insiders that direct corporate lobbying can be expected to seek to obtain and maintain rules that provide insufficient protection to minority shareholders from such opportunism.

A large body of empirical evidence indicates that corporate governance and investor protection are better in countries that are more advanced in their economic and political development. This pattern is usually interpreted as support for the argument that improved corporate governance and investor protection leads to such development.

But causality might also run in the opposite direction. Countries that are more developed, and have political systems that are more accountable to voters and less vulnerable to corporate lobbying, may lead to better corporate governance and investor protection rules.

In sum, corporate meddling in politics is bad not just for those members of society who are not corporate shareholders. It also can be expected to reduce shareholder value and retard the development of an economy's corporate sector. That is bad for capitalists – and thus for capitalism.

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