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Purpose, Stakeholders, ESG and Sustainable Long-Term Investment

This year, each of the major index fund managers, the Business Roundtable, the British Academy, the UK Financial Reporting Council, the World Economic Forum and a number of other organizations (both governmental and nongovernmental) announced that they did not support shareholder primacy and do support sustainable long-term investment and considering ESG matters. However, the initial reaction of the Council of Institutional Investors in denouncing the BRT position from both an economic and legal standpoint, although quickly moderated, has continued to echo in Wall Street trading rooms, at activist hedge funds and in corporate boardrooms. I continue to hear that the shareholders own the corporation and therefore can order the directors to maximize value solely for the shareholders. I also continue to hear that since the shareholders elect the directors, the directors have a primary fiduciary duty to the shareholders. Lastly, I continue to hear from some quarters of academia that economic theory and financial statistics “prove” that shareholder primacy and its concomitant short-termism best serve the economy and are critical elements of capitalism.

I completely disagree with these arguments. I believe that sound economic and legal policies and theories mandate rejection of shareholder primacy. The following is an outline of key points, some or all of which, I use in giving stakeholder governance advice to corporations and boards of directors:

- *The purpose of a corporation is to conduct a successful business with a view to achieving sustainable long-term growth in value.*
- *The shareholders do not own the corporation; they own shares in the corporation.*
- *The directors are elected by the shareholders, but that does not mean that the shareholders are the only stakeholders to whom the directors have a fiduciary duty.*
- *The basic fiduciary duty of the directors is to the corporation to manage its business to create sustainable long-term growth in value.*
- *Directors have a fiduciary duty to promote the best interests of the corporation, and in fulfilling that duty, directors must exercise their business judgment in considering and reconciling the interests of various stakeholders and their impact on the business and long-term value of the corporation.*

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- *In discharging their fiduciary to the corporation to manage its business to create sustainable long-term growth in value, the directors have a fiduciary duty to use their business judgment to take into account the interests of all the stakeholders in achieving sustainable long-term growth in value.*
- *As long as the directors discharge their duty of care and loyalty in managing the business of the corporation to achieve sustainable long-term growth in value, they are protected by the business judgment rule from any liability to any stakeholder argument that they should have received greater consideration or value than any other stakeholder.*
- *The special genius of Delaware law is that it has been animated by a fundamental sense of pragmatism and its fiduciary duty framework has afforded corporations the breathing room they need to address evolving business challenges as well as expectations of shareholders.*
- *Corporations and directors have to recognize that ultimately relatively few asset managers and asset owners, in the aggregate, have a controlling interest in the corporation; therefore periodic engagement with those shareholders to achieve mutual understanding about the strategy the corporation is following is important.*
- *Stakeholder governance and consideration of ESG matters does not reduce or negate accountability, the goal of sustainable long-term growth in value remains.*
- *“The best way to understand and harmonize the divergent interests of all stakeholders is through a shared commitment to policies and decisions that strengthen the long-term prosperity of a company.” (From the WEF definition of purpose.)*

Much of the foregoing discussion points is based on our, [*Some Thoughts for Boards of Directors in 2020*](#), as is the following:

The fiduciary duty of a board of directors is to the corporation; not just to the shareholders. Much of the focus on stakeholder governance has shifted from the question of *whether* a board of directors should take into account the interests of stakeholders other than shareholders, to *how* a board should do so. Directors need to grapple with a host of questions about the practical implications of this new paradigm—such as how to adjust existing board functioning to reflect stakeholder governance, questions about the contours of the board’s legal obligations, and what, if any, modifications should be made to communications and engagement efforts with shareholders and other stakeholders.

In many respects, an embrace of stakeholder governance is best characterized as a recalibration rather than a sea change. The board's objective continues to be the long-term health and profitable success of the corporation, and it must continue to exercise its *business judgment* to achieve that outcome. To be clear, the essence of stakeholder governance is not about altruism, nor does it enable corporations to promote the interests of some stakeholders at the expense of others for reasons that are not squarely anchored in the best interests of the corporation. Shareholder concerns about the prospect of zero-sum trade-offs between shareholders and other stakeholder interests should be mitigated to a large extent by the fact that shareholders are the ultimate beneficiaries of the financial value of the corporation. Profits are not the sole objective of the corporation, but they are one of the objectives that a well-functioning corporate governance regime must seek to achieve.

The [attached article from the Financial Times](#) reflects the growing realization by major asset managers and institutional investors that to preserve capitalism as we now know it shareholder primacy must be abandoned and stakeholder governance and attention to ESG matters must be embraced.

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