

May 26, 2020

On the Purpose of the Corporation

The growing view that corporations should take into account environmental, social and governance (ESG) issues in running their businesses, and resistance from those who believe that companies should be managed solely to maximize share price, has intensified the focus on the more fundamental question of corporate governance: what is the purpose of the corporation?

The question has elicited an immense range of proposed answers. The British Academy's Future of the Corporation Project, led by Colin Mayer, suggests that the purpose of the corporation is to provide profitable solutions to problems of people and planet, while not causing harm. The Business Roundtable has articulated a fundamental commitment of corporations to deliver value to all stakeholders, each of whom is essential to the corporation's success. Each of the major US-based index funds has also expressed their views about the purpose of the corporations in which they invest, which, considered collectively, can be summarized as the pursuit of sustainable business strategies that take into account ESG factors in order to drive long-term value creation. On the other hand, the Council of Institutional Investors, some leading economists and law professors, and some activist hedge funds and other active investors continue to advocate a narrow scope of corporate purpose that is focused exclusively on maximizing shareholder value. The Covid-19 pandemic has brought into sharp focus the inequality in our society that, in considerable measure, is attributable to maximizing shareholder value at the expense of employees and communities.

For our part, we have supported stakeholder governance for over 40 years – first, to empower boards of directors to reject opportunistic takeover bids by corporate raiders, and later to combat short-termism and ensure that directors maintain the flexibility to invest for long-term growth and innovation. We continue to advise corporations and their boards that they may exercise their business judgment to manage for the benefit of all stakeholders over the long term.

As the pandemic disrupts settled expectations and provokes fresh perspectives, we believe it is critical to the vitality of our economic system for corporations – and the asset managers and investors who hold their shares – to recognize that ESG and stakeholder purpose are necessary elements of sustainable business success, and to engage on a regular basis to rationalize their views as to governance and stewardship. The roadmap for this shared understanding is elaborated in *The New Paradigm: A Roadmap for an Implied Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth*, which we developed for the World Economic Forum in 2016.

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These imperatives lead us to a simple formulation of corporate purpose:

The purpose of a corporation is to conduct a lawful, ethical, profitable and sustainable business in order to create value over the long-term, which requires consideration of the stakeholders that are critical to its success (shareholders, employees, customers, suppliers, creditors and communities), as determined by the corporation and the board of directors using its business judgment and with regular engagement with shareholders, who are essential partners in supporting the corporation's pursuit of this mission.

This conception of purpose is broad enough to apply to every business entity but at the same time supplies clear principles for action and engagement. The basic objective of sustainable profitability recognizes that the purpose of for-profit corporations is to create value for investors. The requirement of lawful and ethical conduct ensures minimum standards of corporate social compliance. Going further, the broader mandate to take into account corporate stakeholders — including communities, which is not limited to local communities, but comprises society and the economy at large — directs boards to exercise their business judgment within the scope of this broader responsibility. The requirement of regular shareholder engagement acknowledges accountability to investors, but also shared responsibility with shareholders for responsible long-term corporate stewardship.

Fulfilling this purpose will require different approaches for each corporation, dependent on its industry, history, governance and other factors. We expect that board committees – focusing on stakeholders, ESG issues and the stewardship obligations of shareholders – may be useful or even necessary for some companies. But for all the differences among companies, there is an important unifying commonality: corporate action, taken against the backdrop of this view of corporate purpose, will be fully protected by the business judgment rule, so long as it reflects the decisions of unconflicted directors acting upon careful deliberation.

Executed in this way, stakeholder governance is more consistent with a value-creation mandate than the shareholder primacy model. Directors and managers enjoy broad authority to act for the corporate entity they represent, over the long term, balancing its many rights and obligations and taking into account both risks and opportunities, in regular consultation with shareholders. Directors will not be forced to act as if any one interest trumps all others, with potentially destructive consequences, but will instead have latitude to make decisions that reasonably balance the interests of all constituencies and operate to the benefit of the sustainable, long-term business success of the corporation as a whole.

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