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OPINION

Corporate governance

Directors have a duty to look beyond their shareholders

The stakes for responsible corporate governance have never been higher

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The stakes for responsible corporate governance and investor stewardship have never been higher.

Recognising this urgency, the Business Roundtable, a large group of US chief executives, last month embraced a broader view of governance and urged companies to focus on sustainable value creation. Yet, as directors of American corporations seek to answer these calls, they remain subject to countervailing market pressure to deliver outsized shareholder returns over short periods of time.

Directors need support to mediate this challenge and make responsible long-term corporate decisions. My law firm has long argued for a stakeholder-centred model of corporate governance rather than rote application of the "shareholder primacy" model. Investors and the asset managers who represent them share with the rest of society an interest in sustainable prosperity.

Our "New Paradigm" seeks to rethink corporate governance as a collaboration among shareholders, directors, managers, employees, customers, suppliers, and the communities in which corporations operate.

This solution would be far less intrusive than proposals by presidential candidate Elizabeth Warren to put worker representatives on boards. It also offers an effective alternative to the shareholdervalue maximisation principle that has dominated corporate thinking for 50 years.

The myopic view that shareholder returns are the central aim of corporate governance is no longer politically or commercially viable. Corporate law is in the midst of an evolution that we believe will eventually restore the broader social mission of the corporation.

But directors cannot wait that long. They must manage massive risks to environmental and human capital resources and drive growth without fully-formed governance principles.

The environmental, social, and governance investing movement provides a useful starting point.

ESG proponents urge corporations to adopt long-term sustainable growth policies that take into account the broader costs to society of company behaviour. Some boards have sought to integrate ESG considerations into their decisions; others have yet to address them.

To meet these challenges, directors have the ability, and in many instances the obligation, to use their reasoned business judgment to balance the interests of all stakeholders — not just shareholders, but also employees, business partners, and national and local communities.

We do not need new laws or court decisions allowing well-informed directors to take all stakeholders into account. Some states have enacted "constituency statutes" that specifically reference stakeholder interests; others, including Delaware, where most big US companies are incorporated, have not.

But the controlling legal rule is universal and rock-solid: in every US jurisdiction, boards are allowed to use their "business judgment" to pursue ESG principles for the purpose of creating longterm corporate value.

That is just the floor. Properly informed directors are also empowered to protect corporate reputations and engage with investors about long-term threats from social and environmental issues.

Directors may also safeguard global supply chains and strengthen the ability to recruit and motivate a skilled workforce. Moreover, boards have the affirmative duty to identify business risks and come up with a strategy for dealing with them.

Taken together, directors' duties not only permit boards to address the full range of risks that threaten a company's ability to deliver sustainable growth, but indeed require boards to address them.

However, there remains another issue. Under US law, only shareholders elect directors. That means effective governance requires boards and investors to work together. The prospects for such a partnership are increasingly promising. Large institutional shareholders — notably BlackRock, State Street and Vanguard — recognise that companies must serve broader social purposes. And surveys of major investors confirms that they expect companies to articulate a socially and economically valuable purpose, to take public stands on ethical issues, and come up with plans to address the rising risks of income inequality and environmental deterioration.

The law empowers directors to address these new risks — and to capitalise on the resulting opportunities. Investors should support them in those efforts as a matter of priority.

The writer is a partner at Wachtell, Lipton, Rosen & Katz. William Savitt, another partner, also contributed.