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The Purpose of the Corporation

Whether the purpose of the corporation is to generate profits for its shareholders or to operate in the interests of all of its stakeholders has been actively debated since 1932, when it was the subject of dueling law review articles by Columbia law professor Adolf Berle (shareholders) and Harvard law professor Merrick Dodd (stakeholders).

Following “Chicago School” economics professor Milton Friedman’s famous (some might say infamous) 1970 *New York Times* article announcing *ex cathedra* that the social responsibility of a corporation is to increase its profits, shareholder primacy was widely viewed as the purpose and basis for the governance of a corporation. My 1979 article, *Takeover Bids in the Target’s Boardroom*, arguing that the board of directors of a corporation that was the target of a takeover bid had the right, if not the duty, to consider the interests of all stakeholders in deciding whether to accept or reject the bid, was widely derided and rejected by the Chicago School economists and law professors who embraced Chicago School economics. Despite the 1985 decision of the Supreme Court of Delaware citing my article in holding that a board of directors could take into account stakeholder interests, and over 30 states enacting constituency (stakeholder) statutes, shareholder primacy continued to dominate academic, economic, financial and legal thinking—often disguised as “shareholder democracy.”

While the debate continued and stakeholder governance gained adherents in the new millennium, shareholder primacy continued to dominate. Only since the 2008 financial crisis and resulting recession has there been significant recognition that shareholder primacy has been a major driver of short-

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termism, encourages activist attacks on corporations, reduces R&D expenditures, depresses wages and reduces long-term sustainable investments—indeed, it promotes inequality and strikes at the very heart of our society. In the past five years, the necessity for changes has been recognized by significant academic, business, financial and investor reports and opinions. An example is the 2017 paper I and a Wachtell Lipton team prepared for the World Economic Forum, [*The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth*](#), which quotes or cites many of the others.

This year we are seeing important new support for counterbalancing shareholder primacy and promoting long-term sustainable investment. Among the many prominent examples is the January 2018 [annual letter](#) from Larry Fink, Chairman of BlackRock, to CEOs:

Without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders. It will succumb to short-term pressures to distribute earnings, and, in the process, sacrifice investments in employee development, innovation, and capital expenditures that are necessary for long-term growth. It will remain exposed to activist campaigns that articulate a clearer goal, even if that goal serves only the shortest and narrowest of objectives. And ultimately, that company will provide subpar returns to the investors who depend on it to finance their retirement, home purchases, or higher education.

This was followed in March by the report of a commission appointed by the French Government recommending amendment to the French Civil Code to add, “The company shall be managed in its own interest, considering the social and environmental consequences of its activity,” following the existing, “All companies shall have a lawful purpose and be incorporated in the common interest of the shareholders.” The draft amendment is intended to establish the principle that each company should pursue its own interest—namely, the continuity of its operation, sustainability through investment, collective creation and innovation.

The report notes that this amendment integrates corporate and social responsibility considerations into corporate governance and goes on to state that each company has a purpose not reducible to profit and needs to be aware of its purpose. The report recommends an amendment to the French Commercial Code for the purpose of entrusting the boards of directors to define a company's purpose in order to guide the company's strategy, taking into account its social and environmental consequences.

Also in March, the European Commission in its [Action Plan: Financing Sustainable Growth](#) proposed both corporate governance and investor stewardship requirements:

Subject to the outcome of its impact assessment, the Commission will table a legislative proposal to clarify institutional investors' and asset managers' duties in relation to sustainability considerations by Q2 2018. The proposal will aim to (i) explicitly require institutional investors and asset managers to integrate sustainability considerations in the investment decision-making process and (ii) increase transparency, towards end-investors on how they integrate such sustainability factors in their investment decisions in particular as concerns their exposure to sustainability risks.

Further, the Commission proposes a number of other laws or regulations designed to promote ESG, CSR and sustainable long-term investment.

In addition to these examples, there are similar policy statements by major investors and similar efforts at legislation to modulate or eliminate shareholder primacy in Great Britain and the United States. While it is not certain that any legislation will soon be enacted, it is clear that the problems have been identified, support is growing to find a way to address them and if implicit stakeholder governance does not take hold, legislation will ensue to assure it.

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