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On the Purpose and Objective of the Corporation

As we approach the first anniversary of the Business Roundtable’s abandonment of shareholder primacy and embrace of stakeholder governance, and the fourth anniversary of our development for the World Economic Forum of The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth, we thought it useful to consider in broader context the key issues of corporate governance and investor stewardship today. While there is no universal consensus, the question underlying these issues can be expressed as: What is the corporation trying to achieve? What is its objective?

This question has elicited a wide range of proposed answers. The British Academy’s Future of the Corporation project, led by Colin Mayer of Oxford University, posits that the purpose of the corporation is to provide profitable solutions to problems of people and planet, while not causing harm. This view has been advocated for European corporations by the Enacting Purpose Initiative, of which Professor Mayer is a Co-Chair. In the U.S., 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 U.S.-based index funds has also expressed its 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 environmental, social and governance (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 activist investors continue to advocate a narrow scope of corporate purpose that is focused exclusively or principally on maximizing shareholder value.

Recent events — notably including the pandemic, its disparate impact on various segments of society, and the focus on inequality and injustice arising in the wake of the death of George Floyd — have accelerated the conversation on corporate purpose. The result has been substantial, salutary reflection about the role that corporations play in creating and distributing economic prosperity and the nexus between value and values.

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 — consistent with Delaware law — they may exercise their business judgment to manage for the benefit of the corporation and all of its stakeholders over the long term.

In looking beyond the disruption caused by the pandemic, boards and corporate leaders have an opportunity to rebuild with the clarity and conviction that come from articulating a corporate purpose, anchored in a holistic understanding of the key drivers of their business, the ways in which those drivers shape and are shaped by values, and the interdependencies of multiple stakeholders that are essential to the long-term success of the business.
This opportunity leads us to reiterate and refine a simple formulation of corporate purpose and objective, as follows:

The purpose of a corporation is to conduct a lawful, ethical, profitable and sustainable business in order to ensure its success and grow its value over the long term. This requires consideration of all the stakeholders that are critical to its success (shareholders, employees, customers, suppliers and communities), as determined by the corporation and its board of directors using their business judgment and with regular engagement with shareholders, who are essential partners in supporting the corporation’s pursuit of its purpose. Fulfilling purpose in such manner is fully consistent with the fiduciary duties of the board of directors and the stewardship obligations of shareholders.

This statement of corporate purpose is broad enough to apply to every business entity, but at the same time supplies clear guideposts for action and engagement. The basic objective of sustainable profitability recognizes that the purpose of for-profit corporations includes creation of value for investors. The requirement of lawful and ethical conduct ensures generally recognized standards of corporate social compliance. Going further, the broader mandate to take into account all corporate stakeholders, including communities, is not limited to local communities, but comprises society and the economy at large and 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 the shared responsibility of shareholders for responsible long-term corporate stewardship.

Fulfilling this purpose will require different approaches for each corporation depending on its industry, history, regulatory environment, governance and other factors. We expect that board committees — focusing on stakeholders, ESG issues and the stewardship obligations of shareholders — will 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 formulation of corporate purpose, will be fully protected by the business judgment rule, so long as decisions are made by non-conflicted directors acting upon careful consideration and deliberation.

Executed in this way, stakeholder governance will be a better driver of long-term value creation and broad-based prosperity than the shareholder primacy model. Directors and managers have the responsibility of exercising their business judgment in acting for the corporate entity that they represent, balancing its rights and obligations and taking into account both risks and opportunities over the long term, in regular consultation with shareholders. Directors will not be forced to narrow their focus and 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 in a manner that will promote the sustainable, long-term business success of the corporation as a whole.

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