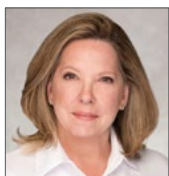




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The Corporate Purpose Debate

In her regular column on corporate governance issues, Holly Gregory discusses the recently reignited debate on the appropriate role of the corporation in society.

**HOLLY J. GREGORY**

PARTNER
SIDLEY AUSTIN LLP

Holly counsels clients on a full range of governance issues, including fiduciary duties, risk oversight, conflicts of interest, board and committee structure, board leadership structures, special committee investigations, board audits and self-evaluations, shareholder initiatives, proxy contests, relationships with shareholders and proxy advisors, compliance with legislative, regulatory, and listing rule requirements, and governance best practice.

The Business Roundtable's recently released Statement on the Purpose of a Corporation (2019 Statement), available at opportunity.businessroundtable.org, has generated new interest in the age-old debate about for whom the corporation is governed. This debate considers whether the primary purpose of the corporation is to return value to shareholders or whether the corporation exists to address a broader set of societal interests.

The 2019 Statement emphasizes that companies serve a public good in providing goods and services, and expresses a commitment to consideration of the interests of a broad range of stakeholders in corporate decision-making. It is similar in tone to the Business Roundtable's 1981 Statement on Corporate Responsibility, which stated that "the long-term viability of the business sector is linked to its responsibility to the society of which it is part." However, the 2019 Statement significantly departs from the view that gained ascendancy in the late 1990s, as reflected in the Business Roundtable's 1997 Statement on Corporate Governance, which emphasized that "the principal objective of a business enterprise is to generate economic returns to its owners."

Today, boards and CEOs recognize that shareholders, directors, and managers function within a larger business and legal environment that shapes behavior, in line with a broader view

of corporate governance that goes beyond the internal affairs of the corporation. Boards navigate through continual changes in technology, business models, and competitive conditions as they guide the corporation. They also must adapt to evolving conceptions about the role of the corporation in society that shape expectations about corporate governance and for whom the corporation is governed.

Economic success is related to how a corporation engages with shareholders and a wide range of constituents. For corporations to succeed, remain durable, and return value to shareholders over the long term, they need to consider the fair interests of these constituents. Satisfying the interests of key constituents and acting in a responsible manner are crucial to competitive success, corporate reputation, and operational effectiveness.

Against this background, this article discusses:

- The key principles of the 2019 Statement.
- Current views on corporate purpose and responsibility.
- The potential legal implications associated with considering a broader corporate role.

THE 2019 STATEMENT

The 2019 Statement, which has been signed by the CEOs of 183 large public companies, including institutional investors BlackRock and Vanguard, reflects that views on the corporation's role in society change with time, and that trust in corporations is essential to their ability to succeed. As stated in the preamble to the 2019 Statement:

"If companies fail to recognize that the success of our system is dependent on inclusive long-term growth, many will raise legitimate questions about the role of large employers in our society. ... Since 1978, Business Roundtable has periodically issued Principles of Corporate Governance that include language on the purpose of a corporation. Each version of that document issued since 1997 has stated that corporations exist principally to serve their shareholders. It has become clear that this language on corporate purpose does not accurately describe the ways in which we and our fellow CEOs endeavor every day to create value for all our stakeholders, whose long-term interests are inseparable."

According to the 2019 Statement, the purpose of the corporation is not solely the creation of profit, but the creation of goods or services that fill a need, with each company serving its own defined purpose (for example, providing health care, generating energy, or producing food), based on the goods or services it provides. This idea echoes a theme that Larry Fink, the Chairman and CEO of BlackRock, sounded in his 2019 letter to portfolio company CEOs (available at [blackrock.com](https://www.blackrock.com)). In the 2019 letter, Fink stated that "[p]urpose is not a mere tagline or marketing campaign; it is a company's fundamental reason for being — what it does every day to create value for its stakeholders. Purpose is not the sole pursuit of profits but the animating force for achieving them."

Refocusing the articulation of corporate purpose on the central activity of the corporation, rather than on the resulting profits,

Business Roundtable Statements on Corporate Governance and Responsibility

The Business Roundtable has issued the following key statements:

- The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation (January 1978).
- Statement on Corporate Responsibility (October 1981).
- Corporate Governance and American Competitiveness (March 1990).
- Statement on Corporate Governance (September 1997).
- Principles of Corporate Governance (May 2002, updated 2005, 2010, 2012, and 2016).
- Statement on the Purpose of a Corporation (August 2019).

is notable. However, the language in the 2019 Statement that has received the most attention in the ensuing debate relates to the commitment to all stakeholders, specifically:

- Customers.
- Employees.
- Suppliers.
- Communities.
- Shareholders.

The Council of Institutional Investors, an association of public and private pension funds and other institutional investors, expressed concern that shareholders were listed last, equating the list of commitments with a prioritization of interests. Significant debate has continued, with some critics asserting that the 2019 Statement attempts to walk back director fiduciary obligations to act in the best interests of the corporation and its shareholders.

On its face, the 2019 Statement does not advocate for any reordering of prioritization of interests under state corporate law, and it is consistent with current fiduciary duty constructs. The 2019 Statement is more appropriately viewed as a consensus among leading CEOs that corporate success and shareholder and stakeholder interests are interdependent. Companies do not return value to shareholders over a sustained period if they fail to satisfy customers and suppliers and attract, train, and retain employees. Similarly, companies risk impairing their reputations and brands, and shareholder value, if they fail to act as responsible participants in their communities and society.

This is the intent of the 2019 Statement as clarified by the Business Roundtable: "For corporations to be successful, durable and return value to shareholders, they need to consider the interests and meet the fair expectations of a wide range of

stakeholders in addition to shareholders, including customers, employees and the communities in which they operate” (Business Roundtable, Redefined Purpose of a Corporation: Welcoming the Debate (Aug. 25, 2019)).

CURRENT VIEWS

Shareholder value, as quantified by metrics such as total shareholder return, has emerged as the primary measurement of the performance of US corporations and their senior executives. However, investor emphasis on improvements in these metrics on a quarterly basis has raised significant concern that corporations may forgo research and development and other long-term investments in innovation and human capital, and that employees in particular are losing out.

Increased focus by investors on the broader societal impacts of their portfolio companies may help assuage concerns about the responsible use of significant economic power by corporations, and by large institutional investors, but metrics that look beyond shareholder value have not yet developed. However, it is in the common interest of investors and corporations to address societal expectations, decrease tensions, and build trust in economic institutions.

EMERGING CONCERNS

The current heightened interest in corporate responsibility is related to growing concerns about income and wealth inequality and the financial fragility of the middle class. These concerns are reflected in the comments of leaders of some of the largest financial institutions. For example:

- Jamie Dimon, the chairman and CEO of JP Morgan Chase, noted in his 2019 annual letter to shareholders (available at jpmorganchase.com) that the American Dream is “fraying” and “the social needs of far too many of our citizens are not being met.”
- Ray Dalio, the founder, co-chairman, and co-CIO of Bridgewater Associates, described the economic system as “broken” and wrote in a recent essay that “[i]n addition to social and economic bad consequences, the income/wealth/opportunity gap is leading to dangerous social and political divisions that threaten our cohesive fabric and capitalism

itself” (Why and How Capitalism Needs to Be Reformed (Parts 1 & 2) (Apr. 5, 2019), available at [linkedin.com](https://www.linkedin.com/pulse/why-and-how-capitalism-needs-be-reformed-parts-1-2-warren-buffett)).

- Warren Buffett, the chairman and CEO of Berkshire Hathaway, noted in a speech at the 2019 annual shareholders’ meeting that capitalism should involve “taking care of people who are left behind.”


Additionally, Chief Justice Leo Strine of the Delaware Supreme Court recently wrote that:

“Companies have become more responsive to the immediate desires of the stock market but are failing to move quickly toward sustainable business practices, adequately invest in human capital and, most importantly, fairly share gains from corporate profits with the workers who create them. ... US public corporations are not playthings. They create jobs, produce goods and services that consumers depend on, affect the environment we live in and build wealth that help Americans lead more secure lives. They are societally chartered institutions of enormous importance and value. Those who govern them should be accountable for the generation of durable wealth for their workers and ordinary investors.”

(Leo Strine, Opinion, Workers Must Be at the Heart of Company Priorities, Financial Times (Oct. 1, 2019), available at [ft.com](https://www.ft.com/content/10000000-0000-11e9-0000-000000000000).)

Chief Justice Strine also advocates for aligning the incentives of large institutional investors with those of the workers who invest in mutual funds through their 401(k) and 529 plans. Strine’s proposal:

- Requires institutional investors to consider and make fair disclosure of their policies regarding employees and environmental, social, and governance factors.
- Suggests reform of the tax system to encourage sustainable, long-term investment and discourage speculation, as well as reform of rules on corporate political spending and forced arbitration.
- Requires societally important companies to have board-level committees charged with ensuring fair treatment of employees, authorizing companies to use European-style works councils to increase employee representation, and



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Corporate Purpose Debate: Historical Context

The Great Depression and the resulting interest in curbing abuses associated with corporate power sparked a debate about corporate purpose between Harvard Law School Professor E. Merrick Dodd and Columbia Law School Professor Adolf A. Berle. Professor Berle asserted that the board exercised its power in trust for the benefit of the shareholders as the sole beneficiaries of the corporation. Professor Dodd countered that the corporation has both a profit-making function and a social benefit function. Professor Berle responded that his shareholder primacy view should prevail because the broader social benefit view provided no clear mechanism to measure the corporation's success and hold the board and management accountable.

As the economy recovered through the post-war period, companies reinvested, wages increased, and shareholders profited, and it appeared that boards and CEOs were meeting societal, as well as shareholder, expectations. In 1954, Professor Berle conceded, stating that "Professor Dodd argued that [corporate] powers were held in trust for the entire community. The argument has been settled (at least for the time being) squarely in favor of Professor Dodd's contention." (Adolf A. Berle, Jr., *The 20th Century Capitalist Revolution* (1954).)

However, in the late 1960s, concerns about product safety and environmental impact reinvigorated the debate about corporate responsibility. In 1970, Milton Friedman famously asserted that "there is one and only one social responsibility of business — to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game" (Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, *The New York Times Magazine* (Sept. 13, 1970)). Ralph Nader in turn called for federal chartering of corporations to provide stricter control over corporate power, due to the failures of shareholders and directors to hold corporations accountable.

Much has changed since then. Managerial capitalism gave way to stronger and more independent boards, shareholding became concentrated in institutional investors, and these concentrated shareholders became a more powerful force. As boards became more focused on their own processes and on the demands of institutional shareholders, language about the interests of shareholders replaced the broader stakeholder language in the Business Roundtable's 1997 Statement on Corporate Governance.

reforming labor laws to make it easier for workers to join a union and bargain for fair wages and working conditions.

(See Leo E. Strine Jr., *Toward Fair and Sustainable Capitalism: A Comprehensive Proposal to Help American Workers, Restore Fair Gainsharing Between Employees and Shareholders, and Increase American Competitiveness by Reorienting Our Corporate Governance System Toward Sustainable Long-Term Growth and Encouraging Investments in America's Future* (Oct. 3, 2019), available at papers.ssrn.com.)

INVESTOR VIEWS

Investors are increasingly questioning the idea that the purpose of the corporation is solely to create wealth for shareholders without regard for other interests. A recent survey of 500 institutional investors found that investors are increasingly taking into account as investment factors longer-term social and environmental considerations and the corporation's cultural health and are expecting companies to take a stand on relevant social issues. For example, 98% of investors surveyed indicated that "public companies are urgently obligated to address ... societal issues to ensure the global business environment remains healthy and robust." The top five issues of concern cited were cybersecurity, income inequality, workplace diversity, national security, and immigration. (See Edelman Trust

Barometer, Special Report: Institutional Investors U.S. Results (Nov. 2018), available at [edelman.com](https://www.edelman.com).)

A growing number of shareholders are insisting that corporations focus on environmental and social issues, as evidenced by:

- The rise in support for shareholder proposals on these topics.
- The increase in demand for specialized indices that offer investment in companies selected on a specific environmental or social issue basis.
- Calls from large institutional investors for corporations to focus on environmental impact and corporate social responsibility.



Search [Corporate Social Responsibility](#), [Corporate Sustainability](#), and [the Role of the Board](#) for more on corporate social responsibility and sustainability issues, including oversight, disclosure, and shareholder engagement.

Large institutional investors, in particular, have encouraged corporate leaders to embrace a broader view and forgo an undue focus on short-term financial results. Institutional investors play a key role in helping corporations navigate this difficult terrain by identifying the environmental and social factors that are meaningful to their investment decisions.

Federal Regulation

Federal regulation may force corporations to rethink how to appropriately measure performance. Senator Elizabeth Warren's proposed Accountable Capitalism Act (S. 3348) would create an Office of US Corporations within the Commerce Department and would require corporations with \$1 billion or more in revenue to obtain a federal charter to operate. That charter would require directors to consider the interests of a broader set of corporate constituents in making decisions, including employees, customers, shareholders, and communities. To make employee interests chief among those interests, employees would elect 40% of the board.

For example, in his annual letters to the CEOs of BlackRock portfolio companies, Larry Fink emphasizes his expectation that the corporations in which BlackRock invests need to not only make profits for shareholders, but also add value to society. Specifically, in his 2018 letter (available at blackrock.com), Fink states that "[t]o prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate."

LEGAL IMPLICATIONS

Under state corporate law, directors' fiduciary duties require that they act in the best interests of the corporation and its shareholders. The 2019 Statement does not seek to change the law, nor does it conflict with the law.

Outside of sale of control transactions, directors have considerable discretion to consider the impact of their decisions on the interests of stakeholders other than shareholders, as long as the decision is in general furtherance of corporate interests and shareholder value over the long term. Boards may take actions that may not maximize profits in the near term, provided there is a plausible connection to a rational business purpose that ultimately benefits shareholders in some way and, as with all director decisions, is without conflict and well-informed.



Search [Fiduciary Duties of the Board of Directors](#) for more on the fiduciary duties of the board, including the core duties of care and loyalty.

Search [Fiduciary Duties in M&A Transactions](#) for information on the standards of review of board conduct applicable in different transaction scenarios and how liability is determined under those standards.

This requires that directors consider all reasonably available relevant information and make independent decisions after good-faith consideration of alternatives. Within this framework, directors are not restricted to a particular time frame in which shareholders must benefit from the action, and they may consider "the impact on 'constituencies' other than shareholders," including employees, customers, and the general community (*Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985)).

To sustain corporate success and return value to shareholders over a sustained period requires fair consideration of broader constituent interests. Directors must exercise their business judgment in factoring these considerations into their decisions, and have broad discretion to do so, as long as they are within the bounds of a sufficient nexus to shareholder value, welfare, and value maximization. For example, a "board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders" (*Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986)).

However, pursuing non-shareholder considerations must be intended to lead at some point to value for shareholders. Directors cannot "openly eschew" shareholder wealth maximization, but instead must act to promote the value of the corporation for the general benefit of its shareholders. In *eBay Domestic Holdings, Inc. v. Newmark*, the Delaware Court of Chancery emphasized that corporate actions, including those that promote the interests of non-shareholder constituents, must be grounded in shareholder value enhancement. If the relevant corporate action is reviewed under the business judgment rule, the court will not question directors' "rational judgments about how promoting non-stockholder interests — be it through making a charitable contribution, paying employees higher salaries and benefits, or more general norms like promoting a particular corporate culture — ultimately promote[s] stockholder value" (16 A.3d 1, 33 (Del. Ch. 2010)).

Decisions by directors that lead to a decrease in share value are legally permissible, but total indifference to shareholders is not.

The views stated above are solely attributable to Ms. Gregory and do not necessarily reflect the views of Sidley Austin LLP or its clients. Ms. Gregory advised on the Business Roundtable's 2019 Statement.