

The Corporate Purpose Debate: Shareholder Value and Corporate Responsibility in an Era of COVID-19 and Social Unrest

BY HOLLY J. GREGORY

“U.S. 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 socially 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 E. Strine, former chief justice of the Delaware Supreme Court, Financial Times (Oct. 1, 2019)

The Business Roundtable Statement on the Purpose of a Corporation issued a little over a year ago generated new interest in the age-old debate about whether the primary purpose of the corporation is to return value to shareholders or serve a broader social purpose. That debate reflects a false dichotomy by suggesting that corporations must choose between the two, as Ralph S. Larsen, when CEO of Johnson & Johnson, emphasized in terming this the “tyranny of the ‘or’.” When asked whether he serves shareholder interests or societal interests, he answered with a simple “yes.” CEOs understand that a company doesn’t succeed and deliver strong shareholder returns for long if it doesn’t provide goods and services of value to society while satisfying the fair expectations of a broad range of key stakeholders.

The corporate response to the COVID-19 pandemic and to ever-growing concerns about racial inequality and social justice has brought into sharper focus the fact that corporations are an essential element of society with a shared interest in the health, well-being and equitable treatment of its members. This is not only a matter of being a responsible corporate citizen, but a business imperative to satisfy investor, consumer and employee expectations. It reads directly on the goodwill value of a corporation’s reputation.

The COVID-19 pandemic underscores the critical corporate role in providing goods and services, innovating solutions, and providing employment. Business continuity concerns including workforce retention and safety, supply chain continuity, demand implications and liquidity concerns are intertwined with issues of corporate social responsibility.

Examples abound of how corporations across industries have stepped up in response to the pandemic. Large auto manufacturers shifted manufacturing to medical equipment; clothing manufacturers shifted capacity to PPE; drug companies accelerated work on vaccines and other potential therapies with some committing to deliver vaccines profit-free; banks excused late payments on auto and home loans while serving as the conduit for government loans and grants to business. Corporations have also increased charitable contributions to address food insecurity and health care access.

In the aftermath of the George Floyd killing and the continuing social unrest over concerns of racial inequality, corporate support for social justice organizations has increased significantly and many corporations are enhancing their commitment to promote an inclusive workplace while recognizing that much more remains to be done. On October 15, 2020, Business Roundtable CEOs announced

Boards and CEOs may wish to reassess corporate activities along the lines of the corporate actions and public policy recommendations addressed by Business Roundtable CEOs in their Oct. 15 release and consider where to focus their own activities consistent with the statement's commitment to stakeholders in the long term interests of the corporation and its shareholders. While each corporation is unique, actions to consider may include:

AT THE CORPORATE LEVEL

- Expand investments in employee training, wages and benefits (as well as in safety as employees return to work).
- Move away from quarterly earnings guidance to focus on longer-term metrics.
- Reassess business practices to identify unintentionally discriminatory practices, for example unfair lending practices, or in the hiring, training, compensation and promotion of employees
- Double down on efforts to improve diversity and inclusion in the workforce, including at the board and senior executive levels, with company leaders setting the tone from the top.
- Expand efforts to identify and contract with minority-owned suppliers and pressing all suppliers to improve diversity and inclusion efforts.
- Consider how to improve disclosure and practices with respect to ESG, which may include enhanced disclosure for example of key workforce and leadership diversity metrics.

IN THE COMMUNITY

- Support disadvantaged public schools, including afterschool programs, art and athletic programs, student meals and access to technology.
- Support foodbanks and efforts to address food insecurity and address urban food deserts.
- Support health care education and delivery improvement and access to wellness checks and prenatal care.
- Support efforts to provide access to safe and affordable housing.
- Expand charitable donations to educational, health and housing initiatives.
- Support organizations dedicated to social justice.
- Continue to support the arts — museums, theater, music.

LEGISLATIVELY

- Support an increase in the federal minimum wage.
- Support assistance to small and minority-owned businesses and entrepreneurs.
- Support federal funding for early literacy programs and early childhood education
- Support efforts to reform and improve community policing, including through improved transparency, accountability, standards and training.

a combination of corporate actions and public policy recommendations to increase economic opportunity, advance racial equity and improve social justice.

The Roundtable's 2019 Statement emphasized that companies serve a broad purpose in contributing to society through the goods and services they provide. It also departed from the rhetoric of the Roundtable's 1997 Statement on Corporate Governance, which emphasized the principal corporate objective is "to generate economic returns to its owners." By recognizing the interests of a range of stakeholders in corporate decisions, the Statement aligns with the BRT's earlier 1981 Statement on Corporate Responsibility, which recognized that "the long-term viability of the business sector is linked to its responsibility to the society of which it is part." This shift was made by the CEO signatories to more closely reflect how they make decisions: by focusing on core operations of providing goods and services in a manner that delivers value to customers, and meets the fair expectations of employees, suppliers and the communities in which they operate, so that shareholder returns are produced.:

As stated in the preamble to the 2019 statement: 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.

Thus, 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.

"Purpose 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,” wrote Larry Fink, chairman and CEO of BlackRock, in his 2019 letter to portfolio company CEOs. “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, is notable. However, the language in the 2019 statement that received the most attention in the ensuing debate relates to the commitment to all stakeholders, specifically customers, employees, suppliers, communities and shareholders.

The 2019 statement was met with both favor and skepticism. “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,” the statement reads in part, “including customers, employees and the communities in which they operate.” Supporters noted its pragmatic reality — that economic success depends on how the corporation engages with a broad range of participants who contribute to corporate success.

Skeptics fell into two distinct camps: They worried either that the Statement was an effort to walk back legal fiduciary standards or that it was mere lip service that would not be followed through with action.

On its face the Statement does not advocate for a reordering of priorities away from shareholder value. It instead reflects a consensus among leading CEOs that corporate success and shareholder and stakeholder interests are interdependent. Nor does it call for a change in state law regarding fiduciary obligations to act in the best interests of the corporation and its shareholders.

Outside of sale of control transactions, directors and officers have considerable discretion to consider the impact of their decisions on non-shareholder interests so long as the decision is in general furtherance of corporate interests and shareholder value over the long term. They may take actions that fail to maximize profits in the near term, provided there is a plausible connection to a rational business purpose that ultimately is intended to benefit the corporation and its shareholders (and they satisfy the other requirements of the duties of care and loyalty).

Within this framework, directors are not restricted to a particular timeframe in which shareholders must ben-

efit from the action, and courts have expressly held that they may consider the impact on constituencies other than shareholders, including employees, customers and the community. The law recognizes that 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 there is a sufficient connection to shareholder value in the form of potential future benefits. Boards have significant discretion to make this determination. Applying the business judgment rule, a court will not question rational judgments about how promoting non-shareholder interests. For example, through making charitable contributions or paying employees higher salaries and benefits, promote shareholder value. Decisions by directors that lead to a decrease in share value are legally permissible; indifference to shareholder value is not.

Corporate efforts to assist in the pandemic response and support social justice reforms are not in opposition to the interests of the corporation and long-term shareholder value even if in the near term they increase costs to the corporation. Such efforts strengthen corporate reputation and build the goodwill value to attract investors, consumers and employees. Articulating the nexus of these activities to the corporation’s unique purpose and strategies will help ensure the efforts are undertaken consistent with the best interests of the corporation and the enhancement of long-term shareholder value.

As members of society, corporations and their shareholders have an interest in the equitable expansion of durable wealth for workers and investors in a just society. Improving economic opportunity, racial equity and social justice is consistent with the best interests of the corporation in building goodwill so as to attract devoted customers and a talented, diverse and dedicated workforce while returning value to shareholders. ■

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