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of private and public organizations

Corporate Purpose, ESG, stakeholders: what's the deal ?

Commentary #3

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Toward Value - Creating Governance®

November 2020

Since the publication in 1932 of Berle and Means' *The Modern Corporation and Private Property*, "capitalist" societies have been engaged in a forlorn quest for an appropriate definition of the role, justification and "raison d'être" of large corporations.

Except for the legal fiction of shareholders as owners, corporations of the 1950's, 60's and 70's, were not really "owned" by anyone but controlled by management. In this context, the manager had to be a man (or a woman) of many constituencies, a nimble balancer of conflicting interests, an impartial purveyor of amenities to one and all, a human synthesizer of the rights and interests of all parties which might directly or indirectly be affected by the actions of the corporation. Whether managers actually internalized these norms of conduct is a moot point. That concept of the corporation gave rise to formidable, dominant companies, such as IBM, Johnson and Johnson, GM, GE.

However for the last 40 years or so, with the rise of "financial capitalism" and the clever linking of executive compensation to share price, "creating shareholder value" became the driver of management, the rallying cry of the executive corps. That worked well for the managerial class. No matter that all large corporations proudly brandish statements about their Vision, Mission, Values and Ethics, recriminations and discontent simmered and eventually crystallized around a bundle of expectations now assembled under the ESG banner. [Environment, Social and Governance]

Institutional funds, pension funds, asset managers of various stripes and index funds particularly have joined, indeed led the bandwagon, relentlessly pushing corporations to include ESG issues in their management. Most corporations have given in to the pressure with various degrees of enthusiasm.

The proxy advisory firms (ISS in particular), their noses firmly in the wind, have sniffed the trend and now intend to include ESG factors in their assessment of corporate governance.

That's the context which led some 181 CEOs of large (mainly American) corporations, under the aegis of the Business Roundtable, to sign a solemn undertaking, a year ago or so. They committed to adopt and impose on themselves a "Purpose" of care for, and nurturing of, their stakeholders. Henceforth, corporate decisions will factor in the interests of various parties, including the civic society and Mother Earth.

Professor Colin Mayer, one of the promoters of the 'corporate purpose", puts it this way: "the purpose of business is to solve the problems of people and planet profitably, and not profit from causing problems". Hum, all leaders of large corporations will subscribe to this broad and vague agenda.

Business circumstances, at least for the oligopolistic leviathans, are changing; the greatest threat to these corporations' survival often comes from the social and political environment, not mainly or solely from the economic and competitive environment. Large companies with slack resources can cope with the piling up of new demands and expectations in matters of environment, social responsibility, diversity and so on. But three points need to be emphasized here:

1. In this quest for a stakeholder oriented corporation and the multiplication of new ESG mandates, what's the role of the entrepreneurial spirit, the drive to create and build a business in a world of sharp competition and evolving technologies? The vibrancy of an economy rests on entrepreneurial activity. Let's be careful, lest we collectively stifle the entrepreneurial drive.

2. As the demands and legal requirements imposed on business corporations largely single out stock-market listed corporations, the current drought of new businesses listing on a stock exchange may worsen as entrepreneurs weigh the costs and benefits of "going public" and private sources of funding mushroom.

3. In Canada, two rulings by the Supreme Court clarified the meaning of acting in "the interest of the corporation" as stipulated in the Canadian Business Corporation Act. Boards of directors in their decisions must give equal consideration to stakeholders and shareholders; boards should not favor any particular group in its decision-making. Basically, we have in Canada a *stakeholder model of governance.* The U.S. jurisprudence is not that clear on this issue; several legal scholars still argue that maximizing shareholder wealth should be the prime objective of boards of directors. For instance, Professor Bainbridge writes "*The law of corporate purpose remains that directors have an obligation to put shareholder interests ahead of those of other stakeholders and maximize profits for those shareholders".*

That is the context for the BRT's "Purpose" initiative: an unclear American legal framework combined with investor and societal/political pressures on management to adopt a sort of stakeholder model.

But In Canada, this whole agitation about "Corporate Purpose" is moot as stakeholder governance is the law! Canadian boards of directors should be governed accordingly although there is yet little empirical evidence as to how that legal fact has impacted governance in Canada.

When all is said and done, managing for the long term, factoring in the multiple interests of the broader society, desirable goals indeed, will only happen when the games of some financial types are checked and executive compensation is re-arranged to support these objectives. Otherwise, all this agitation is perfunctory, pro-forma, "sound and fury signifying nothing".

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