What is a corporation for?

The Purpose of the Corporation project takes on the 'shareholder value myth', as Paige Morrow of public interest law firm Frank Bold explains

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What is the purpose of a corporation? To satisfy customers, pay employees living wages, generate returns for investors, create social good, or some combination of all four? The Purpose of the Corporation project is an apolitical, multi-stakeholder platform that brings together business, academia, civil society and trade unions to answer the question and develop a pragmatic vision for the future of publicly listed companies.

The project takes on the 'shareholder value myth', as it was termed by Lynn Stout of Cornell Law School in her book of the same name, which challenged the dogma that directors are legally obliged to place the interests of shareholders first through a single-minded focus on earnings and share price. The dominant belief, dating back to Milton Friedman in the 1970s, was that the only role of corporations in society was profit maximisation. In fact, as far the law is concerned, a corporation may choose to maximise quarterly returns but boards may equally decide to reinvest profits, increase wages or research new products.

The share price offers a deceptively simple metric for business and managerial performance. Pay for performance schemes often create perverse incentives to engineer short-term performance through share buybacks, mismanagement or accounting fraud. The collapse of giants like Enron and Arthur Andersen were glaring examples of this, but the effects may not be immediately self-evident. The pervasive practice of repurchasing shares diverts cash that could be invested in innovation or expansion into new markets. In 2013, US companies in the S&P 500 index bought back US$500bn of their own stock. A study recently cited by *The Economist* concluded that a doubling of buybacks was correlated with an 8% fall in spending on R&D.

Corporate scandals have been a factor in the push by consumers and civil society for increased corporate engagement with environmental, social and governance (ESG) issues. Is there a trade-off between companies doing well and doing good? New research by Robert Eccles (awarded honorary ACCA membership in December 2013), George Serafeim of Harvard Business School and Ioannis Ioannou of London Business School suggests that sustainability and corporate performance may be mutually reinforcing. Their analysis of 180 US companies from 1993 to 2010 compared a portfolio of businesses with a high commitment to ESG matters to rival businesses with very similar performance, size, capital structure and growth opportunities in 1993 but which failed to show a commitment to sustainability. Whereas US$1 invested in a highly sustainable company yielded US$22.58 in 2010, the same US$1 returned only US$15.35 when invested in a low-sustainability business.

Their research has practical implications. About 6,000 large European Union companies will be required to report on ESG matters when the directive on non-financial reporting becomes effective in 2018. The EU is also contemplating a shareholder 'say-on-pay' similar to the one already in force in the UK. Responsible shareholders could then pressure companies to develop executive bonus plans linked to non-financial indicators in addition to share price.

Social and legal expectations have evolved to require companies to do business responsibly. Many successful global companies, such as Dutch consumer product giant Unilever and Danish pharmaceutical Novo Nordisk, have unlocked the value creation potentially associated with integrating sustainability into core business strategy. Through roundtables, policy briefings and research papers, the Purpose of the Corporation project fosters this discussion of how corporate governance can best advance the interrelated objectives of corporate performance and sustainability. ■

Find the Purpose of the Corporation project and its publications online at www.purposeofcorporation.org and @purposeofcorp