Building Stakeholder Values into Corporate Purpose: An Execution Strategy

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Introduction

Crisis is a message that things must change. COVID-19, the economic collapse of 2020, the ever-rising challenge of climate change and the demand for racial justice in the wake of George Floyd's murder all demand that citizens, particularly those in command of power and resources, think anew and act anew. Many businesses have responded. Companies developed vaccines in record time and put people, money and assets into producing ventilators and personal protective equipment. There were retailers large and small who continued to pay the employees of shuttered stores and firms who committed to retain every U.S. worker. Well ahead of the current administration's return to the Paris Climate Agreement, dozens of companies announced aggressive sustainability goals. Businesses have committed hundreds of millions of dollars to promote economic empowerment in underserved minority communities.

For all the good work being done, two things are clear: (1) deep societal problems remain; and (2) stakeholders want business to do more. COVID-19 will eventually be brought under control, but the U.S. and global public health systems will still be fragile. The economy will rebound, but income inequality, tectonic shifts in global demographics, technological pressure on employment, the dependence of the economy on effective politics and the rule of law are macroeconomic, political, and social challenges no person or company can avoid. Climate inaction is an existential threat and a medium-term economic catastrophe. Complicity in the denial of opportunities to thrive for millions excluded by prejudice or discarded in the drive for growth tortures the conscience and damages the soul.

Citizens want corporations to do more to solve these problems. A 2019 survey by Just Capital shows that "90% of respondents want large corporations to promote an economy that serves all-Americans." Topping the list of concerns are issues that directly affect workers —benefits, wages, and workplace culture. Still, fewer than 50% believe companies are acting on these priorities.[2] Numerous other surveys confirm that workers, communities, potential recruits and customers all want greater corporate engagement in solving common problems.[3]

Perhaps the most telling confirmation of the desire for a more socially engaged capitalism is that the fastest growing segment of the investment business is in socially responsible funds.[4] Corporate leadership shares this view. The Business Roundtable's 2019 "Principles of Corporate Governance" make serving a broad group of stakeholders the fundamental purpose of a company. The World Economic Forum has focused its last two Davos

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[2] https://justcapital.com/reports/roadmap-for-stakeholder-capitalism/

[3] https://www.gsb.stanford.edu/faculty-research/publications/2019-survey-shareholder-versus-stakeholder-interests & numerous others

[4] https://www.uschamber.com/co/good-company/launch-pad/esg-investing-interview-fidelity-impax

convenings on sustainability. Dozens of senior business leaders have written and spoken publicly to the same effect and, as the examples in the first paragraph show, many have acted. Yet recent research of more than 800 publicly-traded companies shows that their leadership are struggling to deliver on major societal priorities during the COVID-19 health and economic crisis and the environment post-George Floyd's murder. Sadly, the 181 signatories of the Business Roundtable's principles fared no better than the wider group of companies surveyed.[5]

To us, this looks like the business community is not meeting a key objective: to reflect in their actions the needs and desires of all their stakeholders. We do not believe this is a failure of will, desire, or imagination. Rather, the current corporate governance system – law, custom and practice – mandates a singular focus on shareholder value and in practice hinders the development of stakeholder-informed goals for corporate engagement.

We offer a program to help companies meet that objective. Every company that wants its decision-making to reflect a fundamental commitment to all its stakeholders should: (1) have an engagement plan; (2) build legitimacy and accountability for the engagement plan into its governance structure; and (3) measure and report on progress implementing the plan.

We lay out below a more detailed description of how a company can execute these three steps. Our program is structural: an outline of internal processes of governance, reporting and accountability. We don't offer specific goals to which companies should aspire on matters of sustainability, economic fairness or social justice. The structural model we suggest asks a company to set specific goals for itself based on the values of its stakeholders and the nature of its operations. Transparent, stakeholder-engaged self-regulation is, in our view, the right path forward because:

It's executable. The program is simple and concrete. Every company, public and private, can do it. There is a lot of learning on how to create a stakeholder-informed engagement plan. Lawyers, accountants and consultants are building practices to support all three phases.

It encourages innovation and differentiation. We do not presume how stakeholders will define the purpose of the particular corporations in which they are invested. Some may want the company to make environmental sustainability a priority. Others may want the company to build economic justice, racial justice, or public health into its corporate DNA. Some may decide that profits should remain management's singular focus. However engagement goals develop, different companies will come up with different ways to pursue those goals. Public discussion and disclosure of the engagement plan and reporting on progress are integral parts of our program. This transparency will allow consumers, employees, communities and prospective recruits to make choices based on their beliefs: where to work; who to buy from; what company they want in their town. This enlists the power of the market to drive companies to reflect stakeholder interests.

It will lead to smarter regulation. Over time, diverse approaches to engagement will show some number of leading practices. Differential levels of engagement will also lead some companies to become advocates for regulations that standardize practices across appropriate sectors of the economy. This is critically important. The crises of 2020 have created pressure for change greater than America has seen in decades. Business can lead by embracing a new, self-regulatory model accountable to stakeholders and transparent to the public. Or business can wait on

[5] Test of Corporate Governance report financed by Ford Foundation. https://www.sustainabilityrisk.org/tcp and NYTimes *"Stakeholder Capitalism Gets a Report Card. It's Not Good."* https://www.nytimes.com/2020/09/22/business/business-roudtable-stakeholder-capitalism.html

the outcome of the old model – business creates wealth and government polices corporate behavior. We believe the former will be better for everyone.

It democratizes corporate purpose. In the US today, the commonly understood fundamental purpose of the corporation is set by the law: maximize economic value for shareholders. In looking forward, our program invites both management and stakeholders into a dialogue about what the purpose of the corporation *should be* and to build that purpose into its governance and management structures. This change reflects a basic fact: investors are people. Pension funds, sovereign wealth funds, mutual funds, insurance companies, endowments – all in the end act for the benefit of real human beings. People care about more than money, and value is created in more ways than just profits. The desire of so much of the public for deeper corporate engagement with societal challenges is one obvious marker of that, if any was needed. Our program recognizes that the people for whom companies exist – investors, employees, consumers, communities – are not the imaginary "value maximizing" machines of old-school economic theory. Fixing that disconnect and helping corporate purpose to reflect people's full human values will set capitalism on more stable footing as it moves toward a new role in building a strong and thriving society.

Building Out The Plan

Companies[6] that want to reflect in their actions the needs and interests of their stakeholders should:

Analyze

- Corporate leadership should investigate stakeholder needs, concerns and desire for the company to engage in seeking solutions with respect to issues they identify;
- Corporate leadership should assess its own ideas regarding engagement alongside those of stakeholders, analyze how the company's operations and long-term value affect and are (or would be) affected by engagement;

Goal-set

- Leadership should develop explicit, measurable engagement goals and milestones based on their analysis;
- Corporate leadership should publish to shareholders the Board's proposed engagement goals and milestones;
- Engagement goals and milestones, together with the leadership's analysis (including the results of the stakeholder discovery), should be submitted to binding shareholder debate, revision and vote;

[6] Our detailed description is for a public company. For companies held by private equity or other funds with multiple limited partners, a similar process of consultation could occur, though the details would be different. There are, in fact, examples of this type of explicit discussion regarding engagement between managers of Impact Funds and their limited partners. All of our arguments in favor of this program are equally applicable to private firms owned by funds. Most importantly, the largest investors in most private equity funds are pension and sovereign wealth funds, both of whom ultimately serve individuals with diverse values. Pension and sovereign wealth funds also have very long time horizons and important interests in macro issues that affect markets and society broadly.

Report

* Management, with the formal approval of the Board, should report to shareholders annually on whether the company is meeting the engagement goals and milestones in sufficient detail to allow both stakeholders and shareholders to accurately judge the company's performance;
* Shareholders should have the right to enforce compliance with the approved engagement goals and milestones, subject to the limits of the Business Judgment Rule; and

Enhance

* The company should repeat the goal-setting process on a periodic basis to keep engagement goals and milestones aligned with current priorities.

Governance Concerns

What we suggest is a significant change in practice for many companies. It entails disruption and risk. We think the risks are manageable and address a number of them here.

It would violate current fiduciary duties. CEOs and boards of public companies are required by law and custom to have a singular focus on shareholder value. Fiduciary rules, accounting systems, compensation structures and reporting requirements reflect that shareholder-first focus. Private companies owned by investment funds generally have a similar singular focus on generating financial returns for their investors.

Our program does not violate current fiduciary obligations. Management and the Board would still have an obligation to maximize the economic value of the firm. We expect that leaders would integrate engagement goals with their mission to produce goods, provide employment and generate returns to investors. The Business Judgment Rule, as applied in Delaware and other key U.S. jurisdictions, gives the Board wide discretion in determining the best methods to pursue the long-term economic interests of the company. The argument of many business leaders in favor of the Business Roundtable's shift to stakeholder capitalism is that it is both right and necessary for economic success.[7] Engaging with issues important to consumers and employees can provide an edge in recruiting and marketing.[8] Stated concerns over certain issues (today, principally climate change) by large investors may mean that engaging on those issues expands access to capital. Studies show that designing business processes for inclusive growth improves long-term profitability.[9] In short, engagement is in the long-term interests of most firms.

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[7] See, e.g., "The American dream is alive, but fraying. Major employers are investing in their workers and communities because they know it is the only way to be successful over the long term." Jamie Dimon, Chairman and CEO of JPMorgan Chase & Co. See also, "By taking a broader, more complete view of corporate purpose, boards can focus on creating long-term value, better serving everyone – investors, employees, communities, suppliers and customers." Bill McNabb, former CEO of Vanguard. Both quoted at: https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans ("Business Roundtable Redefines the Purpose of the Corporation to Promote an Economy That Serves All Americans", August 19, 2019).

[8] "The Power of Purpose: The Business Case for Purpose (All the Data You Were Looking For)" Parts 1 and 2, Forbes, March 2020, https://www.forbes.com/sites/afdhelaziz/2020/03/07/the-power-of-purpose-the-business-case-for-purpose-all-the-data-you-were-looking-for-pt-1/?sh=2379c78030ba and https://www.forbes.com/sites/afdhelaziz/2020/03/07/the-power-of-purpose-the-business-case-for-purpose-all-the-data-you-were-looking-for-pt-2/?sh=2698dcef3cf7

[9] See, for example, Kaplan, Serafeim and Tugendhat, "Inclusive Growth: Profitable Strategies for Tackling Poverty and Inequality," Harvard Business Review, January-February 2018 Issue.

There may be instances in which the engagement goals stakeholders support and shareholders adopt will be in tension with profit. Our program's process of stakeholder consultation, management analysis and shareholder debate and approval is intended to provide management and the Board clear guidance for those difficult situations. Management's job will still be harder than it is under a rule that always puts profit first. Leaders will sometimes have to confront conflicts between profit and other important values. Dissident shareholders may challenge a decision to leave some profit on the table to meet an engagement goal. Shareholder approval should significantly reduce the risk, but change always entails some uncertainty.

Business leaders lack experience and competence to engage with social problems. This is, in one sense, true. Most business leaders have not spent their careers studying climate change, income inequality, demography, social justice or any of the other issues on which people say they want companies to engage. But business people are experts in building structures and processes that focus large institutions on accomplishing complex tasks. The actions we suggest are all common parts of developing and executing on a strategy. Every business analyzes value chains, sets goals, creates metrics and incentives, defines accountability and enhances strategy based on experience. Our suggested actions on governance and measurement follow that familiar path. Our program will likely mean applying those management skills to new types of issues. But there is experience in the corporate world to draw on (a few examples are in our first paragraph) and there are consultants and activists who have for years been developing models of corporate engagement with many issues and methods of measurement. Setting goals, creating a plan, establishing legitimacy and accountability for that plan and measuring and reporting on meeting the goals is squarely within every good corporate leader's skill set.

Engagement goals will be either too vague for accountability or too narrow to make a difference. We believe that our process will naturally lead to innovative, big thinking about how a company can make a measurable contribution to solving societal problems. The most important reason is that most business leaders, in our experience, will want to set goals they are proud of – ones that can inspire others and build loyalty. The public nature of the process, engagement of stakeholders and reporting requirements will reinforce that natural drive.[10] Further, too-small ideas will not tap the feedback loops that make social engagement a creator of firm-specific long-term value.

We also expect the process to result in clearly defined goals. Vague promises will invite shareholder objections and litigation. The public will label broad statements of intent without concrete targets and metrics as "greenwashing".

Expanding accountability to all stakeholders could make corporate governance either impossible (by paralyzing decision making) or ineffective (theoretical accountability to everyone meaning practical accountability to no one). We do not advocate expanding voting rights or litigation rights beyond shareholders. The difficulties of offering voting and enforcement rights to a stakeholder group that is large, difficult to define and constantly changing are severe.[11] There is no need to navigate those difficulties here. Simple logic, public pressure and the importance of stakeholder buy-in will lead most companies to work hard to investigate and reflect stakeholder concerns. In

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[10] Even for privately held firms, a discussion with investors that explicitly addresses social engagement goals will be 'public' in the sense of requiring investors and management to state beliefs and goals and commit to meeting them.

[11] For example, if employees get stakeholder rights, on what basis would you deny the same rights to members of a local community who invest in tax incentives, roads, utilities and supporting businesses in reliance on the promise that a factory or office will remain in their community? Shareholders get one vote per share. How many votes would a 30-year employee get? A new hire? The owner of the dry-cleaner just outside the factory gates?

public companies, any stakeholder who wishes to opt-in to shareholder status to gain voting or lawsuit rights can do so by buying shares.

Expanding the duties of the board and management will cause an explosion of shareholder activism and litigation. The most intrusive shareholder activism today is driven by aggressive financial investors seeking to maximize short-term gains on an investment.[12] Engagement goals approved by shareholders are a powerful response to short-termism. The primary driver of derivative litigation is the availability of large contingency fees for plaintiff's attorneys. Well-written goals could diminish the availability of such fees.

Measurement

Measurement is critical for any company that wants to succeed in the objective of reflecting in their actions the needs and desires of all their stakeholders. Compensation structures, career advancement, internal and external perception of corporate culture, and the self-worth generating aspects of working for or buying from a company perceived as positively engaged: all these factors require transparency and trust.

We suggest that companies should:

- *Treat engagement goals and intermediate milestones as essential parts of corporate operations*. Effective targets are set with specificity through rigorous analysis of strategic goals and competitive circumstances. They are supported by integrated reporting procedures, internal audit functions, management information systems and business decision software that provide feedback to leadership assessing the effectiveness of promotion, training, compensation, asset deployment and strategy. Engagement goals and intermediate milestones set through the governance process we describe should be integrated into the same measurement and feedback systems.

- *Develop and apply materiality policies for public reporting*. Materiality in this context is used to identify information that has an impact on the business and is incorporated into decision-making. It is a pervasive concept that underlies the application of legal and accounting standards. With respect to engagement goals, materiality considerations should reflect both financial materiality (if and when relevant) and materiality in meeting particular goals. For example, after stakeholder consultation a company might set an engagement goal that all full-time employees will be paid a living wage. The company would need to assess the importance of that decision and the impact of the efforts made to meet the goal. The company would also need to develop metrics and other information to assess whether the specific goal is being met and apply a materiality threshold to determine the level of detail to be included in public reporting.[13]

- *Address horizon problems*. Climate change, for example, is an issue that has profound social implications, is of deep concern to many stakeholders and is also of critical financial importance to many companies. But the benefits of climate change initiatives may not be felt during the expected tenure of many senior managers and CEOs. It is important to develop goals and milestones that value current investments in

[12] See, Martin, "Activist Hedge Funds Aren't Good for Companies or Investors, So Why Do they Exist," Harvard Business Review, August 20, 2018, https://hbr.org/2018/08/activist-hedge-funds-arent-good-for-companies-or-investors-so-why-do-they-exist

[13] In the example, the company would not report the wage levels of every individual employee relative to an appropriate living-wage-scale. Questions might include whether to summarize metrics and other information by country or business line, whether to disclose specific dollar levels of the applicable living-wage-scale, how employee turnover effects the goal, whether progress and success are to be evaluated on a functional or geographic basis and many others.

activities that have long-term payoffs to allow those investments to be a meaningful factor in incentives and performance reviews.[14]

* *Collaborate*. It's likely that some issues on which stakeholders want a company to engage may require collaboration with others if the company is to make a meaningful impact. Working with suppliers and distributors, educators and leaders in local communities, advocacy groups and many others will enhance the effectiveness of engagement. Even competitors can be collaborators where an issue is important across an industry.[15]

* *Promote comparability in metrics*. Comparability does not mean uniformity. Measurement and reporting in any company must always reflect managerial decisions and the lens that informed those decisions. However, a collaborative task must be measured through metrics that reflect a common understanding of the task at hand.

Why Now

The problems discussed at the beginning of this essay need solutions. But this is not the first time society has faced crises, nor is it the first time capitalism has been blamed as a cause. And it is not the first time business has been called upon to change. For those who believe that business contributes to the health of society and human thriving first and foremost by producing useful products, supporting research and innovation, creating employment and building capital for future investment, fundamental change requires justification. And what we are advocating is, at least by the "products, jobs and profits" standard, a fundamental change.

One argument is that several threads of history are coming together that require change in our vision of the role of business in society. The expansion of industrial capitalism throughout the developing world puts ever more pressure on natural resources and the climate. Technology is rapidly changing the nature of work and how wealth is distributed in society. Populations within advanced economies are aging and declining, and people are being 'left behind' in the new economy. Technology is also changing the nature of government, privacy, politics, knowledge and many other foundational aspects of the world as we have known it. It is a solid argument and, in different degrees, the authors of this essay agree with it.

A better argument is that wise leaders are prepared when change comes. It is possible that the forces in the paragraph above are not the irresistible push that will drive us to a new understanding of the role of business in society. But they might be. Whether that is a risk or an opportunity for a business depends largely on how management prepares. Engagement is preparation.

The most compelling argument is that engagement is the right thing to do. A company is a collection of people. It is also an institution that wields power and controls resources. The manner in which it exercises that power and uses those resources should reflect the values of the people who create and sustain it.

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[14] A number of companies are currently attempting to recognize non-financial metrics that value investment in social issues. https://corporate-citizenship.com/2020/05/28/making-sustainability-pay-company-examples-of-esg-incentives/

[15] Anti-trust restrictions require care in working with companies within the same industry. We would support changes to anti-trust laws allowing collaboration that promotes a more robust and inclusive social system that benefits stakeholders.

About The Authors

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Wes Bricker is a Vice Chair and PwC's Assurance Leader for the US and Mexico. Prior to joining PwC US, Wes served as the Securities and Exchange Commission's Chief Accountant beginning in 2016. Wes was the principal advisor to the Commission on accounting and auditing matters, and led the Commission's Office of the Chief Accountant. He was also responsible for assisting the Commission with discharging its oversight of the Financial Accounting Standards Board (FASB) and the Public Company Accounting Oversight Board (PCAOB), and also served as chair for the Monitoring Group.

Kahlil Byrd - CEO and Co-Founder, Invest America

Kahlil Byrd (KB) is the founder and CEO of Invest America, an advisory firm that serves the most creative financiers and builders of complex organizations and movements whose aspirations have the potential to reach and improve the lives of 150+ million American voters. Previously, KB helmed the national electoral reform organization Americans Elect and public education reform effort StudentsFirst.

Jamie Gamble - Retired Partner, Simpson Thacher & Bartlett LLP

Jamie Gamble is a retired litigation partner of Simpson Thacher & Bartlett LLP. In 2019, Jamie published an essay, *The Most Important Problem in the World*, which discusses the role of corporate governance in addressing social problems. In July 2019, Jamie's work was profiled by Andrew Ross Sorkin in the *New York Times*. Since then, Jamie has worked on several efforts to advocate reform of corporate governance to empower business to engage in more stakeholder driven capitalism.

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