Will purpose ever replace shareholder value maximisation as the corporate governance lodestar?

As governments wrestle with the economic and public health challenge of COVID, attention is turning to the part business should play in the recovery and aftermath. Will companies funnel government bailouts and wage subsidies into dividends and bonuses? Or repay the debt by committing to their workers and communities and investing more in developing the products and services of the future?

These questions matter because public discontent with business has been rising in recent years over scandals like BHS and Carillion, together with high executive pay often unjustified by performance. This has prompted a debate within major companies about their relationship to society.

Business leaders have been actively exploring the merits of pursuing other objectives besides profit maximisation, for example safeguarding the environment and the interests of future generations, as well as taking into account the interests of a wider range of 'stakeholders' besides owners, including their workers and suppliers.

This is all part of a growing reaction against the Friedmanite doctrine of 'shareholder value maximisation' which has dominated thinking on corporate governance since the 1970s. A focus on generating returns for shareholders to the exclusion of other goals is widely felt to have come at the cost of investment in skills and R&D, which is implicated in sub-par productivity growth since the financial crisis. It has also stoked fears that overly-short-termist firms concerned mainly with their bottom lines will fail to invest what is needed to power the post-COVID economic recovery.

A focal point for the counter-revolution has been the British Academy's project on 'The Future of the Corporation' which presses the point that successful companies are often those that internalise social goals by widening the range of incentives facing managers beyond the narrowly financial. They do this by setting out a corporate 'purpose' distinct from making a profit, such as 'serving our customers and society better', and mandating their board to ensure managers pursue this goal.

In theory, all companies can adopt a purpose not solely related to shareholder value maximisation and act upon it. A growing number, under pressure from institutional investors who have to sell their financial products to an increasingly environmentally and socially aware public, are now doing so in practice.

Major companies such as Blackrock, JP Morgan and BP have endorsed the purpose agenda. Mutual and pensions funds in charge of some $30trn of assets now build detailed environmental, social and governance (ESG) assessments into their decision-making and expect the companies they invest in to explain how they will meet these goals.

Yet the problem exists of how to define ‘purpose’ in a way that clearly shifts the onus away from shareholder value maximisation towards sustainability in all its forms.

Critics of purposefulness argue that requiring company boards to embrace social concerns might salve their consciences, but it does not change their fundamental, underlying, incentives – which are to generate a return for their owners. Given this, simply declaring that executives are accountable to a wider range of stakeholders won’t necessarily make them behave better towards them, particularly if these have divergent interests and unequal power.

Suspicions therefore lurk that talk of purpose geared to delivering *social value* may, in reality, be a device to maximise *shareholder value* in a political environment where social-media empowered consumers can easily mount damaging campaigns against companies that impact their share price.

Moreover, even if CEOs and their boards see the benefits of incorporating purpose into their companies’ missions, it could take years to see a major course correction – just as it took decades for shareholder value maximisation to become the default goal of most public companies. An economy recovering from COVID does not have decades.

One area where declarations of purpose could make a big difference more incrementally is action on climate change. Eighty seven companies, worth $2.3 trillion, signed up to a UN campaign at the 2019 Climate Action Summit to keep global warming to a maximum of 1.5 C. BP has announced a new corporate purpose around ‘reimagining energy.’ Microsoft’s recent pledge to go carbon *negative* by 2030 is significant as the US computer giant sits at the head of major global supply chains which will now be decarbonised.

But these actions, while welcome, could equally be viewed as defensive measures by companies that suddenly find themselves vulnerable to new regulatory or consumer pressures.

Letting companies set and mark their own homework opens the door to purpose-setting as a new form of corporate window-dressing to shore up profitability and fend off state regulation. A survey by the Responsible Business Tracker indicates a large gap between the number of companies saying they have a purpose statement (86%) and those with a realistic plan for achieving it (17%).

Major global firms with valuable brands to protect certainly have much to gain reputationally from adopting purpose and are, predictably, the sort of companies that most readily sign up to it. But what about smaller firms comprising the bulk of the economy that aren’t household names and don’t face these reputational risks?

Whatever its flaws, the pursuit of profit maximisation at least offers clear, measurable goals, albeit by leaving the social value question to governments. Being a purpose-led corporate citizen, however, is more difficult to define and, equally importantly, measure.

A particular focus of the British Academy project has therefore been on outlining a regulatory and accountability framework to provide transparency to consumers and citizens so they can make informed judgments about purchasing and investment decisions. If purpose is to replace shareholder value maximisation as the lodestar of business strategies then this framework will be crucial.

However, it is a work in progress and we are not there yet. At this point in time, therefore, embrace of purpose by companies is probably a necessary, but not sufficient, condition for business to take the lead in building a sustainable and equitable recovery. It is clearly part of the solution to urgent challenges like climate change and low productivity, but should not be a substitute for traditional policy levers such as taxation and robust regulation.

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Notes:

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