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Revisiting the Purpose and Responsibility of Business : Creating Value for Stakeholders

Since early 2020, the coronavirus pandemic has disrupted all business sectors and the lives of people worldwide. This once-in-a-century pandemic will change the world's political and economic order, prompting us to rethink our socioeconomic system and our values.

Indeed, after several hundred years of vibrant development, the free-market economic ideals of capitalism now face various challenges. The impacts of the pandemic seem to be a warning to us that we need to accelerate the pace of reforms and to confront our new predicament. Many governments' temporary relief measures are not sustainable. We need to transform the socioeconomic system into an adaptable one to better balance economic efficiency, resilience and social inclusiveness.

In addition to the need for governments to enact policy reforms, there is a need for the rules of business to continue to change. Attitude shifts are redefining the way we measure business success. Intangible elements like corporate culture, reputation and trust are becoming new guiding principles used to assess business performance and investment potential. Other dynamic forces shaping the ecology of the business landscape include new industry and job structures, Internet-powered transparency, the strengthening of employee and customer voices and the decline in the importance of capital.

Abandoning Profit Maximisation

Capitalism in practice does not always imply free and fair market competition, as the market is always imperfect or failing. In the wake of two financial crises and numerous corporate scandals, Milton Friedman's adage that ‘the one and only social responsibility of a business is to increase its profits', which for 50 years was used to uphold the widespread belief in free markets, is being challenged. Corporate executives have focused on maximising shareholder value (MSV) at the expense of the interests of non-shareholder stakeholders such as employees, customers, suppliers, the community and the environment. This has been responsible for many of the failings of today's capitalist system. Behaviour undertaken in the name of MSV has led to market instabilities, the loss of long-term corporate values, excessive executive compensations, wider income gaps and more conflicts between corporations, government and the public.

One major faulty assumption of MSV is that directors and executives of public companies are, by law, solely the agents of shareholders and have a fiduciary duty to prioritise shareholders' well-being. The truth is that MSV is merely a market norm, rather than a law or a regulation. New constituency statutes and court cases in North America clearly indicate that directors and executives have fiduciary duties to all relevant stakeholders.

Over the last two decades, business leaders and academics have gradually adopted concepts and practices designed to reverse this trend with the aim of serving more the common good. They advocate responsible management; purpose-driven businesses; business as a force for good; corporate social responsibility

(CSR); creating shared value (CSV), which means transforming social problems into business opportunities; and environmental, social and governance (ESG) reporting initiatives.

These concepts address social concerns but often overlook the interests of non-shareholder stakeholders such as employees, customers and suppliers. Many companies spend a lot of money each year on CSR, CSV and ESG activities, while treating their employees and their customers unfairly or even unethically. The ability of these practices to withstand strain on the corporations' income or profits is also a cause for concern. For CSV, many large corporations are only concerned with social issues that come with significant business potential or wealthier clients, often overlooking other less profitable social concerns. If a corporation is predominately concerned with shareholders' short-term profits and has little regard for other primary stakeholders' interests, pouring resources into CSR, CSV and/or ESG is likely to have little social effect.

The Shift to a Stakeholder-Based Governance Model

Corporations are important social institutions that have the capacity to benefit society. In recent years, some business and academic leaders have reflected on the specious concept of MSV and suggested redefining the relationship between corporations and society by creating a stakeholder-based social contract in which stakeholders would have a reciprocal relationship with the company. In other words, companies would bear responsibilities to stakeholders and would consult them before making major decisions. Thus, corporate executives would not concentrate solely on shareholders' interests but rather would optimise the value for all stakeholders upon whom the corporations' existence depends. Corporations need to balance the interests of major stakeholders and aim to make a reasonable and sustainable profit, rather than attempting to maximise profit. While there is no single formula for balancing stakeholders' interests, the allocation of interests should be proportional to the stakeholders' respective contributions.

In early 2020, before the pandemic, the stakeholder-based governance approach was recognised by the Business Roundtable, a US-based non-profit organisation. The CEOs of 181 leading US corporations, including Microsoft, Apple, Amazon, Pepsi, Walmart and Citigroup, jointly signed a 'Statement on the Purpose of a Corporation' in August 2019, stating that their corporations would abandon the doctrine of shareholder primacy and vowing to create value for all stakeholders. The participating leaders at the World Economic Forum in January 2020 jointly signed 'The Davos Manifesto 2020: The Universal Purpose of a Company'. The global pandemic has further exposed the shortcomings of shareholder primacy, and more and more corporations are trying to change the rules of the game.

During the peak of the pandemic, some corporations took advantage of the crisis to seek exorbitant profits. One practice involved paying high cash dividends while conducting large-scale staff layoffs. However, many other corporations consciously took better care of their employees, valued more their customers, treated suppliers more fairly, supported the community and cared for the environment. The pandemic has undoubtedly struck a heavy blow to most corporations, but it has also presented an opportunity to reflect and chart a win-win path towards building sustainable value for all stakeholders. These corporations increasingly accept the principles of stakeholder capitalism, which they ignored or only paid lip service to in the past.

Analysts have found that when compared with other companies of the same size, companies that adopted a stakeholder-based governance approach during the 2008 financial crisis were more likely to survive. Empirical evidence suggests that stakeholder-based corporations had more competitive advantages and outperformed their peers (BlackRock, 2021). Many investors now prefer social or impact investing that aligns with the concept of stakeholder value.

In fact, the most successful corporations never use profit or MSV as their only goal. In his 2021 Letter to CEOs, Larry Fink, Chairman and CEO of BlackRock, expressed that 'shareholders in your company will benefit if you can create enduring, sustainable value for all of your stakeholders'. He went on to note that 'despite the darkness of the past 12 months, there have been signs of hope, including companies that have worked to serve their stakeholders with courage and conviction'. According to Peter Drucker, the late guru of modern management, the bottom-line is not, by itself, an adequate measure of the performance of management and enterprises. An organisation needs to use diverse measures to assess its health and performance.

The form of capitalism that promotes profit maximisation needs urgent reforms to ensure its continued legitimacy and sustainability. The global pandemic has exposed the shortcomings of shareholder primacy, and more and more corporations have been trying to change the rules of the game. Indeed, if mainstream corporations continue to adopt a stakeholder-based approach, we may not need many social enterprises (with narrow financing sources and restricted profit distribution to shareholders) and certified benefit corporations. It is difficult to tackle social problems such as poverty, inequality and climate change without the most resourceful and powerful businesses getting involved.

Practical Reform Measures to Restore Core Values

To help restore the core values of the free-market economy, we need to make a concerted effort to change the mindsets and values of business leaders and to redefine the purpose and responsibilities of corporations. Only in this way can we attain a promising future for free-market economies. Upholding a stakeholder-based governance model grounded in social contract theory requires a transformation process. This transformation process depends on trail-blazing businesses and academic leaders to create a power base for reform, and every corporation must take concrete, measurable steps.

Among other initiatives, this author suggests the following key practical reform measures:

(1)To revise the company regulations and policies to specify that the fiduciary duty of directors and top executives is not restricted to shareholders;

(2)To establish a Stakeholder Advisory Council within the corporation;

(3)To institute and report key performance indicators (KPIs) to evaluate the value created for different stakeholder groups;

(4)To link the executive compensation scheme to these KPIs rather than basing it upon profit figures and gradually reduce or phase out the issuing of executive stock options;

(5)To compensate the operational-level employees by committing a minimum percentage of the corporation's annual net profit as bonus; and

(6)To undertake at least one sizeable social innovation project related to the core businesses at any one time to help resolve pressing social problems and enhance corporate profits.

This reform cannot be achieved solely through the efforts of individual actors. If businesses, governments, academia and civic organisations make fundamental changes to their values, they can jointly promote and establish a new stakeholder-based governance model. In fact, many of today's social innovations cut across the traditional boundaries separating different sectors and stakeholders with free flows of ideas, values and resources.

Business leaders have the noble job of creating real value for all stakeholders. Directors and CEOs who actively engage in strengthening civic life will not only help create a better world; they will also lead more authentic and fulfilling lives. Furthermore, we need to change the way that we teach our university students about the socioeconomic role of corporations. Reform should be oriented towards a more just, inclusive and sustainable stakeholder-based economy.

(The contents only represent the author's personal opinions)

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