Unrealized Potential: Misconceptions about Corporate Purpose and New Opportunities for Business Education[1]

Miguel Padró, The Aspen Institute Business & Society Program

May 28, 2014

The dominant conception of the corporation today is that firms exist to maximize value for shareholders. Unfortunately, a narrow understanding of this paradigm causes many business leaders to believe that they are legally and morally obligated to maximize stock price for their investors. This conventional wisdom unnecessarily constrains thinking about the role of corporations in the long-term health of society. In doing so, it may also be an impediment to building the skills that companies, investors, and society are demanding from corporate leaders. We clarify the widespread assumption that shareholders own the corporation, then explore the implications for what is being taught to business students about value creation, risk, accountability, good management, and good governance. Business education is uniquely positioned to develop business leaders and investors who exercise sound judgment, resist the allure of the short term, and thus help realize the full potential of the corporate form.

The Challenge

The first quarter of 2011 at Google was, in the words of CEO Larry Page, "tremendous." The company, still navigating the global recession, saw its revenues rise 27% and income was up 17%. For the quarter, Google earned $7.04 per share, up from $6.06 a year earlier. However, in afterhours trading following the announcement, Google saw its stock price drop 5%. Analysts bemoaned increases in Google's costs, particularly employment costs, as the tech giant hired 1900 new employees in the quarter (as part of a plan to hire 6200 new employees over the course of the year) and gave a 10% raise to its employees. More than half of the new hires were in business areas that made Google the most money but the increased costs kept the company's

Note: This paper emerged from a series of Aspen Institute Business & Society Program roundtables, meetings, and private conversations with more than one hundred law and business scholars, corporate leaders, and investors over the past three years. It is intended to open dialogue in business education and encourage new pathways to educate the business leaders of tomorrow. We are deeply grateful to everyone who has engaged with us on this topic over the past three years and to the UCLA School of Law, The Wharton School at University of Pennsylvania, and NYU-Stern School of Business for hosting Aspen roundtables. Particular thanks to those who offered their constructive criticism during this paper's development, including Constance Bagley, Sally Blount, Christopher Bruner, Bruce Buchanan, David Ciepley, Tom Donaldson, Roger Martin, Dylan Minor, Moses Pava, Nicola Persico, Lynn Stout, Klaus Weber, and Robert Whitelaw. Please direct comments and questions to Miguel.Padro@aspeninstitute.org.

earnings per share below analysts' expectations. *The New York Times* reported that when analysts pressed for a justification of the increased spending, Google executives:

> *"…stressed that the hiring was necessary to help build emerging products like mobile and YouTube that will pay off in the long run. Patrick Pichette, Google's chief financial officer, emphasized that Google was disciplined and that all units had to justify their costs.*
>
> *'Everybody that has a cost center has to demonstrate productivity,' he said.*
>
> *That response got a cool reception from analysts. 'They can't continue to invest at this rate because the law of diminishing returns will kick in at some point,' said Ross Sandler, an analyst with RBS Capital Markets."*[2]

Stories like this are not unusual today, and they highlight the tensions facing corporate leaders who are simultaneously being asked to build their companies' long-term prospects while focusing on immediate value for investors. Balancing the need for sound, independent judgment in the C-suite with proper accountability is one of the great challenges facing corporations today.

While corporations are arguably the world's most influential institutions, this influence is accompanied by deep public skepticism about the nature of the corporation, the motivations of its leadership, and its ability to advance the public good. CEOs are among the least trusted leaders in society. Edelman's 2014 Trust Barometer found that only "one in four General Public respondents trust business leaders to correct issues and even fewer – one in five – to tell the truth and make ethical and moral decisions." [3] Small and medium-sized family-owned companies are significantly more trusted than large public corporations. Further, private companies are viewed as more entrepreneurial and innovative than their larger, corporate counterparts.[4]

Such findings are sobering given the potential for our largest corporations to help solve the great challenges of our day, from developing and scaling clean energy to curing disease. Throughout history, the corporate form has been used for constructive and remarkably diverse purposes: establishing settlements in the New World (Massachusetts Bay Company), building America's first railroads (The Granite Railway Company and The Baltimore and Ohio Railway Company, among others), bringing the automobile to the masses (Ford Motor), treating diabetes (Novo Nordisk), making air travel affordable (Southwest Airlines), and making the world's information accessible and useful (Google). However, an equally powerful narrative of the corporation views it as an engine of income inequality and a threat to the sustainability of our natural environment and the civic institutions charged with protecting society's interests. Both of these narratives hold a fair share of truth and are deeply rooted in historical experience.[5] And yet both assessments are incomplete on their own.

Conventional wisdom unnecessarily constrains thinking about the role of corporations in the long-term health of society. In doing so, it may also be an impediment to building the skills that society, companies, and investors are demanding from corporate leaders. New perspectives are required to develop businesses and leaders capable of achieving the potential of the corporation, both in relation to business and to society. Business education has an important, and perhaps underappreciated, role to play in bringing business, investors, and society into a more constructive union.

The Role of Business Education

Business education is uniquely positioned to develop business leaders and investors who exercise sound judgment, resist the allure of the short term, and thus help realize the full potential of the corporate form. Broadening the way graduate (MBAs) and undergraduate business majors[*] are trained to think about corporate purpose is a critical step toward realizing this potential.

Undoubtedly, the real world complexity of the modern corporation invites simplifying heuristics to help managers focus on business. In the words of one business scholar, "Think how hard it would be to teach that class [strategy] if every case you talk about, you're saying, well what is the real purpose of Walmart? What are we really about?"[6] However, simplification that masks the complexity of the modern corporate environment can create blind spots for managers and may inadvertently impede, rather than enhance, managerial excellence. Herein lies a great challenge and opportunity for business education: developing business leaders who can manage to complexity, while offering clarity of purpose to investors, employees, customers, and to society as a whole.

The dominant conception today is that corporations exist to maximize value for shareholders.[7] Unfortunately, a particularly narrow understanding of this paradigm leaves many MBAs believing that they are *legally and morally obligated* to maximize stock price for their investors. Over three years of dialogue among and with scholars, business practitioners, and investors, we have observed deep concern that such a view is not only untrue as a matter of law, but unwise as a practical business matter. Unfortunately, the narrow paradigm persists strongly throughout business education and surprisingly little new thinking about corporate purpose has emerged from the business academy for some time.

By revisiting our understanding of corporate purpose, the accountability of business leadership, and the role of business education in maximizing the potential of corporations to make positive contributions, this paper hopes to encourage such new thinking.

Clarifying Our Understanding of Corporations

In this section we clarify the widespread belief that shareholders own the corporation, then explore the implications for what we teach business students about value creation, risk, accountability, good management, and good governance, particularly for corporations in the United States.[8] To this end, we identify four key points about corporations and the relationship between business leadership and shareholders:

1. *In the United States, a corporation is not the property of its shareholders.*

---

[*] As shorthand in this briefing, we refer to all graduate and undergraduate students of business as MBAs (Masters of Business Administration).

2. *In practice, maximizing shareholder value is not a clear objective because shareholders' interests and time horizons are diverse, not homogeneous.*
3. *Delaware corporate law's "schizophrenia"*[9] *regarding corporations is a feature, not a flaw. It provides flexibility for rethinking the nature and distribution of risk in today's corporate environment and for the design of innovative business models and governance arrangements appropriate to changing context.*
4. *The law does not dictate corporate purpose; purpose is a choice. Corporate purpose is a foundational business decision that can and should be defined clearly at the firm-level and communicated to shareholders, employees, customers, and others directly impacted by a corporation.*

The following discussion examines each of these points in turn, using historical, academic, and legal arguments to clarify conceptions of corporate purpose and the relationship between shareholders and corporations.

1. In the United States, a corporation is not *the property of its shareholders.*

A corporation, by definition, is not owned by anyone, just as towns, universities, and monasteries (all themselves forms of corporations) are not owned by anyone. A corporation is a distinct entity that owns property; it is not property itself.[10] Managers of the corporation are charged with controlling the use of the corporation's assets in the best interest of the corporation (not for their own personal interests), while shareholders are granted a set of economic rights and a role in governing the corporation. This is not an historical accident. It is a design feature of the corporate form.

Despite its ubiquity in modern society, the business corporation represents a paradox for capitalism. The corporation has come to dominate the free enterprise system by breaking the rules and constraints of private property through a government intervention: the granting of a corporate charter. In this sense, corporations are born of government, yet live in markets. They are neither fully private nor public.[11] The corporation differs from proprietorships or traditional partnerships, forms of business which can be established through private contract, are actually owned, and hew more closely to the logic of private property. Therefore, traditional theories of the firm based on property rights offer an incomplete, and perhaps misleading, understanding of corporations.

Even among the most sophisticated corporate thinkers, the corporation defies simple description. William Allen, former Chancellor of the Delaware Chancery Court, has described corporate law as "schizophrenic,"[12] given the seemingly inconsistent way it treats corporations as distinct legal entities ("persons") on one hand, while simultaneously granting shareholders distinctive powers in corporate governance. Others have noted corporate law's "enduring ambivalence"[13] when defining the purpose of a corporation. Perhaps it should then come as little surprise that when asked what a corporation is, answers among experts range from a "franchise of government,"[14] to a "nexus of contracts," "a person," and even a "sociopath."[15]

The corporation is ownerless *by design* and this design has particular benefits. Professor Margaret Blair of Vanderbilt Law has argued that the corporate form's remarkable emergence in the 19th century United States was largely the result of its ability to "lock in" capital provided by a number of investors under a unified owner—the corporation—to be deployed for ambitious and risky long-term projects.[16] This ability to lock in capital was made possible by breaking the logic of property ownership and rearranging control, liability, and asset ownership in a unique way.[17] By socializing capital and assets within a corporation, large, long-term projects could be undertaken without risk of the business being dissolved due to an investor pulling their capital out and disrupting operations—a limitation endemic to partnerships. The corporate form allowed capital to be fixed under the ownership of the company itself no matter who held the stock.

This arrangement proved to be enormously attractive for both corporations and investors, and was crucial to the ascent of the United States to a global economic power.[18] It enabled companies to raise and deploy sums of capital to fund growth and expansion not viable under other legal arrangements. The corporation became the form of choice for businesses undertaking major projects such as building roads and canals, mining, or growing capital intensive manufacturing operations—industries that fueled the Industrial Age and the development of our modern economy. More recently, the corporate form has enabled millions of people to save for retirement and college educations by holding relatively small amounts of corporate stock without the risks and responsibilities that would come with owning a business themselves. These benefits, however, were accomplished by creating a different set of rules, conditions, and incentives than those of private property.[19] While many cite the separation of stock ownership and control as the critical *problem* to be solved in corporations, it is also the source of many of the primary *benefits* of the corporate form.

For all of its advantages, the corporation presents an accountability dilemma that has concerned observers and governments for centuries. The very structure of the corporation treats risks and liabilities differently than other property-based forms of business. Neither shareholders who provide capital nor management who control the corporation shoulder the full risks and liabilities that, for example, a sole proprietor of a business would. Neither management nor stockholders can be expected to act like owners because neither shareholders nor management *are* owners. The public which grants the corporation its charter relies on a mix of market pressures, appropriate regulation, the corporation's internal governance structure, and faith in sound corporate leadership to ensure that accountability gaps and opportunities to externalize costs are not exploited.

Moving beyond assumptions of ownership requires a deeper consideration of shareholders, who clearly play an important but also intentionally limited role in corporate governance. Considering that shareholders are both the providers of equity capital and the constituency with the power to oust management, the metaphor of ownership may appear to be a reasonable placeholder for the more complicated truth, but it remains a factual distortion. The limitations of the metaphor of ownership loom particularly large in the modern corporate context.

Thinking of shareholders as owners in today's context masks at least two important factors that impact corporate accountability. The nominal shareholders today are large institutions investing as agents of average people saving for retirement or college; they are generally not investing their own capital, and thus are not "principals" as agency theory suggests. There are substantive differences between the incentives and pressures shareholders face—and the choices available to them—and those of actual business or property owners. The logic of "ownership," while attractive for its simplicity and familiarity, is insufficient to describe the actual incentives, risks, and pressures that shape the actions of corporate shareholders and management.[20] We ignore these differences to our detriment. This suggests a deep need, and indeed, a rich opportunity to develop theories *specific to the corporate form* to better navigate the unique nature of risk, value, incentives, externalities, accountability, and efficiency *in corporations*.[21]

2. In practice, maximizing shareholder value is not a clear objective because shareholders' interests and time horizons are diverse, not homogeneous.

One of the great attractions of the maximizing shareholder value norm has been its potential to simplify decision making for corporate leaders. Yet such simplicity has proven illusory in practice. Many corporate leaders and institutional investors have observed that maximizing shareholder value has too often been interpreted as maximizing short-term share price. Perhaps this is a logical reaction when corporate management is confronted with conflicting signals from investors with different time horizons and motivations. Which investors should they be maximizing value for? At the same time, institutional investors managing retirement and other long-term investments are frustrated by what they see as an overly short-term focus of corporate management fueled by poorly designed stock-based incentive systems that crowd out longer-term thinking and the intrinsic motivations of corporate leaders. Corporate management dedicates significant time and resources to quarterly earnings calls[22] and a media news cycle that is fed with short-term issues often immaterial for long-term value creation. Further, the corporate system is riddled with conflicting notions of what "long term" actually means. Over years of Aspen Institute dialogues we have asked business leaders, investors, and scholars what constitutes "long term" and responses range from one year to a generation.

The challenge of managing to conflicting time horizons is frequently noted by corporate leaders and investors alike. The well-known 2005 study by Graham, Harvey, and Rajgopal found that, "because of the severe market reaction to missing an earnings target… 78% of the surveyed executives would give up economic value in exchange for smooth earnings." Further, they found that, "…55% of managers would avoid initiating a very positive NPV project if it meant falling short of the current quarter's consensus earnings."[23] In 2013, a *McKinsey Quarterly* survey of more than 1100 board members and C-suite executives worldwide found that 63% said the pressure to generate strong short-term results had increased over the previous five years. Forty-four percent said they use a time horizon of fewer than three years in setting strategy. "What explains this persistent gap between knowing the right thing to do and actually doing it?" asked McKinsey CEO Dominic Barton. "In our survey, 46% of respondents said that the pressure to deliver strong short-term financial performance stemmed from their boards—they expected their companies to generate greater earnings in the near term. As for those board members, they made it clear that they were often just channeling increased short-term pressures from investors, including institutional shareholders."[24]

Describing the complexity of interpreting today's shareholders' interests, one business scholar recently noted, "…the dimensions that are relevant are not so much individuals vs. institutions. It's all institutions now.…[For] the average company, 75% of their shares are owned by institutions. Mom and Pops mostly don't exist. So we can rule them out. It's really, 'What do the institutions think?' And there the diversity is peculiar. I don't think we really understand yet what those interests look like."[25]

The variability of investor interests and time horizons underscores the importance of a corporate leader's ability to rise above the interests of different factions and exercise independent judgment on a correct long-term course of action for the company.

In U.S. corporate law, the Business Judgment Rule allows the board and management to exercise judgment for the health of the enterprise, in good faith, and to make mistakes (which are inherent to taking risks) without being held legally liable for business losses that may incur. At the same time, the law also imposes duties of care and loyalty on the board and management to ensure that corporate assets are deployed in the best interests of the corporation and not to advance the personal interests of directors and management. Corporate managers surely should attend to the political and market power of shareholders and pay attention to the useful information that shareholders offer, but sound business leadership requires the ability to exercise independent judgment for the long-term health of the corporation and to rise above the demands of shareholders (as well as other corporate constituents such as employees and even customers) when necessary.[26] The interests of the corporation and the interests of shareholders are not synonymous. Indeed, the tensions between these interests are at the heart of corporate governance and many corporate law cases today.

The long-term health of the corporation may be better served by corporate leaders who embrace the discretion afforded them by the law to craft corporate strategy from a clearer, firm-specific purpose. A clearly articulated corporate purpose accompanied by a clearly articulated strategy and business model for achieving that purpose provides a framework for independent judgment and transparent communications to investors about the long-term value drivers of the business. Since such clarity can only come from the individual firm-level, it is useful for business students to grapple with the variability and vast potential for the corporate form, as well as the real tensions, pressures, and choices that encourage or undermine sound, *long-term* business judgment.

3. Delaware corporate law's "schizophrenia"[27] *regarding corporations is a feature, not a flaw. It provides flexibility for rethinking the nature and distribution of risk in today's corporate environment and for innovative business models and governance arrangements appropriate to different contexts.*

If one is looking for a prescribed purpose for all corporations in U.S. law, it is easy to be left wanting by the law's treatment of corporate obligations to shareholders. There is no requirement, for example, in Delaware's corporate code for management to maximize value for shareholders. Under normal operating conditions, the corporation is treated as a distinct legal entity, controlled by management and its board so long as they take adequate care when making decisions and don't use corporate assets to advance their personal interests. The board is granted legal latitude so broad, for example, that it is under no obligation to accept an unsolicited offer to purchase the company even when that offer includes a substantial premium for shareholders.[28] On the other hand, case law has clearly established unique protections for shareholders such as the requirement to take the highest possible price in a board-initiated sale of the company—the "Revlon standard"—and for protecting shareholders from the corporation being used to advance the personal agendas of management.[29]

Why then do shareholders enjoy distinct powers in the corporation relative to other constituents? One influential theory argues that corporate law protects shareholders because they are viewed as particularly vulnerable "residual claimants." Shareholders don't control the corporation and don't negotiate individual contracts with the corporation and so are unprotected if things go bad for a company due to irresponsible management. Their vulnerability justifies special protection during a board-initiated sale and also, some theories argue, makes shareholders uniquely qualified, both practically and morally, to monitor management; the role of shareholders as the check on management is justified, not because of shareholder power as owners, but rather because of their relative vulnerability among other constituents.

The underlying logic that those who bear great risk in the corporate enterprise are particularly attuned to monitor management is compelling, but the assumptions about who bears risk in a modern corporate context warrant deeper consideration. As described previously, the corporate form, by design, *reduces* risk for shareholders *because* they don't own the corporation. Modern investment strategies, from portfolio diversification to hedging, are employed explicitly to reduce risk for shareholders. Modern stockholding is primarily conducted by enormous investing institutions (many of them corporations themselves) investing other peoples' money, not their own. The growing popularity of index investing reduces the risk that any single under-performing company will meaningfully impact the investor. What cumulative effect do strategies that *reduce* risk for shareholders have on their ability to monitor corporate management? In liquid markets dominated by highly diversified investors, do shareholders have incentive to sufficiently fulfill the monitoring role on their own? If risk-bearing is the fulcrum on which the right and the ability to monitor corporate management rest, might other risk-bearing constituents also play valuable roles in corporate accountability?

These questions suggest promise in developing a deeper understanding and responsiveness to the levels and nature of the risks borne by the various contributors to the corporate enterprise, including different kinds of shareholders. Further research into the shifting, context-specific dynamics of risk and uncertainty[30] may also yield useful insight. For example, in periods of high unemployment or under conditions in which employees lack leverage to negotiate contracts, how might employee voice be harnessed in corporate governance to improve corporate accountability and efficient capital allocation?[31]

4. The law does not dictate corporate purpose: purpose is a choice. Corporate purpose is a foundational business decision that can and should be defined clearly at the firm-level and *communicated to shareholders, employees, customers, and others directly impacted by a corporation.*

Delaware corporate law, among the most shareholder-friendly corporate law in the United States, remains "fundamentally ambivalent" about defining the purpose of corporations.[32] As a legal matter, the extent of shareholder power and management's discretion is constantly evolving. Despite volumes of case law, the precise boundaries of the responsibilities of management to the corporation and shareholders remain elusive. Simply put, the law does not dictate corporate purpose.

Delaware's corporate code states that corporations "can be formed to conduct or promote any lawful business or purposes."[33] Within the corporate charter, corporations are often required to state their purpose, though, as Cornell Law Professor Lynn Stout observes, "the overwhelming majority of corporate charters simply state that the corporation's purpose is to do anything lawful."[34] The law's ambivalence places the onus on corporate management to clearly communicate the purpose, goals, strategy, and values of their organization to investors, employees, and communities and to be held accountable for them. Business leaders need the skills, tools, and frameworks to conceive of corporate purpose and then develop relevant long-term strategy, identify long-term risks, and communicate the strategy and risks. Likewise, investors need tools to understand how a company translates its purpose into its business model, what the drivers of value are for different companies, in different industries and markets, at different stages of corporate life.

Great opportunity exists for MBAs who see the corporation not merely as a vehicle for *distributing* financial surplus to shareholders, but as a tool to *create* true long-term value.[35] Corporate purpose is a strategic and ethical decision with broad implications for company performance and all who are affected by management's choices. The law defers to the board and management to define their organization's purpose and harness its potential—a privilege and responsibility many overlook to the detriment of the company, its investors, employees, and society.[36]

Rethinking Corporate Potential in Business Education

The business corporation is rife with ambiguity thanks to a legal structure that lacks the built-in risk/reward accountability that comes with business ownership. To the extent that the shareholder value maximization norm continues to be narrowly or uncritically imparted on business students, business education is missing an important opportunity to develop skills that corporate leaders need to exercise sound judgment that modern society, shareholders, and employees require.

The tendency to oversimplify the corporate form is understandable. The metaphor of shareholder-ownership of a corporation offers an illusion of clarity but it is misleading. In practice, senior executives frequently lament the expectation that they treat shareholders as owners, and long-term shareholders are frustrated by managers who seem unable to communicate their long-term strategy. Neither companies nor investors are getting the business leadership they demand and deserve when short-term financial performance crowds out consideration of the long-term drivers of value or blinds managers to longer-term risks.

Still, perhaps the greatest source of discontent with business leadership today comes from the public at large. The last three decades of shareholder empowerment have been accompanied by a perceived explosion in executive compensation and a dearth of shared prosperity. To the extent that shareholder empowerment aligns the interests of CEOs with investors by pushing aside the best interest of other constituents and the public, it will continue to erode public trust and invite greater regulatory oversight.

In this light, corporate law itself must be understood as an important, yet incomplete, accountability mechanism. While corporate law both constrains corporate management and sets limits to shareholder power in the corporation, it is insufficient to ensure corporate managers focus on the long-term drivers of their business. Shareholder power is likewise an insufficient protection for society from the full downsides of harmful corporate activity and provides often conflicting incentives for long-term value creation. The gaps left by the checks and balances designed in the law and regulation must be filled by sound corporate leadership.

Society expects business leaders to be independent yet dutifully accountable, bold yet wise, results-oriented yet long-term focused. In training our future business leaders, business schools are tasked with producing MBAs with skills that enable managers to be decisive, to be solicitous of feedback from a range of constituents, to be judicious in their assessment of risks over all time horizons, and to be courageous in exercising good judgment for the benefit of a host of conflicting interests. The first step toward these educational ends is acknowledging the ambiguity surrounding corporations. Rather than imparting a misleading sense of clarity to business students, a critical examination of the corporation and corporate purpose exposes ambiguity and offers a promising pathway to build the leadership skills that future generations of business leaders will require.

Corporate law is "fundamentally ambivalent" about defining the purpose of corporations; it merely sets the acceptable boundaries. Corporate purpose is a business decision that should be clearly defined and communicated by management. Corporations should provide transparency around their purpose to maintain their social license to operate, set investor expectations, guide strategic and ethical choices, and ensure accountability. Business education can play an important role in developing leaders with the skills to make these goals a reality.

Concluding Thoughts

The design of the business corporation is remarkably flexible. This flexibility presents opportunity to re-shape our thinking about corporations to better fit changing market and social contexts.[37] Yet, the logic of shareholder "ownership" and other short-hand ways of interpreting US corporate law impede robust exploration of the business corporation's full potential. The characteristics of modern corporations and shareholders call for a reassessment of who bears risk, contributes to value creation, and is best positioned to ensure corporate accountability — and what business students are consequently taught.

In order for capitalism to properly calibrate corporate accountability, efficiency and fairness, it may require new norms that focus on a deeper understanding of how long-term value is created. While financial surplus is certainly one vital sign of corporate health, it offers little insight into the ability of a corporation to create financial and other forms of value in the future. Business education can play a central role in developing tools and frameworks that help managers interpret, prioritize, and respond to the full range of factors that collectively create value.

Market forces, public sentiment, labor and consumer pressure, and other areas of law (environmental, labor, human rights, anti-trust, etc.) also have a potentially constructive role to play in aligning the great capacities of corporations with the long-term health of society. Today's distrust of corporate management reflects a growing unease that the corporate form is being abused to privatize gains for a few while socializing costs and downside risks on to society. To the extent that shareholder power has grown at the expense of broader civic and social interests, the shareholder value maximization norm may have inadvertently weakened manager accountability and the quality of corporate leadership rather than strengthened it. Dividing power in the corporation between two constituencies who bear far less downside risk for their choices than owners who control other forms of business still leaves the accountability dilemma endemic to the corporate form unresolved.

This introduces a multitude of questions. How then do we ensure that the privileges granted to the corporation, its management, and shareholders are used to produce positive-sum value for society and not to simply enrich some at the expense of others? Is it appropriate or fair to require management to be solely accountable to shareholders, shareholders who are protected from the full downside risks of corporate decisions, who enjoy a range of protections and market power other stakeholders do not, and who stand to profit from companies externalizing costs? Might other constituents who bear risk in the corporation offer additional useful information to managers and markets to help ensure both better long-term corporate performance and accountability? What kinds of management behavior and outcomes should be incentivized? How might such outcomes be measured?

Such questions call for new, broader thinking about corporate purpose, how we define and measure risk and value creation in business, how we measure the performance of corporate leaders, how we distribute the rewards for increased corporate productivity, and how we improve accountability, incentives, and regulation. In exploring questions of corporate purpose more deeply in their research and the classroom, business faculty can shape MBAs into leaders able to more fully realize the vast potential of the corporation, both for their own success and for the long-term health of society.

Endnotes

---

[1] This paper focuses on US corporate law, although we believe the themes of this paper apply more broadly. Though corporate law varies across jurisdictions, the basic structural features of the corporate form remain quite consistent across the globe. See: John Armour, Henry Hansmann, and Reinier Kraakman, "The Essential Elements of Corporate Law." Oxford Legal Studies Research Paper No. 20/2009; Yale Law, Economics & Public Policy Research Paper No. 387; Harvard Law and Economics Research Paper No. 643; Harvard Public Law Working Paper No. 09-39; ECGI - Law Working Paper No. 134/2009. Available at SSRN: http://ssrn.com/abstract=1436551

[2] Verne G. Kopytoff, "Revenue Rises at Google but Profit Misses Forecasts and Analysts Point to Spending," *The New York Times,* April 14, 2011.

[3] 2014 Edelman Trust Barometer, "Trust in Business," accessed May 7, 2014, http://www.edelman.com/insights/intellectual-property/2014-edelman-trust-barometer/trust-in-business/.

[4] Ibid.

[5] See: David Rothkopf, *Power Inc.:The Epic Rivalry Between Big Business and Government--and the Reckoning That Lies Ahead*, Farrar, Straus and Giroux, 2012.

[6] The Aspen Institute, "Unpacking Corporate Purpose: A Report on the beliefs of executives, investors and scholars", conducted by The Keller Fay Group for the Aspen Institute Business & Society Program, May 2014, pg 34. www.aspeninstitute.org/UnpackCorporatePurpose

[7] Ibid. See also Darrell West, "The Purpose of the Corporation in Business and Law School Curricula," Brookings Institution, July 2011 and Jia Lynn Yang, "Maximizing Shareholder Value: The Goal that Changed Corporate America," *The Washington Post*, August 26, 2013.

[8] Although we sometimes refer to "U.S." corporate law, each corporation (other than national corporations, such as some banks) is incorporated in a specific state, which has its own specific statutes concerning the formation and governance of corporations incorporated in that state. Nonetheless, there are many common provisions that form the basis of much of the analysis in this briefing. Because most large American public corporations are incorporated in Delaware and many states have patterned their statutes and base their case law on Delaware law, we pay particular attention to that jurisdiction.

[9] William Allen, "Our Schizophrenic Conception of the Business Corporation," *Cardozo Law Review,* 14. 261 (1992).

[10] See: Frank H. Easterbrook and Daniel Fischel, *"The Economic Structure of Corporate Law"*, 36-39 (1991); for a shorter argument of this point, see: Stephen Bainbridge, "Once more with feeling: Shareholders Don't Own the Corporation," March 5, 2010. Accessed May 7, 2014, *ProfessorBainbridge.com* http://www.professorbainbridge.com/professorbainbridgecom/2010/03/once-more-with-feeling-shareholders-dont-own-the-corporation.html.

[11] David Ciepley, "Beyond Public and Private: Toward a Political Theory of the Corporation," *American Political Science Review,* Vol. 107, No 1 (February 2013).

[12] Allen, "Our Schizophrenic Conception of the Business Corporation."

[13] Christopher Bruner, "The Enduring Ambivalence of Corporate Law," *Alabama Law Review*, Vol. 59:5:1385 (2008).

[14] Ciepley, "Beyond Public and Private: Towards a Political Theory of the Corporation"

[15] *The Corporation,* directed by Mark Achbar and Jennifer Abbott (2003), based on the book, *The Corporation: The Pathological Pursuit of Profit and Power*, by Joel Bakan.

[16] See: Margaret M. Blair, "Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century," *UCLA Law Review*, Vol. 51, No. 2, pp. 387-455, (2003); Henry Hansmann, Reinier Kraakman, and Richard Squire, "Law and the Rise of the Firm" (January 2006); *Yale Law & Economics Research Paper* No. 326. Available at SSRN: http://ssrn.com/abstract=873507.

[17] Blair, "Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century."

[18] Ralph Gomory and Richard Sylla, "The American Corporation," *Dædalus* 142 (2) (Spring 2013).

[19] Dow Votaw, *Modern Corporations*, Prentice-Hall, (1965) p 96-97: "Property consists of a bundle of rights which the owner of property possesses with regard to some thing- rights to possess, use, dispose of, exclude others, and manage and control. The corporate concept divides this bundle of rights into several pieces. The stockholder gets the right to receive some fruits of the use of property, a fractional residual right in corporate property, and a very limited right of control. The rights to possess, use, and control the property go to the managers of the corporation."

[20] Christopher Bruner, "Conceptions of Corporate Purpose in Post-Crisis Firms," *Seattle University Law Review*, Vol. 36, No. 2, (2013), p. 527. Bruner observes that shareholders are the constituency who benefit most from risk-taking while being protected substantially from the downsides of those risks. This stands in sharp contrast to how we traditionally think of ownership in which the risk and reward are bundled together.

[21] David Ciepley has argued, for example, that "corporations need to be placed in a distinct category—neither public nor private, but 'corporate'—to be regulated by distinct rules and norms." See: Ciepley, "Beyond Public and Private: Towards a Political Theory of the Corporation."

[22] Peggy Hsieh, Tim Koller, and S.R. Rajan, "The Misguided Practice of Earnings Guidance," *McKinsey on Finance*, (Spring 2006).

[23] John R Graham, Campbell R Harvey and Shiva Rajgopal, "The Economic Implications of Corporate Financial Reporting," *Journal of Accounting and Economics*, v 40, (December 2005), 3-73, http://www.nber.org/papers/ w10550.

[24] Dominic Barton and Mark Wiseman, "Focusing Capital on the Long-Term," *Harvard Business Review*, (January 2014), http://hbr.org/2014/01/focusing-capital-on-the-long-term/ar/1.

[25] The Aspen Institute, "Unpacking Corporate Purpose: A Report on the beliefs of executives, investors and scholars" pg 28.

[26] It is notable that prominent critics and advocates of the shareholder primacy norm agree that there is no legal obligation for managers to maximize share price. Advocates of greater shareholder power believe that greater accountability to shareholders offers the strongest incentives for sustained corporate performance. See: Lucian Bebchuk, "The Case for Increasing Shareholder Power," *Harvard Law Review*, Vol. 118, No. 3, pp. 833-914 (January 2005), Harvard Law and Economics Discussion Paper No. 500. Available at SSRN: http://ssrn.com/abstract=387940; Stephen Bainbridge, "Director Primacy: The Means and Ends of Corporate Governance," UCLA School of Law Research Paper No. 02-06, (February 2002);

Jonathan Macey, "Sublime Myths: An Essay in Honor of the Shareholder Value Myth and the Tooth Fairy," *Texas Law Review*, Vol. 91 No. 4, March 2013.

Critics of granting greater shareholder control over corporations fear that maximizing shareholder value sets *too low* a bar for corporate leadership, that it too easily leads to the use of short-term share price as a metric of performance, and distracts managers from the drivers of sustained business performance. See: Margaret Blair, *Ownership and Control,* Washington DC, The Brookings Institution, (1995); Kent Greenfield, "There's a Forest in Those Trees: Teaching about the Role of Corporations in Society," *University of Georgia Law Review*. Available at SSRN: http://ssrn.com/abstract=202291; Roger Martin, *Fixing the Game: Bubbles, Crashes and What Capitalism Can Learn from the NFL*, Boston, Harvard Business Review Press, (2011); Lynn Stout, *The Shareholder Value Myth*, Berrett-Kohler, (2012).

[27] Allen, "Our Schizophrenic Conception of the Business Corporation".

[28] *Air Products and Chemicals, Inc. v. Airgas Inc.*, Civ.5249-cc,5256-CC (Del. Ch., Feb. 15, 2011).

[29] Leo Strine Jr., "The Social Responsibility of Boards of Directors and Stockholders in Change of Control Transactions: Is there any "there" there?", *Southern California Law Review*, Vol 75:1169, (Sept. 2002).

[30] This includes what are commonly referred to as "non-financial risks." We intentionally avoid the term "non-financial risks" in recognition of a point made to us in an Aspen Institute dialogue that non-financial risks are really just "not-yet-financial risks."

[31] We do not mean to suggest that importing the German co-determination model is the answer. Rather, this is an area of potential innovation in which the United States can draw on its own tradition of diverse governance arrangements like co-ops, mutuals, and ESOPs for engaging employees more productively within a corporate structure.

[32] Bruner, "The Enduring Ambivalence of Corporate Law."

[33] From Lynn Stout, *The Shareholder Value Myth*, citing Delaware General Corporation Law, Section 101 (2011).

[34] Ibid, pg. 28.

[35] Vontobel Asset Management, "In Praise of Long-Term Thinking," Investor letter, January (2014).

[36] Ed Freeman, "Managing for Stakeholders: Tradeoffs or Value Creation" *Darden Business Publishing*, (2008): "The key idea which holds this value creation mindset together is the idea that businesses can have a purpose. And, there are few limits on the kinds of purpose that can drive a business. Wal-Mart may stand for 'everyday low price.' Merck can stand for 'alleviating human suffering.' The point is that if an entrepreneur or an executive can find a purpose that speaks to the hearts and minds of key stakeholders, it is more likely that there will be sustained success."; also Niko Mourkouganis, "Purpose: The Search for Strategic Alignment," AMA Seminars (Sept. 2007-June 2008).

[37] Leo E. Strine, "The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face." *Delaware Journal of Corporate Law*, Vol. 30, No. 3, (2005) pp. 673-696. Available at SSRN: http://ssrn.com/abstract=893940 "It is managerial ingenuity that creates stockholder wealth through the invention and exploitation of new products, the development and more efficient provision of services, and sound financial management. Delaware corporate law recognizes that reality by investing central management with wide discretion to make business decisions and a wide choice of means to effect those decisions. Those investments facilitate creativity and risk-taking."