A Sense of Purpose and the New Paradigm:

Governance Trends Apparent in Blackrock's Annual Letter to CEOs

By Chat Ortved

Over the past several years, a debate has sometimes simmered, sometimes raged around the question of whether so-called "activist investors" are on the whole good for companies, their stakeholders and the economy as a whole. Underlying that debate – and the accusations that are inevitably hurled about short-termism, value extraction and board insulation – is a deeper concern, impossible to apply to any one company or any one shareholder, about the role of the public company in our economy and our society more broadly. If companies are not run in the narrow interests of a particular (and particularly vocal) shareholder, then in whose interests are they run? Who are the beneficiaries of the wealth that corporations are meant to create?

Recently, Larry Fink, the CEO of Blackrock, Inc., the world's largest asset manager, published his annual letter to CEOs. In the letter, which he titled "A Sense of Purpose", Mr. Fink turned his pen to a subject once thought inimical to the creation of "shareholder value": social purpose. And, in evaluating each particular corporation's purpose, he urged his readers to consider something that will be familiar to anyone who has been involved in Canadian corporate governance in the last ten years: the interests of a broad range of stakeholders. Fink told his readers: "The public expectations of your company have never been greater. Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate."

This statement represents almost a revolution in a culture that has accepted, at least since the 1970's, that the "business of business is business." But Mr. Fink is no bleeding heart socialist. His organization is responsible for literally trillions of dollars of other people's money, and in his effort to manage and expand that money he is alluding to something much more nuanced than a hoary "corporate social responsibility." His advice is grounded in a sophisticated understanding of how businesses are formed and placed into corporations, how they create and sustain value and what our public companies are ultimately meant to achieve. In this understanding he is aligned with a growing movement that has reacted against the cult of "shareholder value" and conceived - or reconceived, in a sort of corporate anamnesis - the corporation as an important element of the complex, diverse, intricate system in which we all live, prosper and enjoy our political and economic freedoms.

This movement, which promotes a new paradigm of corporate governance reliant on robust corporate governance principles, including long-term strategic planning, and engagement with shareholders by executives and directors, recognizes that each corporation runs a business that aims to fill a particular societal need or desire that over the long term, if achieved, will generate value for every group that holds a "stake" in the corporate endeavour. It also recognizes that a failure to consider these stakeholder groups can have long term consequences that damage the company's value, including for shareholders. Ignoring direct stakeholders like shareholders, creditors, customers and employees can have obvious negative short-term effects. Ignoring indirect stakeholders, like the borrowers whose credit data are gathered by a credit bureau, the residents in the town down the hill from a rail yard or factory, or the citizens misled by fake news stories posted on a social media platform, can also have corrosive effects on value in the longer term.

Long-term planning requires a broad assessment of stakeholder interests because a well-conceived strategic plan will account for the social, cultural and economic trends that affect the many groups of stakeholders, as well as the risks of a negative impact on any one of those groups. As Mr. Fink continued: "The statement of long-term strategy is essential to understanding a company's actions and policies, its preparation for potential challenges, and the context of its shorter-term decisions. Your company's strategy must articulate a path to achieve financial performance. To sustain that performance, however, you must also understand the societal impact of your business as well as the ways that broad, structural trends – from slow wage growth to rising automation to climate change – affect your potential for growth."

In other words, the corporation's leadership, including its management team and every member of its board, should be attuned to and focused on every element of the business's long term success, taking into consideration the impact on all direct and indirect stakeholders. In Canada, consideration of stakeholder interests is required by corporate law, as a component of the fiduciary duty; it should not be lost on boards and executives that doing so requires a breadth of thought achieved best through collaboration, and is a key reason why the call from major investors, regulators, legislatures and academics for all kinds of diversity on every board of directors has become so much louder.

Who, then, are the beneficiaries of the wealth that corporations are meant to create? If one takes Mr. Fink, and the movement of which he appears to have become a part, at face value, the answer is simply everyone. Under the corporate law, the shareholders are a particularly important group of stakeholders, given a bundle of rights and a quiver of remedies not available to others. But they will only enjoy meaningful financial returns if the corporation achieves its business aims in the long term. John Stuart Mill wrote: "Those only are happy…who have their minds fixed on some object other than their own happiness… Aiming thus at something else, they find happiness by the way." Like happiness, shareholder value should not be sought for its own sake. It is a by-product of a well-governed business that begins, and endures, with a sense of purpose.

Chat Ortved, cortved@lawsonlundell.com, has a broad, transactional-based practice involving all aspects of corporate and securities law, with particular focus on public and private mergers and acquisitions, private equity, corporate governance and corporate finance. Chat advises clients on a wide range of domestic and international transactions, including public and private acquisitions and divestitures, raising capital, corporate reorganizations and private equity transactions, working closely with other experts within the firm to negotiate and implement optimal transaction structures. In addition to transactional work, Chat also assists companies with their corporate governance and continuous disclosure obligations and advises on general corporate law.