

Client Advisory

Stakeholders, not just shareholders

By Rob Yellen

On August 19, 2019, the Business Roundtable updated its Statement on the Purpose of a Corporation to recognize a broader commitment to all stakeholders. Each version of that document issued since 1997 has stated that corporations exist principally to serve their shareholders – shareholder primacy.

Recognizing that the older statements do not reflect today’s realities, the Business Roundtable updated its statement to better reflect how businesses and their CEOs work to create value for all stakeholders today.

Key elements of the Statement on the Purpose of a Corporation include:

Principles

- Our economy should allow “each person to succeed through hard work and creativity and to lead a life of meaning and dignity.”
- The free-market system is the best.
- Companies share a “fundamental commitment to all stakeholders.”

Five commitments (summarized)

1. Delivering value to our **customers**.
2. Investing in our **employees**. We foster diversity and inclusion, dignity and respect.
3. Dealing fairly and ethically with our **suppliers**.
4. Supporting the **communities** in which we work . . . protecting the environment by embracing sustainable practices.
5. Generating long-term value for **shareholders**. We are committed to transparency and effective engagement with shareholders.

Shareholder primacy . . .

“[T]here is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game. . . .”

Milton Friedman, The Social Responsibility of Business is to Increase its Profits, The New York Times Magazine, 1970.

What does this mean for business?

The change is a big one. The Business Roundtable has formally acknowledged that in addition to shareholders, other stakeholders matter too – customers, employees, suppliers and our communities. Most businesses already consider how to engage with these stakeholders broadly. Nevertheless, the statement provides a critical update to outdated notions of corporate responsibility.



More in keeping with today's reality, the updated Statement acknowledges that business answers to a broader set of stakeholders.

- Technology, Millennials, connectivity, sharing economy, diversity, equality, cyber, privacy and on-demand workforce are all examples of changes that have impacted how businesses and their stakeholders interact.
- Social media campaigns, such as #MeToo, have the power to compel changes in days rather than the years it takes for litigation to play out.
- One viral video can materially damage a reputation and cause a precipitous stock drop.
- The gig economy has challenged our notions of workforce and work-life balance.
- The global investment community's interest in environmental, social and governance (ESG) issues has investors pressing leaders to improve sustainability and other practices.
- Cyber is not a one company problem – rather it is an ecosystem problem
- Customer feedback via social media can dramatically impact success (or failure).

To succeed, businesses have to take this broader set of stakeholders into account – and must mitigate the attendant risks to their business and reputations.

Aligning the updated Statement with applicable laws

While the Business Roundtable may have moved forward, legal duties to stakeholders imposed by law remain unaffected. Those duties vary by state, and not all laws have evolved to recognize, as the Business Roundtable has, that successful companies owe duties to a broader set of stakeholders. Some examples . . .

- **New York** permits broader consideration of the interests of employees, retirees, customers, creditors and community. (New York Consolidated Laws, Business Corporation Law - BSC § 717. Duty of directors)
- **Delaware**, by contrast, follows a more traditional view. Directors must seek “to promote the value of the corporation for the benefit of its stockholders.”

“Despite attempts to muddy the doctrinal waters, a clear-eyed look at the law of corporations in Delaware reveals that, within the limits of their discretion, directors must make stockholder welfare their sole end, and that other interests may be taken into consideration only as a means of promoting stockholder welfare.”

Honorable Leo E. Strine, Jr., *The Dangers of Denial: The Need for A Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 Wake Forest L. Rev. 761 (2015)

Impact on risk – a good D&O thing!

If businesses and leaders truly see their roles as do the 181 CEOs who signed this new Statement on the Purpose of a Corporation, we should see fewer D&O (and EPL, cyber, E&O, crime and other) claims and overall severity should diminish. From the perspective of D&O risk, this is a good thing.

Some have suggested that the updated Statement potentially broadens the constituencies beyond shareholders who will look to bring claims. Maybe, but that increase, if any, is not likely to be material any time soon. Those constituencies already bring claims – such as those based on employment practices, environmental concerns, wage and hour, consumer protection and, more recently, privacy.

Also, the threat from those constituencies exists beyond traditional claims venues. A broad set of constituencies have found, thanks to social media, that the court of public opinion does not need Delaware law to support claims. Social media campaigns have the power to exact justice in real time, and the Business Judgment Rule provides little protection against social accountability.

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Successful businesses look well beyond the risk of claims in managing their business risk. The danger that customers and/or business partners may choose to take their business elsewhere may be a far greater concern than claims. Similarly, losing the trust and engagement of your workforce can have catastrophic impact – even before any claims work their way through the legal system. Where, in contrast, improved human capital sustainability can drive success and enhance value.

In addition, the update Statement's commitment to "long term value" could prove impactful in the debate over whether business leadership should prioritize short-term or long-term goals. The Business Roundtable statement affirmatively weighs in with "long term." We will have to wait to see how, if at all, this impacts the debate and trends in shareholder activism as activists challenge longer-term strategies.

Action items

For **U.S.-based businesses and companies subject to U.S. securities laws** and their directors and officers:

- **Culture assessment.** Survey your business culture – including practices that foster diversity, inclusion, dignity and respect – against the Business Roundtable's updated Statement on the Purpose of a Corporation. Culture can be an effective tool for mitigating risks relating to D&O, employment and cyber practices as well as fostering diversity and inclusion, dignity and respect.
- **Sustainable human capital and the talent experience.** Review the components of your talent experience and talent value proposition (TVP) to ensure sustainability, including the four key components of TVP: **Purpose** (the reason why the business exists, as well as mission, vision and values); **People** (the relationship of employees with their colleagues, from senior leadership to direct managers to peers); **Work** (considerations such as the physical work environment and the availability of contemporary tools and resources to perform one's job); and **Total Rewards** (fair pay; purpose-driven benefits; career and reskilling; physical, emotional, financial and social wellbeing).

- **ESG.** Now more than ever, perceptions about environmental, social and governance matter. How well do your plans for 2020 and beyond take ESG into account?
- **Communication.** Consider updating critical communications to better reflect your business's alignment with the updated Statement. While it is likely you already take the broader stakeholders into account, this is an opportunity to better acknowledge those efforts and build credibility with the broader stakeholder set.
- **Insurance.** At this year's renewal, consider key policy provisions impacted by the broader set of stakeholders.
 - **Crisis/reputation coverage.** The broader set of stakeholders have made crisis and reputation coverage more valuable. Recent innovations in this space could make it more valuable to you.
 - **Shareholder activists.** Shareholder activist-specific wordings that help D&O policies respond more predictably to today's exposures may be available to you.
 - **Cyber/privacy.** How has your risk changed over the last year? How will it change in the next 18 months? Have your D&O, employment practices and cyber insurance programs kept up? Have you considered how your policies will interact? Is there a coverage gap you need to close?
 - **Environmental.** Review how your D&O policy responds to environmental and sustainability exposures. Can exclusions impair coverage from acting as intended?

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