Three Core Inquiries Define Corporate Purpose



TARGET

Should a corporation be run for its shareholders alone, or for everyone affected by it?

REALITY

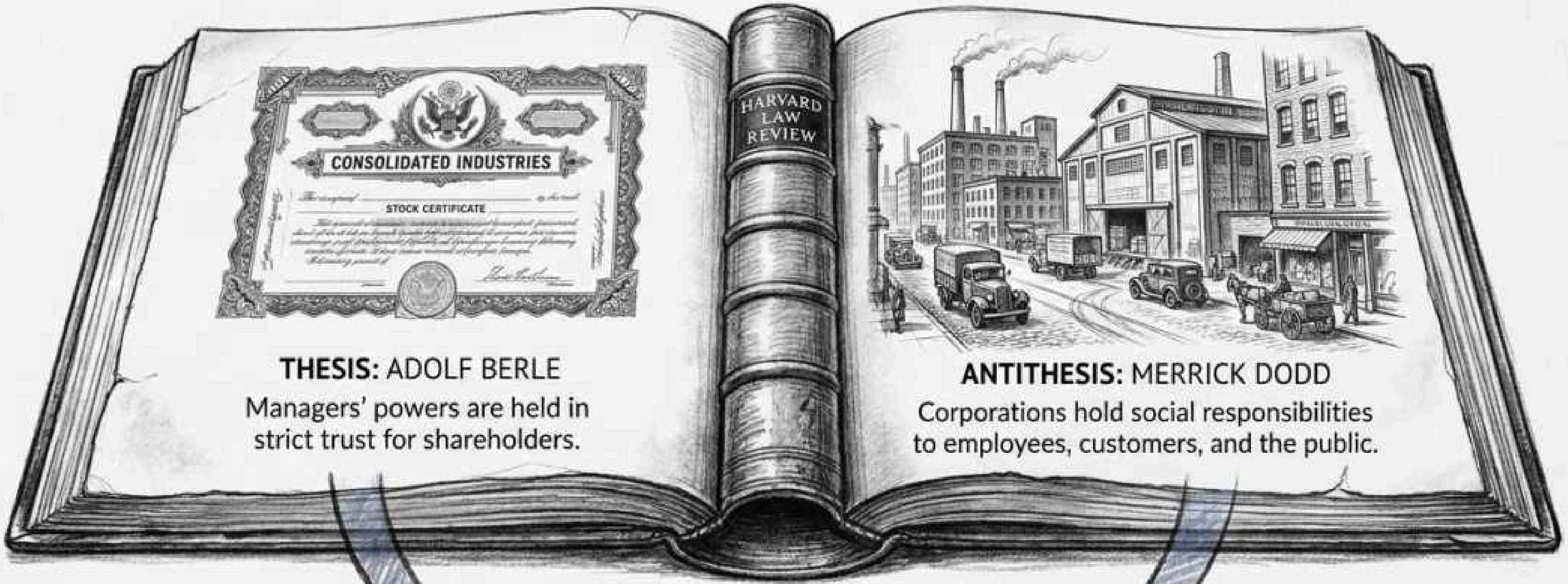
What do the law and actual business practice dictate?

INNOVATION

What new legal forms and investment movements have attempted to alter corporate purpose?

A 1932 Academic Exchange Frames the Century-Long Debate

¶ 5.2



THESIS: ADOLF BERLE

Managers' powers are held in strict trust for shareholders.

ANTITHESIS: MERRICK DODD

Corporations hold social responsibilities to employees, customers, and the public.

SYNTHESIS

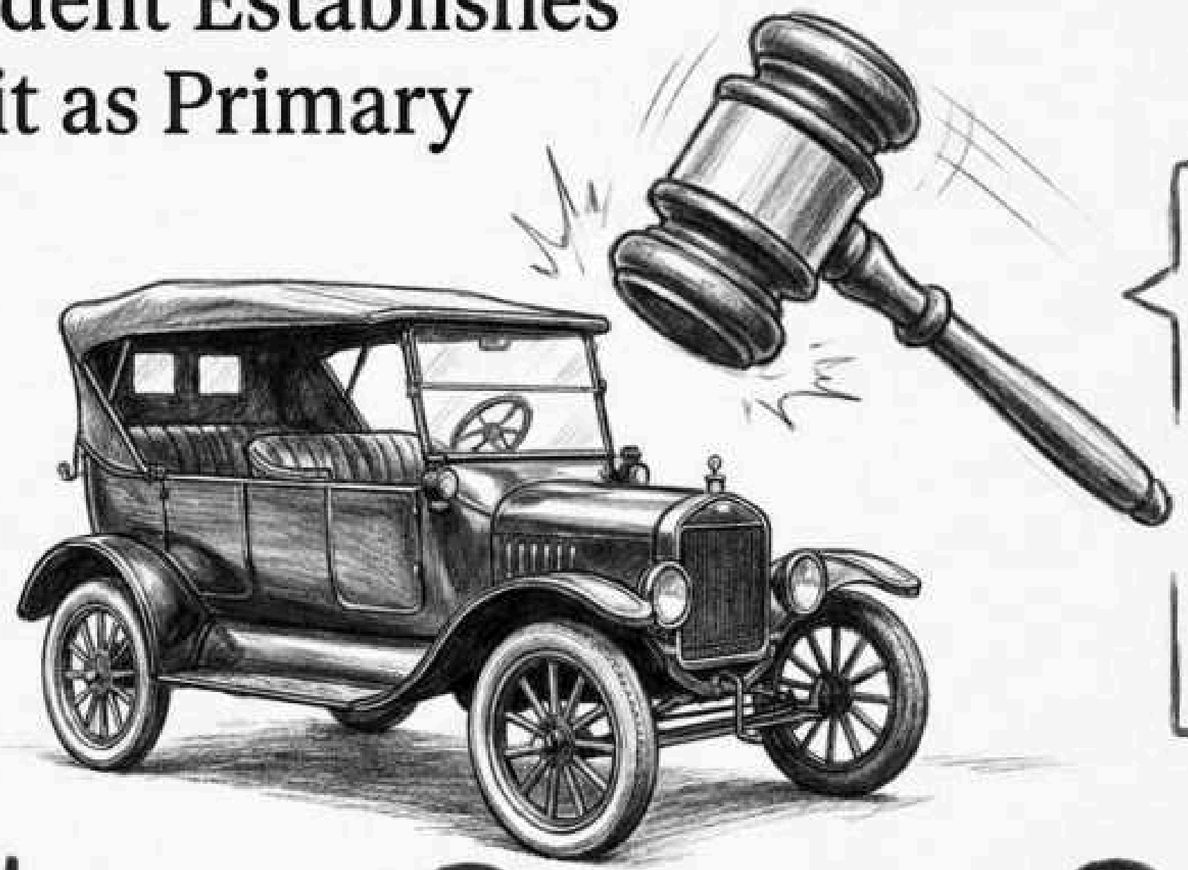
Their exchange framed a debate that continues nearly a century later.

Early Legal Precedent Establishes Shareholder Profit as Primary

¶ 5.3

THE CONTEXT

In 1916, Henry Ford halted special dividends to use profits to employ more men and spread industrial benefits. Shareholders John and Horace Dodge sued.



THE RULING

The Michigan Supreme Court ordered Ford to pay the dividend in 1919, officially enshrining the primacy of stockholder profit in business organization.

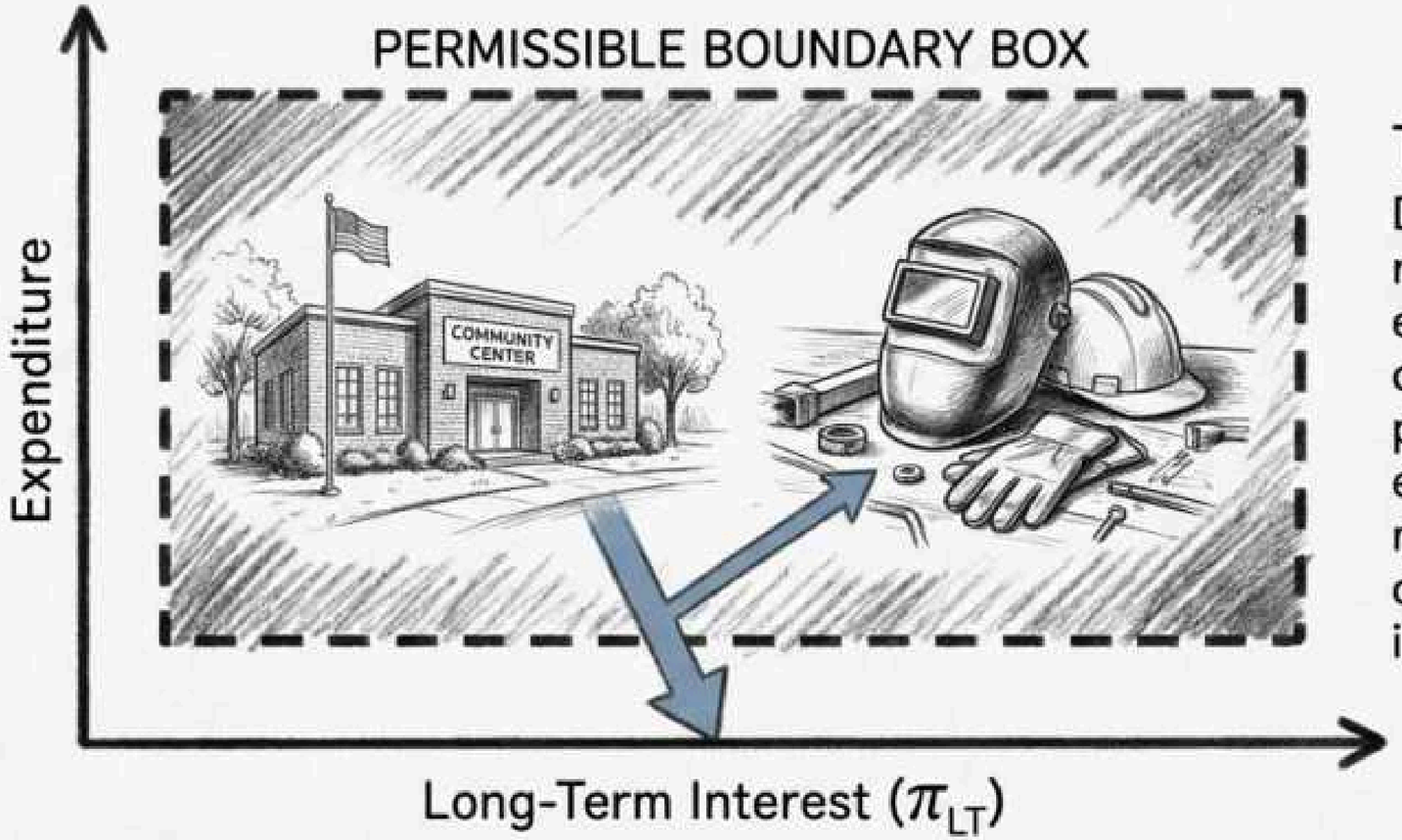
Corporate Purpose = Primary Profit for Stockholders

The Business Judgment Rule Provides Expansive Operational White Space

¶ 5.4

LEGAL REALITY

Scholars debate the absolute constraints of *Dodge v. Ford*. The court deferred to business judgment, allowing Ford's expansion plans to proceed.



THE MECHANISM

Directors possess wide room to spend on employees, communities, or charity, provided the expenditure links mathematically to the company's long-term interest.

TAKEAWAY: The law in most jurisdictions permits considerable concern for stakeholders, even if it does not explicitly require it.

Milton Friedman Cements the Doctrine of Shareholder Primacy

Max(Profits)

subject to constraint C

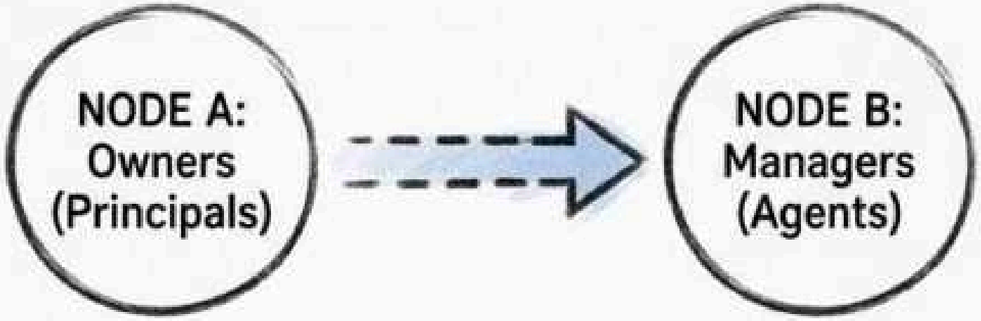
Where C = Free Competition
- Deception
- Fraud

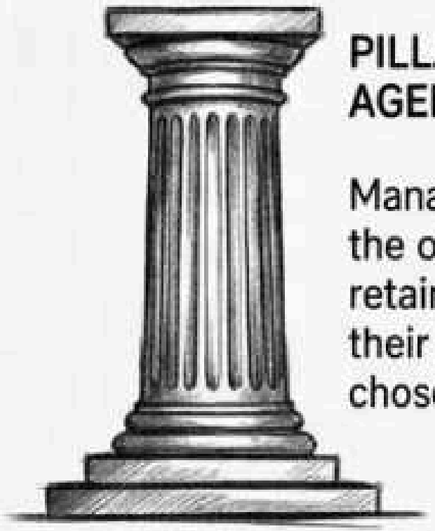


THE CORE ARGUMENT (1970)

The sole social responsibility of business is to increase profits within the rules of the game. Executives spending company money on social goals are illegitimately spending other people's money without consent.

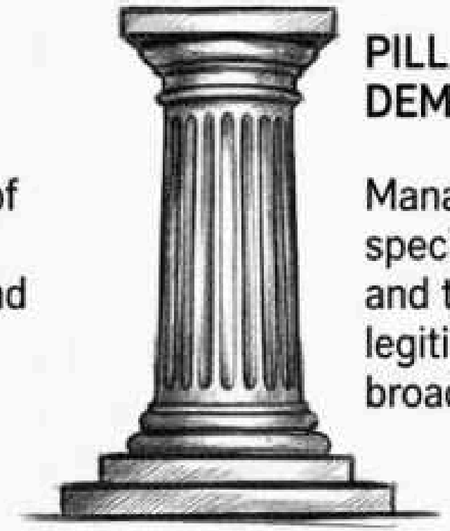
Three Logical Pillars Support Friedman's Shareholder Argument





PILLAR 1:
AGENCY LAW

Managers are agents of the owners. Owners retain the right to spend their own money on chosen causes.



PILLAR 2:
DEMOCRATIC DEFICIT

Managers lack the specialized knowledge and the democratic legitimacy to decide broad social questions.



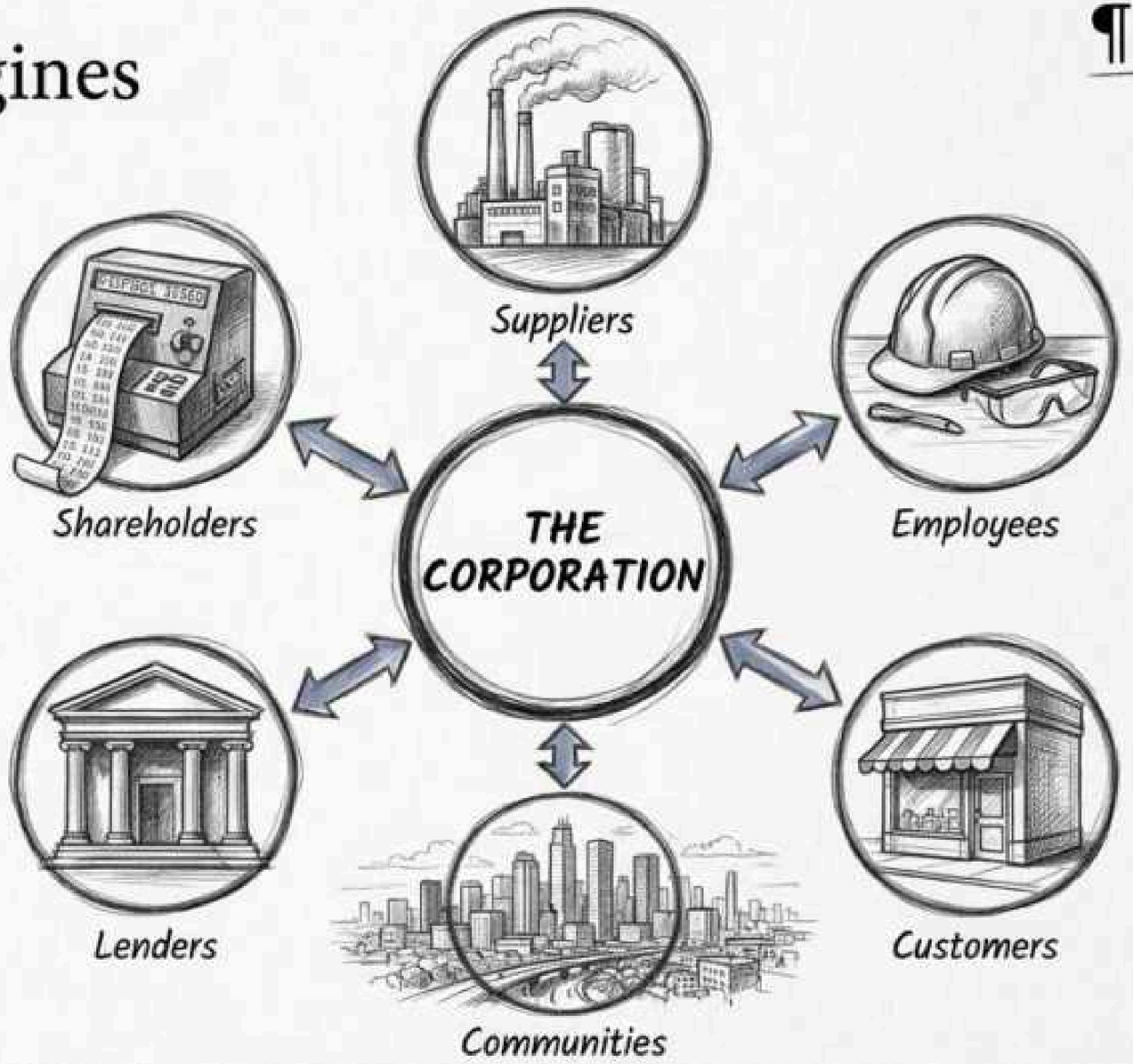
PILLAR 3:
ROLE OF THE STATE

Governments, not companies, must set social goals through law and taxation.

CONCLUSION: Society is best served by companies efficiently producing goods that people actually want.

Stakeholder Theory Reimagines the Corporation as an Interconnected Network

THE ORIGIN: *In 1984, philosopher R. Edward Freeman published Strategic Management: A Stakeholder Approach.*



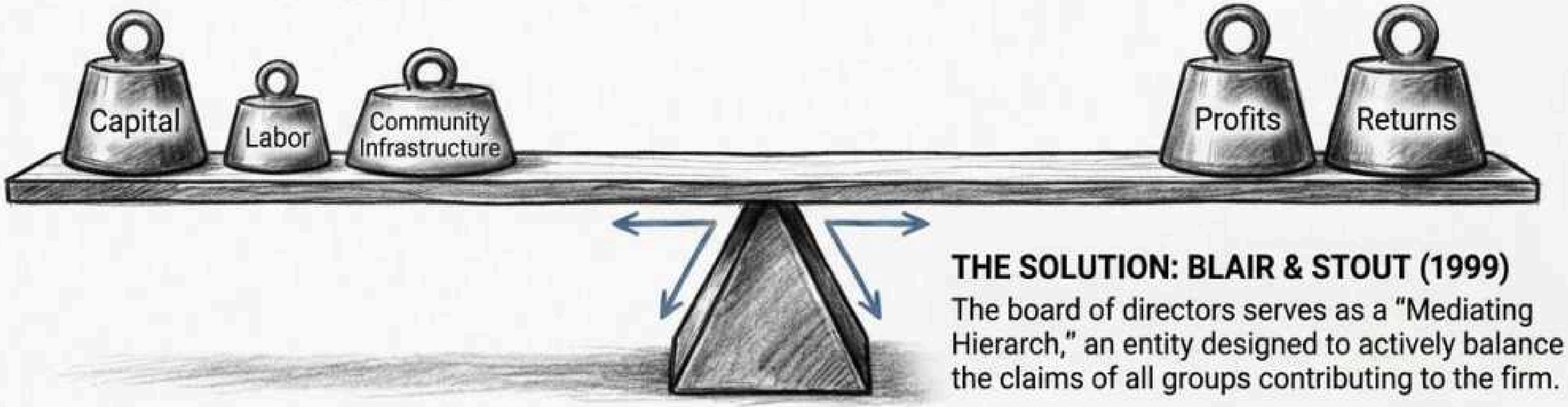
OPERATING RULE: *A stakeholder is any group affecting or affected by the firm. Managers must [Balance Interests + Create Multi-Directional Value].*

Non-Shareholder Contributors Bear Uncontracted Risks



THE VULNERABILITY

These groups bear real, uncontracted risks without formal legal protection.

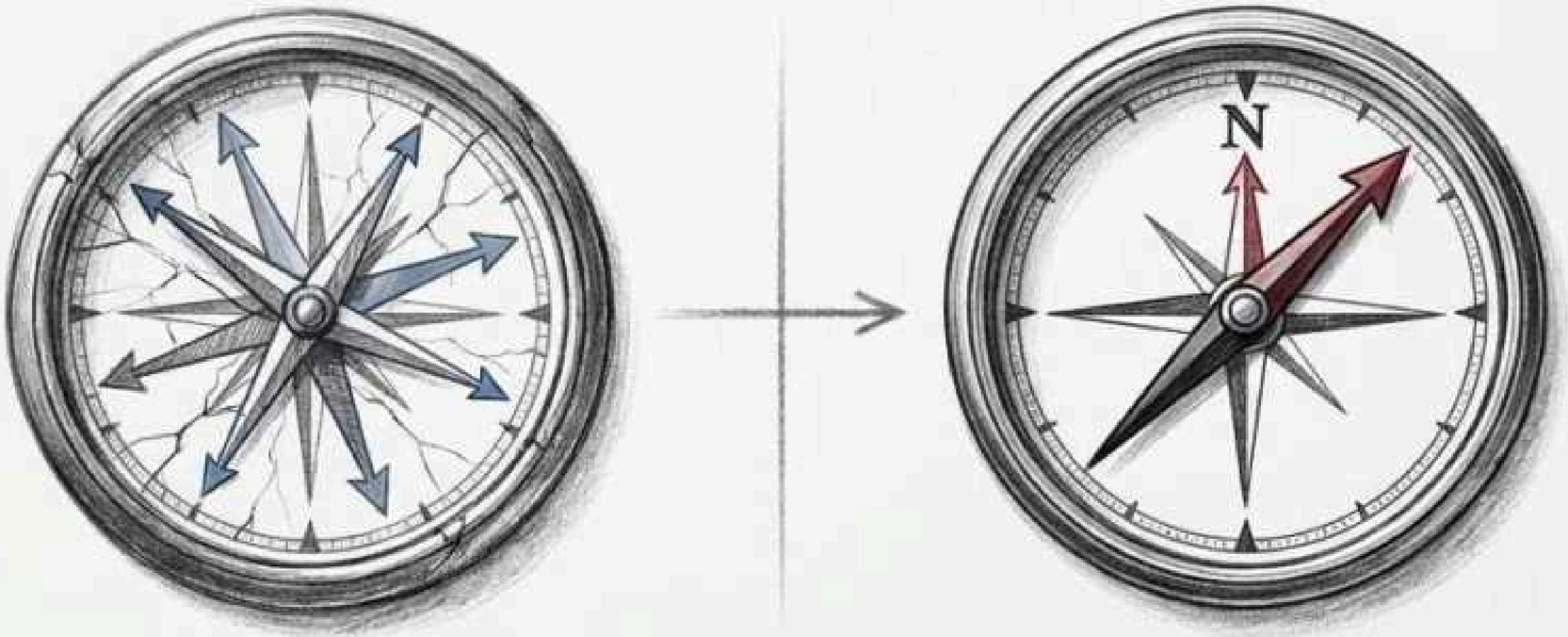


THE SOLUTION: BLAIR & STOUT (1999)

The board of directors serves as a "Mediating Hierarch," an entity designed to actively balance the claims of all groups contributing to the firm.

Enlightened Value Maximization Requires a Single Output Metric

¶ 5.9



THE CRITIQUE

Serving everyone means being accountable to no one. If managers can justify any decision by pointing to an arbitrary stakeholder, they gain freedom to pursue their own self-interests.

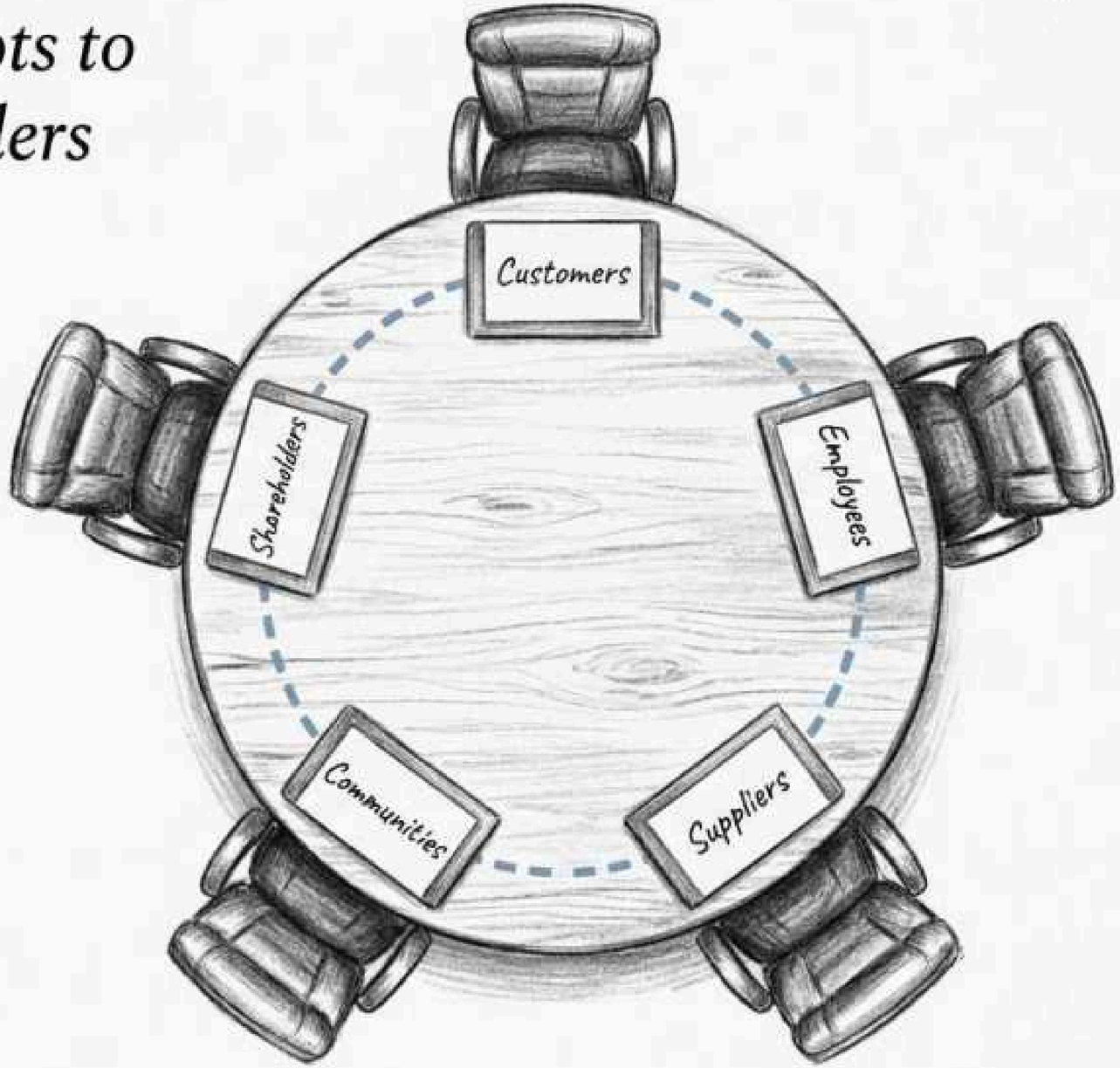
THE SYNTHESIS

Jensen's Enlightened Value Maximization. A single objective metric is necessary to accurately measure corporate success.

$$Max(Total\ Long\text{-}Term\ Value)$$

Treating stakeholders well is a required INPUT, but total long-term value is the sole OUTPUT metric.

The Business Roundtable Pivots to Deliver Value to All Stakeholders



THE PIVOT (2019)

The Business Roundtable, representing major US chief executives, issued a new *Statement on the Purpose of a Corporation*, officially overriding their 1997 shareholder-primacy endorsement.



Signed by ~180 chief executives committing to deliver value to all stakeholders.

Empirical Evidence Clashes with Sociological Shifts Post-2019



THE SKEPTICS' REALITY CHECK

- Signers did not amend legal charters, alter governance, or change pay structures.
- Few executives sought board approval before signing.
- Post-2019 studies reveal minimal behavioral divergence between signatory and non-signatory firms.



THE SUPPORTERS' VIEW

- The statement serves as a vital sociological marker.
- It represents a fundamental shift in societal expectations.
- This normative shift functions as a catalyst capable of altering corporate behavior over time.

British Law Codifies a Middle Path for Directors





Enlightened Shareholder Value =

Promote Success_Members × ∑ Regard (Stakeholders + Environment + Reputation)

THE MANDATE

- Requires directors to benefit the members (shareholders).

THE CONDITION

- Explicitly mandates they "have regard" to employees, suppliers, customers, and communities in the process.

THE ENFORCEMENT

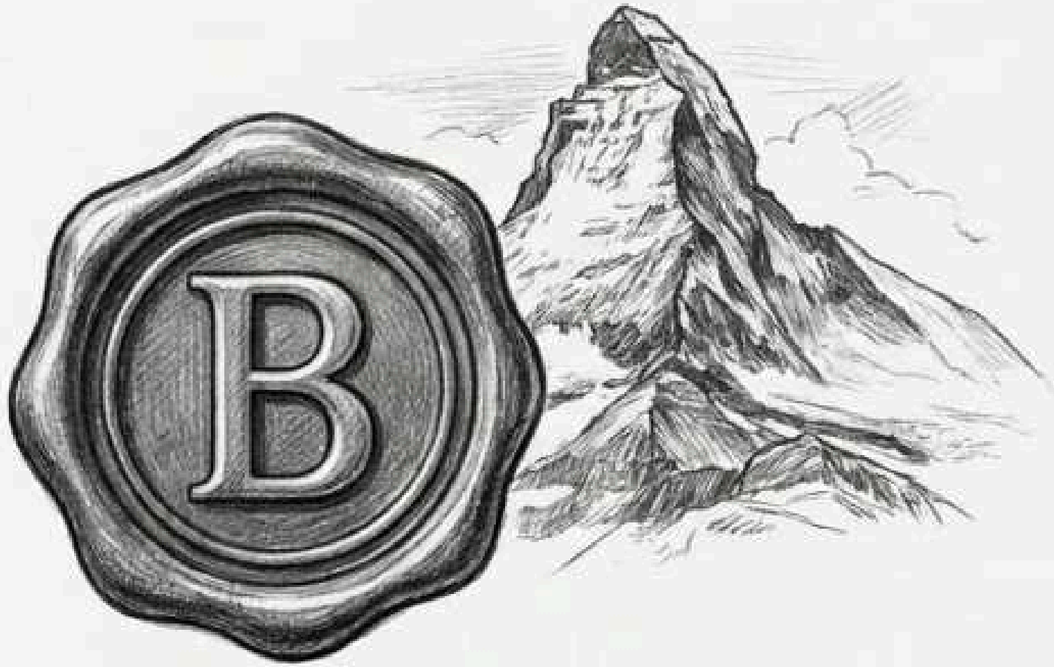
- Large companies face strict, mandatory reporting requirements on these exact metrics.

Reformers Engineer New Charters and Private Certifications



PATH 1: STATE LEGAL FORMS

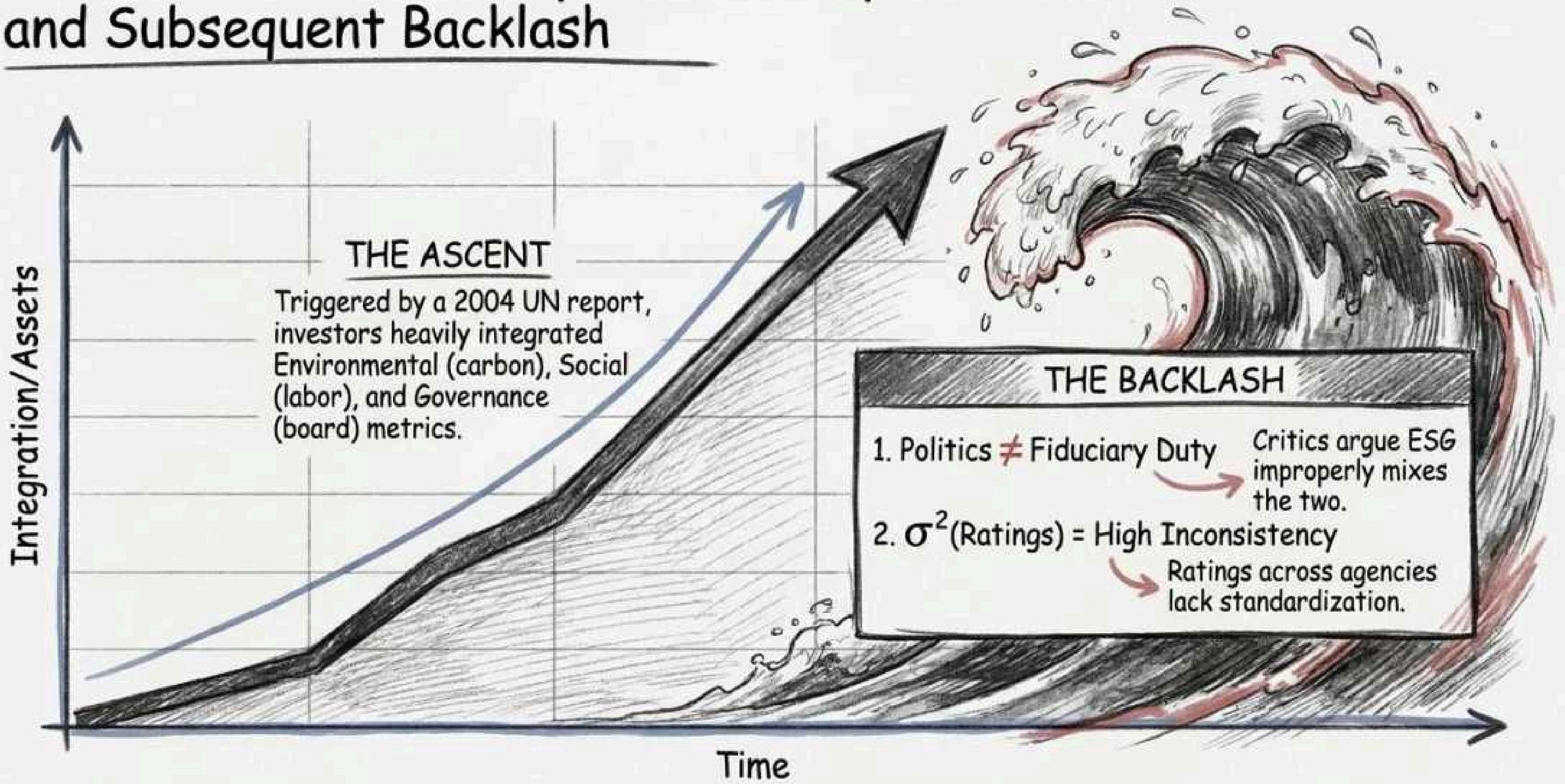
- Maryland (2010): Created the first "Benefit Corporation", legally bound to pursue public benefit alongside profit.
- Delaware (2013): Followed with the Public Benefit Corporation charter.



PATH 2: PRIVATE CERTIFICATION

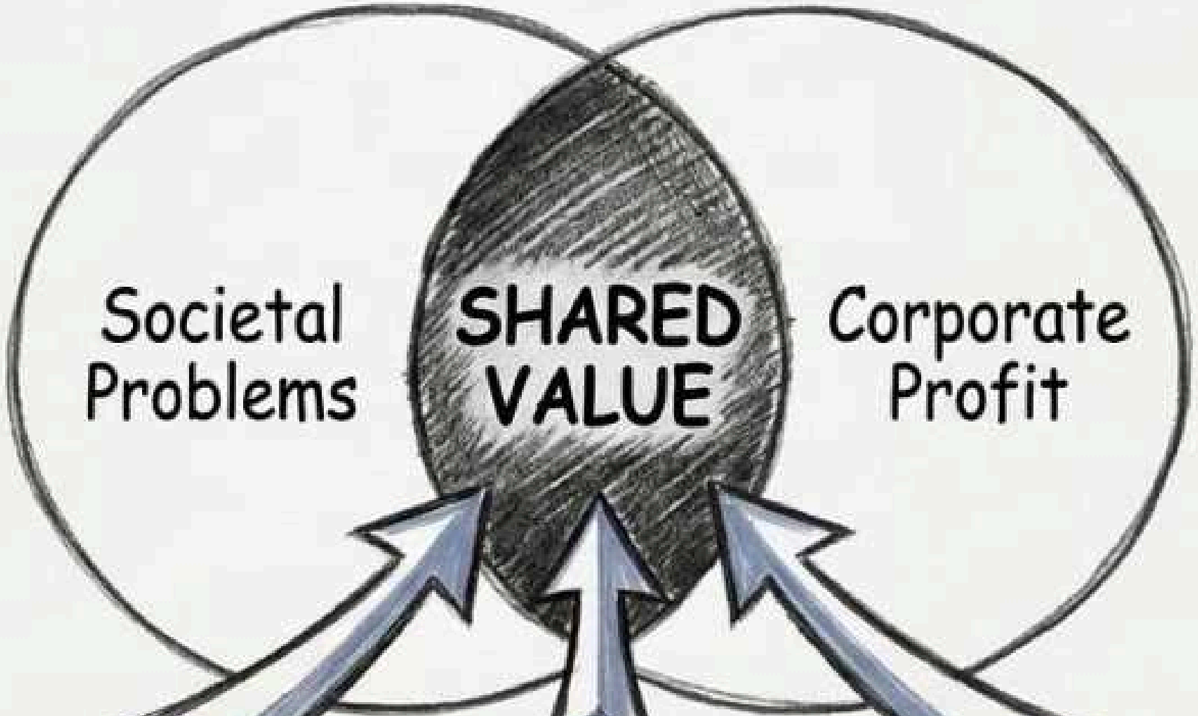
- B Lab: Assesses social and environmental performance entirely outside state charter structures.
- B Corp Certification: Provides a third-party audit of corporate purpose.
- Patagonia serves as a prime, well-known example of this model.

The ESG Movement Experiences Rapid Ascent and Subsequent Backlash



Creating Shared Value Aligns Corporate Profit with Societal Solutions

Porter & Kramer, 2011



1. Redesigning products for underserved consumers.
2. Improving supply chain efficiency.
3. Helping local supplier clusters grow.

TAKEAWAY: The conflict between profit and society is often exaggerated. The most effective strategies find profit specifically by solving social problems.

Corporate Charters Must Serve as Mechanisms for Credible Promises

THE PROSPERITY FRAMEWORK

Proposed by economist Colin Mayer (2018).



Purpose = Profitable Solutions – Profiting from Problems

THE LEGAL MECHANISM

Mayer argues companies must explicitly state their purpose in their corporate charter to be held legally **accountable**.

The debate over purpose is not merely about values; it is about how the the law can make corporate promises credible and **binding**.

Auditing the True Purpose of the Modern Corporation



APPLICATION EXERCISE

Locate the purpose statement and sustainability report of a large company.

WHITEBOARD WORKSHEET

1. Which specific stakeholders benefit from its primary decisions?
2. Does the stated purpose actually guide operational reality?

THE DIALECTIC CHECKLIST

- ☐ Friedman Approved? (Maximizing profit within the rules)
- ☐ Freeman Approved? (Balancing multi-directional value)

FORWARD LINK: Lecture 6 will examine the corporation today and the questions shaping its future.