Do we need corporate purpose to improve corporate governance?

In recent years, the debate over purpose has reemerged and gained traction. Is a clear sense of purpose what's needed to make companies more effective *and* socially responsible? Here are three discussions that may lead us closer to the answer.

November 26, 2020

By Jordi Canals

The debate on corporate purpose is heating up. The recent IESE Corporate Governance

Conference — in cooperation with ECGI — on this theme helped explain why. Purpose and mission are not new concepts, neither in management nor in governance. For decades, leading scholars have considered them to be useful pillars for designing better organizations.

In recent years, the debate has reemerged as business leaders, scholars and asset managers consider ways for companies to have a net positive impact on society beyond financial performance. The environmental impact of companies, the role of boards of directors on executive pay and its impact on social inequality, and the need to fix some of capitalism's negative effects and reinvent it are among the factors driving the debate. As Harvard Professor Rebecca Henderson highlighted in the IESE conference, society is facing serious challenges. Companies are part of the solution and purposeful companies can help drive change.

The IESE conference covered many of these themes. I will highlight three of them which are relevant for management and governance. The first is that purpose can be truly effective when it offers a clear explanation on why a company exists and does what it does. It should express the intention to solve or tackle customer needs or problems. In doing so, it offers a unifying reason for the cooperative action of different parties — employees, shareholders, and other stakeholders — as well as clarity on the strategy adopted and commitment on how to do things. Purpose is not a technical solution to some corporate problems. Conference participants discussed how purpose can help employees find meaning through their work and show a stronger commitment. As Professor Patrick Bolton (Columbia) put it, purpose is a call for ethical behavior, starting at the top of the firm.

Purpose summarizes some shared beliefs and values and expresses the willingness to offer solutions to problems, as Professor Colin Mayer (Oxford) pointed out. If it is authentic, it commits the company and its management to take responsibility for the actions of the firm and their effects, including the costs of externalities it incurs such as its environmental impact. But purpose needs to project some ethical values that the top management team believe in.

The second theme is how to implement purpose, the "how" of purpose. This is probably the most difficult part of it. The contributions of CEOs and board members in the conference were extremely relevant to this discussion. As Paul Polman (former CEO of Unilever) said, purpose needs to reflect the aspiration that the company has to create a net positive value for society, not only for shareholders. Each company should do this in its own way. There is no one-size-fits-all solution. Each company's idiosyncrasies and particular governance structure should facilitate innovation. The experience of companies that are implementing purpose well suggests that purpose should influence corporate culture, be integrated in the firm's strategy, influence the choice of performance indicators, be a main criterion in hiring and be taken into account in the compensation system.

Purpose implementation is the responsibility of senior managers. However, boards of directors should debate corporate purpose and formally approve or refine the firm's purpose, making sure that the board's major decisions are consistent with it and that the CEO and top managers are working
in line with it.

The third theme is the role of shareholders in purpose. Institutional investors and asset managers also have a relevant function. If investors only pay attention to short-term financial performance, companies will have a hard time making progress to become more purposeful and effective organizations. Asset managers need to consider that companies are essential for both wealth creation and social prosperity. Companies that thrive over the long term are the backbones of dynamic societies. Investors need to make sure that companies cover the costs of their own externalities. Moreover, they should trust companies that show stronger long-term orientations and a clear sense of purpose, well-integrated in their business models and that deliver results.

Some institutional investors are increasingly paying more attention to purpose, often through the perspective of ESG (Environmental, Social and Governance) factors. Nevertheless, there is still a long way to go. If investors want to improve the quality of their stewardship, paying attention to purpose is an indispensable way to do so. They can also work with companies to define their main performance indicators beyond financial profitability. As the Nobel Laureate and MIT professor, Bengt Holmstrom, expressed in the conference, reinforcing the importance of accountability is one of the most relevant contributions that asset managers and rating agencies can make.

Purpose is not the only solution to make companies more effective and responsible for their impact on people, society and the planet. But purpose can express an ethical commitment in decision-making, be an effective driver of positive change in companies, inspire better behavior and performance, and help companies understand what they want to do beyond trying to create economic value. For these reasons, purpose can help management engage the firm's people better, offer a better customer proposition and eventually improve governance and performance. It is not an easy journey, but its benefits can be truly great. It is worthwhile that companies seriously consider the adoption of purpose and its integration with strategy.

This article was first published in IESE's Center for Corporate Governance newsletter. The sessions of the conference "Can Purpose Deliver Better Corporate Governance?" are available online.

www.iese.edu/insight