Opinion

Allen Mendenhall: Don't change the purpose of corporations

Allen Mendenhall | 03.25.23

The Business Roundtable is a national association of influential CEOs from numerous fields, industries, and publicly traded companies. It lobbies for policies that allegedly generate jobs and economic growth. In 2019, it issued a controversial statement purporting to redefine the purpose of corporations.

What, historically, *was* the purpose of corporations? The traditional understanding was that chiefly they maximized profits for shareholders. Profits, of course, are the total revenues of a corporation minus its expenses.

If they don't earn profits, companies go out of business.

The Business Roundtable suggested that shareholder primacy was no longer optimal for corporations. Instead, *stakeholders* were at least as important as shareholders to companies' long-term health.

What's a stakeholder? It's difficult to say. Some stakeholders are easy to identify — employees or customers, for instance. Others are vague: communities or society writ large.

The Business Roundtable predicated its announcement on two fallacies: first, that businesses don't help communities or society when they prioritize profits and, second, that businesses pursuing profits don't adequately account for the interests of customers, employees, or suppliers.

In fact, businesses that satisfy customers, employees, and suppliers outperform competitors. Moreover, profits enable companies to contribute to communities and society. After all, companies need profits to hire employees, offer benefits packages, provide goods and services, reach new markets, and expand their operations.

Without profits, companies cannot satisfy financial obligations. Simply put, companies that aren't profitable fail. And what can failed companies do for communities or society — other than provide useful data about their failure?

Consider what profits, directly or indirectly, make possible: cures for disease, ease of communication and transportation, renewable energy, and revolutionary technology. Because individuals and companies sought profits, we live longer and healthier than our ancestors did.

Even successful creatives who chased dreams or ideals rather than solely profits could not realize their ambitions without profits to support them.

Although The Business Roundtable intended its redefinition to make corporations look good, it inadvertently widened the latitude for executives to do harm. Profits are a clear measure of success and usually a straightforward matter of accounting. But how to assess ambiguous standards like "societal impact"?

A company president might explain away declining profits by prevaricating, "The purpose of our corporation isn't strictly the profit motive. We may have sold fewer units this year, but we met our benchmarks by integrating environmental and diversity quotas in our governance and practices." This excuse illustrates how executives can characterize losses as wins, or failures as successes.

Moreover, stakeholder capitalism empowers bad actors to conceal mischief and mismanagement by diverting attention from the company's bottom line and towards popular social trends. For example, corporations have misled consumers and regulators by "greenwashing" or "wokewashing." (If you don't know those terms, look them up!)

A perfect example is Silicon Valley Bank (SVB). Its 2022 Environmental, Social, and Governance (ESG) report is full of grand declarations about responsible governance and risk management. A few months after issuing this report, SVB failed, precipitating banking troubles all over the world.

Or consider the failed crypto exchange and hedge fund FTX Trading, which received high ESG ratings despite a governance structure that contributed to financial collapse and bankruptcy.

Businesses that follow the law, differentiate themselves with hospitality and customer service, engage in philanthropy, and operate honestly and ethically *already* improve the lives of stakeholders, multiply opportunities across society, and add value to communities. They need not reinvent themselves along the modern model propounded by The Business Roundtable.

"If it ain't broke, don't fix it." The Business Roundtable's definition is unnecessary and damaging. Although outlier businesses have been guilty of scandal or fraud, and not every executive is honest or upright, most businesses most of the time act with decency and integrity when the laws they follow are just and the appropriate incentives are in place.

Just because some famous CEOs claim they're changing corporations for the better doesn't make it so. They may have ulterior motives.

This article is adapted from Allen Mendenhall's regular segment "Word to the Wise" on Troy Public Radio.

Allen Mendenhall is Associate Dean and Grady Rosier Professor in the Sorrell College of Business at Troy University and Executive Director of the Manuel H. Johnson Center for Political Economy. Visit his website at AllenMendenhall.com.

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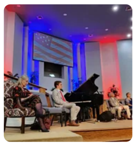

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