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A Company's Sole Responsibility is to Profit?

American economist Milton Friedman once espoused that "the social responsibility of [a] business is to increase its profits.". His statement ushered in a new phase into Anglo-American society where jingoist capitalists supported Friedman's view that maximising shareholder wealth is a company's *raison d'etre* — where profits are the only real goal of the business — and viewed Friedman's theory as a timely manifesto that clearly outlined the proper role of executives in a free market economy.

However, the world has become a more complex place over the last few decades. The significant rise of activism in the West is eroding the age-old assumption that "greed is good" and threatening the foundation of a truly *laissez-faire* market, which begs the question that underlies this schism — that raging elephant in the room:

Whether a company's sole responsibility is to profit?

We opine:

Yes, from an ontological perspective and no, from a normative ethics standpoint. Yet, considering how Anglo-American corporate law[1] may be shaped by the vicissitudes of life — that confluence of forces arising from the vacillating developments in the Western social, political and economic landscapes with increased stakeholder activism — we submit that the ontological perspective does not diametrically oppose the normative standpoint, and like the Gordian knot, we can strike at this crux by uniting the opposing debates with an integrated solution:

the enlightened shareholder value model.

(A) Traditional perspective — shareholder primacy model

A director's legal duty is to act in the company's best interests. According to the Anglo-American legal tradition, this meant that a director was a fiduciary agent that acted in the best interests of the owners of the company, which were the company's shareholders. Thus, a director of the company had the sole responsibility to maximise shareholder value for the company. Discretionary management objectives outside of a director's profiteering duty were not in the financial interests of shareholders.

[1]In the interest of time, we restricted our examination of this issue to the Anglo-American common law system (as there is evidence that common law countries offer stronger legal protection for investors than their civil law counterparts) and how Singapore companies may learn from their system with regards to corporate social responsibility.

(i) America's traditional legal perspective

In **Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919)**, the issue before the Supreme Court of Michigan was whether Henry Ford, who was the corporation's president, majority shareholder and director, could withhold dividend payouts to the company's shareholders to use such payouts to employ more workers "to help them build up their lives and their homes" and decrease car prices for consumers. The Supreme Court ruled for the shareholders, asserting:

"*A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself, to the reduction of profits or to the non-distribution of profits among stockholders in order to devote them to other purposes.*"

In essence, the Michigan Supreme Court held that Henry Ford must operate the company in the shareholders' interest of profiteering, rather than re-directing profits in a charitable manner for the benefit of his employees and customers.

(ii) United Kingdom's traditional legal perspective

The Company Law Review Steering Group ("**CLRSG**") issued its *Final Report* in July 2001. This represented one of the largest investigations into United Kingdom company law, which recognised that the United Kingdom, *by default*, preferred the company's interest to be governed by the concept of shareholder primacy over the pluralistic stakeholder approach, which meant a due regard for the interests of different classes of stakeholders over the needs of shareholders. A substantial majority of respondents from the regulatory, legal and business sectors, who were consulted by the CLRSG, rebelled against the concept of a director's inclination towards the wider concerns that were outside his or her usual corporate profit maximisation duty i.e., social welfare, environmental and ethical stakeholders. This staunch regard for shareholder primacy is reflected in the now-repealed provisions of **Section 309** of the Companies Act 1985 of the United Kingdom, which state that:

"*(1) The matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members.*

(2) Accordingly, the duty imposed by this section on the directors is owed by them to the company (and the company alone) and is enforceable in the same way as any other fiduciary duty owed to a company by its directors."

(iii) Advantages and disadvantages of the shareholder primacy model

The historic defence of the importance attributed to the shareholder primacy model is based on the following perceived advantages of such a model. Proponents for such a model assert that the shareholder primacy model maximises a director's knowledge and experience in efficiently creating wealth for the company's shareholders. Thus, requiring such a director to deal with other social and ethical considerations is inefficient and unreasonable. Furthermore, under this model, a company can easily meet and satisfy other social needs and requirements by generating wealth for the company.

Dissenters of the shareholder primacy model argue that such a model encourages a short-term directional focus within companies at the expense of a longer-term strategy and the shareholder primacy model diminishes the likelihood of the development of stakeholder relationships. There should be a fair division of the pie created by the firm since all stakeholders have a role in determining the ultimate size of the pie.

Furthermore, the implications of a shareholder primacy model on employees meant longer hours for employees with decreased employee productivity and satisfaction. During reign of the shareholder primacy era in Anglo-America, employees' dissatisfaction with companies became more pronounced with the companies' introduction of resource-based strategies. Such strategies, which included an increase in employees' work duration without pay increments, were introduced with the hope held by companies that there would be a significant increase in work output at a cheaper cost. The foregoing meant underpaid and overworked employees, which over a sustained period, led to a decline in employees' productivity rate and a high rate of resignations. *Thus, in essence, exclusive focus on economic growth leads to short-term profit-maximisation.*

(B) United Kingdom's current legal perspective — the enlightened shareholder value

The CLRSG, in its *Final Report* of June 2001, concluded that the United Kingdom should not purely adopt the shareholder primacy model due to the changing social landscape. At the same time, the CLRSG determined that the country should not wholeheartedly embrace the pluralistic stakeholder approach, which detracted a company away from its ontological profit-making duties. Instead, the CLRSG took a balanced approach by developing a novel concept that integrated the shareholder primacy model and pluralistic stakeholder approach — the enlightened shareholder value model.

The enlightened shareholder value model still required a director to act in the best interests of the company's shareholders, which was profit-maximising in nature, but that obligation was tempered by a broader and more inclusive approach, which required the directors to consider the interests of other stakeholders. The foregoing meant, or at the very least could be interpreted as, shifting a company's emphasis from short-term wealth generation to corporate sustainability in the long term by satisfying stakeholders' interests.

The enlightened shareholder value model was accepted by the United Kingdom government and enshrined in **Section 172** of the Companies Act 2006 of the United Kingdom — the current successor to (the now-repealed) **Section 309** of the Companies Act 1985 of the United Kingdom. Pursuant to **Section 172** of the Companies Act 2006, a director must now consider the company's stakeholders, *inter alia*, the company's employees, suppliers, customers and the environment. These considerations reflect wider expectations of responsible business behaviour to promote the company's success. However, zealous advocates for the enlightened shareholder model may argue that such legal drafting do not oblige a director to advance such considerations in promoting the success of the company. In fact, whether a director chooses to apply such considerations to the business to promote the company's success is a subjective determination by the director based on that director's good faith judgment (not subject to a court's determination), which may still tend towards profiteering at the expense of all other social considerations to maintain his position in the company.

(C) America's shift towards the enlightened shareholder value

The enlightened shareholder value model introduced by the CLRSG did not seem so foreign to America as at that material time, America's judicial system seemed to embrace the enlightened shareholder value model. In **A.P. Smith Mfg. Co. v Barlow 13 N.J. 145, 98 A.2d 581 [1953]**, the board of directors of a corporation, which manufactured and sold valves, fire hydrants and special equipment, adopted a resolution that set forth that it was in the corporation's best interests to donate a sum of USD$1,500 to Princeton University as a contribution towards the university's maintenance.

This corporate action was questioned by stockholders and the president of the corporation testified that he considered the contribution to be:

"*a sound investment, that the public expects corporations to aid philanthropic and benevolent institutions, that they obtain good will in the community by so doing, and that their charitable donations create favorable environment for their business operations. In addition…in contributing to liberal arts institutions, corporations were furthering their self-interest in assuring the free flow of properly trained personnel for administrative and other corporate employment.*".

In that case, the Supreme Court of New Jersey ruled that they had no hesitancy in sustaining the validity of the donation by the corporation as:

"*there [was] no suggestion that it was made indiscriminately or to a pet charity of the corporate directors in furtherance of personal rather than corporate ends. On the contrary, it was made to a preeminent institution of higher learning, was modest in amount…and was voluntarily made in the reasonable belief that it would aid the public welfare and advance the interests of the plaintiff as a private corporation and as part of the community in which it operates…it was a lawful exercise of the corporation's implied and incidental powers under common-law principles.*"

In essence, American corporate law permits a company's reasonable corporate expenditure for activities that transcend profit maximisation to include charitable or social welfare activities, since corporate gift-giving would increase a company's reputation and long-term shareholder value.

The Supreme Court of New Jersey continued, rationalising:

"*there is now widespread belief throughout the nation that free and vigorous non-governmental institutions of learning are vital to our democracy and the system of free enterprise and that withdrawal of corporate authority to make such contributions within reasonable limits would seriously threaten their continuance. Corporations have come to recognize this and with their enlightenment have sought in varying measures, as has the plaintiff by its contribution, to insure and strengthen the society which gives them existence and the means of aiding themselves and their fellow citizens. Clearly then, the appellants, as individual stockholders whose private interests rest entirely upon the well-being of the plaintiff corporation, ought not be permitted to close their eyes to present-day realities and thwart the long-visioned corporate action in recognising and voluntarily discharging its high obligations as a constituent of our modern social structure.*".

Paramount Communications, Inc. v. Time Inc. 571 A.2d 1140 (1989) is another corporate case law where the Supreme Court of Delaware preferred long term wealth maximisation over the shareholder primacy model. This case concerned a merger between Time Inc. ("**Time**") and Warner Communications ("**Warner**"), which were two cable corporations. Time's board consented to the merger with Warner, but only if Time controlled the board of the resulting corporation, which thereby preserved a management committed to Time's journalistic integrity. Despite Paramount Communications's ("**Paramount's**") higher all-cash takeover offer to purchase Time's outstanding shares, Time's directors rejected Paramount's offer and merged with Warner at a lower price. Time's board's prevailing belief was that Paramount's bid posed a threat to Time's control of its own destiny and retention of the "Time Culture" — the journalistic integrity that would potentially be jeopardised under Paramount's ownership. Time also believed that its shareholders would not understand why Warner was a better suitor.

Time's belief was right. Subsequently, Paramount and two classes of Time's shareholders brought a preliminary injunction action in the court to prevent the Time-Warner merger. The Supreme Court of Delaware ultimately ruled that the merger of Time and Warner was valid on the ground of preserving Time's journalistic integrity, which was crucial for long term corporate sustainability that would be undermined under Paramount's ownership. This case affirms that directors may prevent a company's shareholders from accepting an immediate high premium offer for their shares if the directors act in pursuit of the corporation's long-term financial interest. In essence, American corporate law allows a company to consider other social factors if such a consideration can advance a company's long-term financial goal.

In essence, the Anglo-American legal system has become more receptive, or at least less inimical, to the pluralistic stakeholder approach by prioritising a company's long-term rewards over short-term profiteering.

(D) Singapore's current perspective and the way forward

Focusing solely on the Singapore Companies Act, the current legislative provision on a director's duty to act in the best interests of a company, which is contained in **Section 157** of the Companies Act 1967 of Singapore, and a director's consideration of its employees' interests in **Section 159** of the Companies Act 1967 of Singapore are similar to the concept drafted into **Section 309** of the Companies Act 1985 of the United Kingdom, which is based on a shareholder primacy model.

As explained in the earlier paragraphs, Singapore company law should prefer an enlightened shareholder value approach over the shareholder primacy model to ensure that a director maximises a company's wealth in the long term. The shareholder primacy concept found in **Section 157** of the Companies Act 1967 of Singapore with its accompanying case law has become an anachronism and no longer reflects the realities companies now face — the global financial crisis; Covid-19 pandemic; and multiple other urgent environmental and social challenges that are forcing companies to a rethink about the role and purpose of companies.

Our proposal is to re-draft **Sections 157** and **159** of the Companies Act 1967 of Singapore to reinvent the duty of a director "to advance the purpose of the company" by advocating the interests from a multitude of stakeholders as described in **Section 172** of the Companies Act 2006 of the United Kingdom. However, there is still much work to be done. Other than **Sections 157** and **159** of the Companies Act 1967 of Singapore, there are other areas of corporate law that are quite inimical to the pluralistic stakeholder approach, and which are less keen on adopting the enlightened shareholder value.

We submit that public regulation is not enough to strengthen a company's social duties. We propose that companies strengthen their corporate sustainability via their internal governance systems that should advocate for a variety of social causes that interplay with a company's sustainability in the long term.

In this twenty-first century, the rise of stakeholder pluralism has become more pronounced in Anglo-America where purpose may now be purportedly championed over profits. This was seen in the recent news of Patagonia, Inc., where the founding shareholders of an American retailer corporation transferred all their ownership of the corporation, which was valued at USD 33 billion, to a specially designed trust and a non-profit organisation focused on preserving the corporation's independence and ensuring that all its profits — some USD100 million per year — are used to combat climate change and protect undeveloped land around the globe. We wait with bated breath to see if this case will herald a new age of activism — where purpose alongside profits will win in the long run and usher in

a new case for companies to adopt the pluralism stakeholder model or a more vigorous approach to the enlightened shareholder model — or simply become a one-hit wonder.

Until that time, the Singapore corporate legal system still has much room to learn, and grow, from the Anglo-American legal system.

To find out more about how your company can develop and strengthen its corporate sustainability practices, please contact the author below.

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