

Addressing the Crisis of the Modern Corporation: The Duty of Societal Responsibility of the Board

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1. Introduction

Many and extensive are the analyses of recent years on how capitalism is failing us.¹ A core element of most analyses is the shareholder primacy doctrine that has taken hold of corporate law and corporate governance in the wake of Milton Friedman's watershed 1970 article in the *New York Times Magazine*. "In a free-enterprise, private-property system" Friedman wrote, "a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom... there 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." Although Friedman may not have intended to free the corporation of all moral responsibility (Hess, 2017), nonetheless his theory has been understood, elaborated upon and practiced to generate a corporate reality that the corporation is largely responsibility-free beyond the responsibility to create value to shareholders. The costs of shareholder-value creating actions to others, such as employees, customers and wider society (e.g. environmental and climate costs) are of no concern to the corporation itself. In the hands of the capital markets, investment banks, institutional investors, hedge funds and heavily incentivized executives corporations have become, if not immoral, at least amoral. What matters in corporate decision-making is the prospective financial outcome for shareholders, not much else. I oversimplify, I am aware, but I am afraid I am not oversimplifying too much.

I am writing these lines in the middle of the COVID-19 crisis, during weeks of quarantine and social distancing. The pandemic and the governmental lockdown measures to flatten the curve create a massive shock to societies, people and corporations across the world. We can debate at length whether failing capitalism is part of the cause of this unprecedented crisis. But the way society will get out of this crisis undoubtedly also depends on how business perceives its responsibility in society. Also, with the lockdown a unique, global pause button has been pushed. At least temporarily everything must be done differently, priorities shift and new ways of collaboration are explored. The forced break can be used to reflect how to turn it into a fundamental reset. It would be an illusion to think this will happen by itself. But if ever there was a time that society needs business to take responsibility beyond its own immediate financial success, that time is now. We can no longer afford corporations to be amoral. The challenge is to ignite a sense of societal responsibility within corporations. This can only come from the people

¹To mention just a few books targeting today's capitalism: *The Selfish Capitalist* (2008) by Oliver James, *Postcapitalism* (2015) by Paul Mason, *Confronting Capitalism* (2015) by Philip Kotler, *Nine Visions of Capitalism* (2015) by Charles Hampden-Turner and Frans Trompenaars, *Throwing Rocks at the Google Bus* (2016) by Douglas Rushkoff, *Doughnut Economics* (2017) by Kate Raworth, *The Value of Everything* (2018) by Mariana Mazzucato, *Firm Commitment* (2013) and *Prosperity* (2018) by Colin Mayer, *The Code of Capital* (2019) by Katharina Pistor and *The Infinite Game* (2019) by Simon Sinek.

who make the corporation an actor in society. In this paper I will argue that a duty of societal responsibility should be imposed on the board of the corporation. I will first put forward my version of the analysis of the problem of responsibility of business in society, par. 2. A critical factor is that the amoral corporate context is man-made but paradoxically, often we believe there is little we can do about it. In par. 3 I will review certain solutions that have been put forward to address aspects of the problem. In all solutions the role of the board is crucial. But the proposals do not address adequately what is needed for the board to commit the corporation to being a responsible corporate citizen in society. A specific duty for boards to do so could be introduced in corporate law, par. 4. Such a duty will have to be elaborated in corporate law and corporate governance practices, which I will discuss in par. 5. I will conclude in par. 6 that a duty of societal responsibility should indeed be introduced in corporate law and under circumstances can emerge from law itself.

2. The Heart of the Matter: the Modern Corporation has become Amoral

In a recent paper (Winter 2019a) I have set out a number of factors that have contributed to a context of corporations that I would describe as dehumanized, stripped of human inspiration, meaning and judgement, disengaged from society, from what the people that make up society believe is important. My analysis is by no means complete. It is focused on the human aspects of the context of the modern corporation, both how this context is created by ourselves and how it affects us. This is essential. The core of the problem is not outside of us, it is in us. It is in how we design our corporate reality and how we conduct ourselves within it. By the combination of design and conduct we shape the context in which corporations exist and act in society. Solutions therefore are also not beyond us, but within our reach, they are about us.

Let me summarize my argument of how the corporation has become amoral. Five factors jointly and interactively cause concerns on the state of the modern corporation: (i) the dominant theory of the firm, (ii) the way capital markets and institutional investors have come to view corporations, (iii) the efficiency driven organizational practice, (iv) the effects of regulation and (v) the remuneration of executives.

- (i) The shareholder primacy theory of the firm that originated from Friedman's work has come to dominate thought and practice on the corporation and inside it. In thought, it was developed into the agency theory: managers are primarily seen as agents who should act in the interest of shareholder as their principals. As managers act rationally in their self-interest, they will not always further the interests of shareholders. Corporate law and corporate governance have the function to ensure that managers do act in the interests of shareholders. In practice, executive remuneration and takeover bids have been developed as mechanisms that discipline managers to do so. Executive remuneration aligns managers' interests with those of shareholders. Takeover bids may force managers out of their jobs if they underperform for shareholders. Other stakeholders who have interests in the corporation and its business, such as employees, customers and the wider community, are no longer seen as relevant principals for whom managers should act as agents. Externalities such as the costs of environmental and climate damage or the social damage caused by restructuring are not factored in this shareholder value model. Put in a different way: in today's dominant corporate context only financial capital is rewarded, at the expense of human capital (well-being of employees), social

- capital (public goods, social infrastructure, community) and natural capital (resources, environment and climate) (Roche, Jakub, 2017; Mayer, 2018).
- (ii) Building on this theory of the firm, capital markets and their main players over time have come to view corporations as bundles of assets and liabilities. They represent separate units of financial value that can be realized at specific prices. Listed corporations do not *have* a balance sheet, they *are* a balance sheet with assets and liabilities that can be realized in individual transactions. The financial value of those individual transactions, the price somebody apparently is willing to pay, is justification for breaking down the corporation as an integrated entity that in myriad ways is connected to society. Advisors in the capital markets context (investment banks, business consultants, analysts, tax-advisors, auditors, lawyers) receive compensation as a spin-off from the financial value thus attributed to assets and liabilities, which value is extracted through transactions that crystalize it. Derivative financial instruments further remove investors from the reality of the corporation as an organization where real people work and that is connected to society through a multiplicity of parties and relationships. In financial capitalism, investors are only interested in the financial value that emerges from these instruments, it is all that matters. Institutional investors who excessively diversify their portfolios are no longer investing in individual corporations but search for mathematically calculated absolute and relative returns. Intermediation of the whole investment process removes investors even further from the corporations they invest in. Financial capital is uncommitted to the corporations in which it invests (Mayer 2013).
- (iii) The world of modern management as taught in business schools and practiced in corporations is characterized by its endless search for efficiency improvement and cost savings as a means of maximizing shareholder value. Employees are a cost factor and staff reductions maximize shareholder value. Employees that stay are directed through key performance indicators, control systems, target setting and measuring and compliance e-tools to ensure they perform and behave according to plan. A plan that is overly based on illusions and scientific pretensions of certainty, while in reality corporations are constantly faced with uncertainty and unpredictability. The dominant organizational pattern is mechanistic, steering towards predetermined objectives and controlling employees through formalistic accountability procedures in bureaucratic processes. The capacity for human judgement of employees is no longer utilized.
- (iv) The managerial control bureaucracy is augmented with more and more external regulation defining what corporations can, must and may not do. After every new crisis, new rules give a false sense of control over a reality that was never under control before the crisis hit, with more and more external supervision through regulatory authorities. The paradoxical consequence has been to reduce the sense of responsibility that people have from a responsibility for the consequences of their behavior towards others to a responsibility to comply with the rules. We actually feel less responsible and no longer train our moral muscle, a regulatory crowding-out effect. This has become what I call a Perfect System Syndrome, taken from the words of T.S. Eliot in his poem the Rock from 1934: “They constantly try to escape, From the darkness outside and within, By dreaming of systems so perfect that no one will need to be good.”

- (v) Executive remuneration has been developed on the back of the agency theory. Significant short- and long term incentives seek to align the interests of executives with the interests of shareholders. They produce their own crowding-out effect: executives start to believe they are working hard for the extrinsic motivation of financial reward, rather than an intrinsic motivation to do well and act pro-socially. It is no longer in the personal interests of executives to consider any other interests than the shareholders' as relevant for their decision-making.

These factors combined may have devastating results, as we see in the numerous cases of environmental degradation and neglect of employees, customers and wider communities by corporations. A common theme through these factors is an excess of rationalization and system building, in an attempt to control reality, with a view to ensuring one particular outcome, value for shareholders. Such formal rationalization through bureaucracies, systems and processes comes at the cost of human values, as Max Weber already explained some 100 years ago (Ritzer, 2007). Weber, one of the founding fathers of sociology, points at one specific factor that is crucial. In a formally rational economy “decisive are the need for competitive survival and the conditions of labor, money and commodity markets; hence matter-of-fact considerations that are simply *nonethical* determine individual behavior and impose *impersonal* forces between the persons involved.” Weber believed this formal rationality would come to overtake substantive rationality, in which choices are guided by some larger system of human values. As a result, we were to be left in the modern world with people who simply followed the rules without regard to larger human values (Weber, 1921/1968). Later Erich Fromm would describe the process in different words. Fromm was a German psychoanalyst who moved to the United States in the 1930s. In 1956 he described modern American society from a psychoanalytic perspective in his book *The Sane Society*. In it, Fromm writes about alienation and conformity. Alienation for Fromm is related to idolatry, man building an idol that he then worships as if it is outside of him. The idol typically is a projection of one partial quality in man himself, which then stands over and above him. Man becomes a servant of a Golem, which his own hands have built. “The very fact that we are governed by laws [of the market, jw] which we do not control, and do not even want to control, is one of the most outstanding manifestations of alienation. *We* are the producers of our economic and social arrangements, and at the same time we decline responsibility..” Authority is no longer overt, but anonymous, invisible, alienated authority. “The mechanism through which anonymous authority operates is conformity. I ought to do what everybody does, hence, I must conform, not be different.. I must not ask whether I am right or wrong, but whether I am adjusted, whether I am not peculiar, not different.” (Fromm, 1956).

Weber’s and Fromm’s descriptions preceded the work of Friedman and the way shareholder primacy has come to dominate the corporate context. But I find it striking to see how their insights precisely describe the transformation of the corporate context since the 1970s. In this corporate context the sole objective is to generate value for shareholders, other considerations are not relevant. As academics we theorize, research and teach about aspects of the corporate context from this perspective. Within corporations we steer and organize to maximize efficiency towards this objective, through rational mechanisms that create impersonal forces between the persons involved. Through executive remuneration with substantial short and long term incentives executives have a personal interest in maintaining the system. Thus we have made the financial value-maximizing corporate context an idol, something to cherish and worship that we benefit from by worshipping it. In the process we have started to conform to a corporate context created by ourselves as if this is beyond us, for which we bear no responsibility and which cannot

be contested. We have thus successfully alienated ourselves (in the sense of worshipping and not taking responsibility) from the corporate context we have created. The corporation has no responsibility beyond its objective to generate value for shareholders, and neither do we, who can only live with this matter-of-fact, anonymous and impersonal law of the market. And so the corporation and its inhabitants have become amoral. Moral responsibility, in the sense of having responsibility for the consequences of one's behavior towards others, has become an externality itself: it only is meaningful and relevant for and within the corporation to the extent the external world imposes it on the corporation and its inhabitants through laws or other moral codes, as Friedman's quote in the introduction shows.² Our ability to conform to this perceived corporate reality-as-a-matter-of- is amazing and even frightening.

3. Proposals for Change and Some Reflections

Various proposals and attempts in practice are made to address the corporate context that I have presented above. These are positive signs that we start to wrestle ourselves loose from the impersonal forces that hold us, that make us conform to a corporate reality that we no longer want. Signs that we actually start to take responsibility for the corporate context we have created ourselves. This is all the more so when proposals come from those who inhabit the corporate context themselves, business leaders and others who work with and within corporations and academics who theorize, research and teach about this context. If I see it correctly, proposals generally take three directions: (a) reduction of shareholder rights, (b) formulation of a wider corporate purpose, and (c) involvement of other stakeholders than shareholders. Sometimes combinations of these directions are proposed. I will discuss these below and provide some initial reflections.

a. Reduction of Shareholder Rights

This strategy is applied in order to make shareholders less dominant principals of the corporation. The Dutch corporate governance regulatory context is rife with proposals along these lines. After the financial crisis it was suggested to restrict the control rights of shareholders in banks as this increased the risk taking by banks.³ The proposal was not formalized in the Corporate Governance Codes for Banks. The rights of shareholders to launch inquiry procedures has been limited following litigation by activist shareholders seeking to extract cash from corporations.⁴ And finally, in response to a takeover attempt of a US company targeted at AkzoNobel, a proposal was made to Parliament that listed companies subject to the threat of a hostile takeover attempt will enjoy a waiting period of 250 days, during which shareholders cannot have a general meeting convened in which they

² Hess (2017) notes, referring to this quote, that Friedman never suggested that the business arena is a morality-free zone. That may be so, but the morality to which the corporation and its inhabitants are to be subject needs to come from outside of the corporation. Within these external confines, the corporation and its inhabitants do not (have to) produce any morality, any responsibility beyond the responsibility to generate value for shareholders.

³ Report of the Maas Committee Naar Herstel van Vertrouwen (2009), https://www.dekamer.be/kvvcr/pdf_sections/comm/common/asset.pdf

⁴ In inquiry procedure the Enterprise Chamber of the Court of Appeal in Amsterdam can order immediate measures. The bar for initiating this procedure was raised in 2013 for listed corporations in order to make it harder for activist investors to start inquiry proceedings, see art. 2: 346 par 1 (c) Dutch Civil Code. The discussion whether this really has been effective or not continues, see Minister of Legal Protection Letter to Parliament 20 December 2018, TK 29 752, 12, <https://zoek.officielebekendmakingen.nl/kst-29752-12.html>

vote to dismiss executive or supervisory directors. The current government wishes to proceed with the proposal but it is still pending in Parliament. At a European level, a similar approach was taken by the introduction of article 12 in the 13th Directive on Takeover Bids. Article 12 allows Member States to opt-out of the provisions of article 9 and 11 of the Directive, which seek to facilitate takeover bids by prohibiting that boards frustrate a takeover bid once it is announced (board neutrality rule) and by allowing for breakthrough of pre-bid existing defensive measures (break-through rule). The opt-out regime effectively has resulted in Member States continuing with, or sometimes even adding to the defensive mechanisms that are available in their corporate laws, making it harder for shareholders to benefit from takeover bids.

This strategy touches upon a core weakness of corporate governance of the corporation that is listed on a stock exchange. Managers of firms that are not effectively controlled by shareholders (or by others) have wide discretion to act in their own interests and are accountable to none. This is partly what the Friedman paradigm and the agency theory sought to address. Taking away shareholder discipline and not replacing it with something else, leaves corporations with effectively non-accountable directors. And paradoxically, these managers may still act primarily in the interests of shareholders, also due to how they are incentivized. In the AkzoNobel case, the board and management decided to reject the offer, to sell-off a substantial part of the business and to return most of the proceeds to shareholders, in order to placate shareholders who missed out on the takeover premium. A pattern that is seen more often and only confirms the shareholder primacy dogma.

b. Defining a Wider Purpose

A second strategy is to define a wider purpose, the fulfillment of which corporations need to work towards. I would distinguish between a ‘strong’ purpose approach and a ‘weak’ purpose approach. A strong purpose orientation may contain the following elements (see also Mayer, 2018). The wider purpose of the corporation is framed in the context of the contribution that the corporation makes to wider society, to people and to our planet. Profit is not the objective of the corporation as such but is one outcome of this process in which the corporation seeks to be valuable to society. Performance of the corporation should be measured in relationship to how the corporation delivers on its purpose, not only or primarily on whether it is profitable in doing so and provides rewards for financial capital. Performance in relation to such wider purpose involves understanding and at least to some extent measuring the way that human capital (employees), social capital (the communities in which the corporation operates) and natural capital (natural resources and environmental and climate degradation) are used, maintained and compensated besides financial capital. These impacts are accounted for in performance accounting which is radically different from the current financial annual accounts. A core notion in such a purpose-oriented context is sustainability. Sustainability brings into view our responsibility for the consequences of current decisions and conduct for future generations.

The development of so called Benefit Corporations in the US offers an example of such a strong corporate purpose orientation. Many US States now allow for the incorporation of Benefit Corporations that pursue some form of social impact or other public benefit. This specifically allows boards to not maximize returns to shareholders. The development of B corps is still early days, its future expansion and success remains to be seen (Dorff, Hicks, Solomon, 2020).

The Benefit Corporation movement is a reaction against the shareholder primacy orientation of ‘normal’ corporations. Many normal corporations in recent years have formulated some sort of broader purpose to which they claim to work. Some, and critics would say many, of these purpose statements are pretty hollow, boilerplate, motherhood and apple pie like, with little discernable effect on the corporation’s conduct and orientation. They offer only a ‘weak’ version of purpose orientation. Making a purpose statement in itself does not guarantee that the corporation will indeed orient its decision-making and conduct towards the purpose it has defined. Critics blame corporations for ‘green washing’ their unchanged business practices by purpose statements that remain without consequences and that only dilute the accountability of directors. This is also part of the critique against the Statement on the Purpose of the Corporation of the US Business Roundtable. A number of CEOs of large US corporations as co-signatories to the statement have stated that they have a responsibility not only to shareholders but also to employees, customers, suppliers and wider communities in which they operate⁵ (for the critique, see Bebchuk, Tallarita, 2020). Another form of critique is that corporate governance, including redefining the purpose of individual corporations, is not best suited to deal with the problems of society. Tax laws and social regulation designed and imposed by the government can better address concerns of inequality and economic insecurity.⁶ Even if it is true that some form of external regulation can more effectively deal with specific societal concerns, it does not follow that the corporation as such should have no responsibility for societal concerns.

Other ‘weak’ versions of purpose orientation seek to mitigate how the shareholder primacy doctrine has been taken as an absolute. One version of absolute shareholder primacy is that shareholders’ financial interests immediately and at every moment take priority over other interests. This leads to an excessive focus on delivering financial value to shareholders on the short term. A second version is that the shareholder primacy has been understood and practiced as a need to maximize shareholder value. Only the maximum possible financial outcome for shareholders is the right outcome of corporate decision-making. The two effects, short-termism and shareholder value maximization, often go hand in hand, they are two aspects of the same underlying problem: shareholder primacy is understood as an absolute maxim. Various forms of regulation seek to address this, with either more emphasis on short-termism or on shareholder value maximization. The short termism effect is addressed for example in the Dutch Corporate Governance Code. Principle 1.1 of the Code describes the key role of corporations to create long-term value, within a context that suggests that interests of various stakeholders are to be balanced.⁷ The shareholder value

⁵ See <https://opportunity.businessroundtable.org/wp-content/uploads/2020/03/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures.pdf>.

⁶ Jeffrey N. Gordon, Addressing Economic Insecurity: Why Social Insurance Is Better Than Corporate Governance Reform, the Columbia Law School Blog on Corporations and Capital Markets, see <https://clsbluesky.law.columbia.edu/2019/08/21/addressing-economic-insecurity-why-social-insurance-is-better-than-corporate-governance-reform/>.

⁷ See <https://www.mccg.nl/?page=4738>. The Dutch corporate governance context requires boards to balance the interests of all stakeholders. In practice however many listed companies engage in governance practices that are primarily geared to generating shareholder value, among other through substantial variable executive remuneration schemes. Substantive variable pay geared to align the interest of executives exclusively with the interest of shareholders is perfectly possible in the Dutch stakeholder context (Lokin, 2019). The stakeholder approach is often only championed opportunistically when the corporation would come under threat of a takeover bid (Winter, 2017). The Dutch stakeholder approach in fact never has given any guidance to corporations on the purpose they would need to work towards, as corporations responsible in society. In

maximization effect is addressed by introducing an enlightened shareholder value approach in UK company law. Section 172 of the UK Companies Act 2006 requires directors to promote the success of the company and its members and in doing so have regard to, among others, interests of company's employees, the need to foster business relationships with suppliers and customers and the impact of the community and the environment. Similarly French law now prescribes that corporations should be managed in furtherance of its corporate interests while taking into consideration the social and environmental issues arising from its activity, art. 1833 French Civil Code as amended by the Pacte Statute (Robé, Delaunay, Fleury, 2019). I would call these approaches weak versions of purpose orientation. They address the problem of taking shareholder primacy as an absolute, but do not alter the underlying assumptions of the ultimate objective of the corporation to generate value for shareholders. Taking a longer term view and having regard for the interests of others all serve the ultimate purpose of generating value for shareholders. For some that is already good enough (Ferrarini, 2020). However, human, social and natural capital can still be treated as only marginally relevant for the corporation, that seeks ultimately to generate value for shareholders. The Dutch long-term oriented stakeholder approach in practice often at best compares with this enlightened shareholder value approach. The French Pacte Statute also allows for the introduction of the pursuit of a *raison d'être* in the articles of association, which has some elements of a stronger purpose orientation, art. 1835 French Civil Code.

c. Stakeholder Involvement

The third strategy is to actually involve different stakeholders in the governance of the corporation. Some countries have decades of experience in particular with involving employees in the governance of companies. Co-determination was developed in the context of the classic conflict between capital and labour. Often the involvement of works councils is only marginal, not fundamentally changing the course of the corporation. In some jurisdictions various forms of co-determination of the board (typically the supervisory board in a two-tier model) by employees exist. The results are mixed. In the Netherlands the co-determination regime allows works councils to nominate 1/3 of the members of the supervisory board, who may not be employees or trade union representatives. The regime is often seen as a mechanism that more than anything increases the power of the supervisory and executive boards to the detriment of the power of shareholders, and gives little real power to employees. In Germany employees can appoint 1/3 or half of the members of the supervisory board, who may be and in practice are employees and trade union representatives. In some comments the engagement of employees in the core decision-making is seen as a positive contribution to decision-making. In other comments it is pointed out that the resulting regime leads to a split board and a more complex, antagonistic governance reality. Whatever may be the value of these forms of co-determination, it is clear that they only provide for a partial governance solution, i.e. for employees who provide human capital. It does not address concerns relating to the use of social capital, and natural capital.

practice, the applicability is often limited to having regard to interests of employees. Social and natural capital hardly feature in any analysis of the stakeholder approach. Whatever emerges out of the process of balancing interests is what can be done. The neutral instruction to simply balance interests, allows for truly purposeful orientation and conduct as well as for shareholder primacy conduct and orientation to the extent that interests of other stakeholders are not overly trampled.

A more comprehensive and more radical approach, is the development of the multi-stakeholder co-operative as an alternative legal form for conducting business. In many countries co-operatives have a long history of community based economic co-operation (Restakis, 2010). The core of the co-operative economic approach is that various members contribute to a joint effort, the value of which is not extracted from the co-operation by one type of participant but is shared among the various members and surplus value is reinvested in the co-operative. Co-operation requires establishing longer term relationships instead of one-off transactions. Co-operatives are now more and more being used as a legal form in which different classes of members join forces, towards a common purpose that connects them. A multi-stakeholder co-operative may have investor members who provide financial capital, working members who provide human capital, community members who provide social capital, and representative members who represent various ngo-type of organizations, including organizations focused on environmental and climate matters. In some multi-stakeholder co-operatives the different classes of members are also represented at the level of the board, in others the board may be an independent body and members participate primarily in the general meeting. In both cases the board needs to balance the interests of all classes of members in view of the co-operative's purpose. The province of Quebec in Canada, several US States, France and Italy have issued specific regulation that facilitates multi-stakeholder co-operatives.⁸ Multi-stakeholder co-operatives may become particularly relevant in the digital platform economy. Modern digital information and communication technology, artificial intelligence, 3-D printing and the internet of things allow many to connect to many others, to produce and provide service at ever lower costs and to share assets and resources with others. An economy of collaborative commons may to a large extent replace social-economic activity that is now organized through classic market economy (Rifkin, 2015; also Zizek, 2017). In such an economy the multi-stakeholder co-operative is a natural legal form to organize and govern the co-operation between multiple parties involved.

4. The Board and the Duty of Societal Responsibility

In each of these three approaches to address the problem of the responsibility of the corporation the role of the board⁹ is crucial. In the reduction of shareholder rights approach, the discretion of the board only increases to take any course of action it sees fit. If remuneration incentives for executives and underlying beliefs and orientations remain as they are, the corporation will not act very differently and will in all likelihood continue to focus solely on creating value for shareholders. Also when a wider purpose for the corporation is explicitly formulated, this is not a guarantee that the board and others who act on behalf of the corporation actually are guided by that purpose in all of their actions. Again, when remuneration incentives for executives and underlying beliefs and orientations remain as they are, no change will happen. Purpose can be a shield behind which corporate conduct continues as before. Finally, also when stakeholders are involved in the governance of the corporation, through some form of co-determination, or in the more radical form of a multi-stakeholder co-operative, it is still up to the board to direct the

⁸ See Solidarity as a Business Model, A Multi-stakeholder Cooperatives Manual, published by the cooperative development center @Kent State University, <https://community-wealth.org/content/solidarity-business-model-multi-stakeholder-cooperatives-manual>

⁹ I refer to the board in this article as to include both the singular board in the one-tier model as well as both boards in a two-tier model.

corporation or co-operative towards achieving the purpose that connects the various stakeholders and to balance their interests in the process. Therefore, in any of these approaches that are being proposed, without commitment of the board to direct the corporation towards achieving a purpose that benefits society and our planet, it is unlikely that the corporation will indeed do so.

This brings us to the core question that is not answered in the proposed approaches: how do we ensure that the board is indeed committed to a broader responsibility of the corporation beyond merely serving the financial interests of shareholders? Colin Mayer stresses the need for commitment in his book *Prosperity*: “By articulating clearly in whose interest the corporation is run, making the corporation explicitly liable to those parties, accounting for those liabilities in a transparent way, *and making someone specifically responsible for ensuring that the corporation does not deviate from its stated purpose*, it is able to offer credible commitments to other parties.”¹⁰ Mayer then goes on to describe how certain large, long-term owners of European corporations have transferred their ownership to foundations, exercising control over these corporations. The board of such a foundation is responsible for ensuring that the corporation abides by the principles and values of the foundation, often linked to a charitable purpose. This may offer an avenue to create commitment to responsible corporate conduct for corporations who have large, long-term shareholders. But many corporations do not have such shareholders, only have dispersed short-term shareholders, who are unable to generate any such commitment. Mayer’s conclusion is that the “United Kingdom, in particular, with its dispersed ownership, is dominated by short-term shareholders rather than long-term shareowners, and is therefore a low commitment economy... Where corporations do not or are unable to offer the level of commitments that society demands of them, then it resorts to prescriptive regulation in place of permissive enabling legislation.”¹¹

But why should we stop there? Why should we accept that when a corporation only has uncommitted shareholders, external, prescriptive regulation will have to bring about the level of responsibility that society expects of corporations? In such a view, societal responsibility of the corporation with dispersed owners indeed remains an externality: it only exists to the extent external regulation imposes it on the corporation and its board, as per the Friedman doctrine. We can do better, by turning to ourselves. The core of the problem of the amoral corporation is a human failure of succumbing to self-made formal rationalization and alienation. This human failure can only be conquered by addressing who we as humans are in the corporate context. We need to look at the board of the corporation, the people who make up the board, as its prime agent. It is people who act on behalf of the corporation, who allow for it to participate in economic activity (Rönnegard, Velasquez, 2017). Without people the corporation cannot participate in society.¹² The quality of taking moral responsibility, i.e. responsibility for the consequences of one’s acts, is a human quality (Comte-Sponville, 2009). It requires empathy, the ability to imagine what others would experience, and more broadly human emotions such as remorse or guilt. In order for societal responsibility to come from within the corporation, the responsibility of the people who are its agents needs to be activated. The board is legally

¹⁰ Mayer (2017), p. 161.

¹¹ Mayer (2017), p. 164-165.

¹² More and more corporations’ actions can be generated by computers and artificial intelligence. This leads to the human challenge of how to equip computers and artificial intelligence with a sense of human morality, of other-regard (Tegmark, 2017; Russell, 2019). This should press us to pro-actively ensure that corporations assume human responsibility. If we cannot have human morality determine what corporations do when and as long as they still require human agency, we are even worse off when corporate conduct starts to depend more and more on computers and artificial intelligence.

responsible for the actions of the corporation.¹³ It takes its core decisions and directs the people and organization of the corporation. The board is the key body that should consider interests of different stakeholders and the uses of different forms of capital. In the board also rests the authority within the corporation to ensure that others who act on its behalf are guided by the principles and values determined by the board. Corporate law could formulate a duty of the board and the directors to ensure that the corporation acts responsibly with a view to the interests of society and the way it uses investor, human, social and natural capital. I would call this the duty of societal responsibility, a duty to ensure that the corporation acts as a responsible corporate citizen in society. I take these latter words from the King IV Corporate Governance Report of South-Africa (2016), principle 3: “the governing body should ensure that the organization is and is seen to be a responsible corporate citizen.”¹⁴ If this would not just be an aspirational statement, but a firm duty of the board and directors, this would generate a commitment from within the corporation to drive the corporation towards fulfilling the needs of society.

In an approach that focuses on the formulation of a strong wider purpose of serving society, the duty of societal responsibility could be formulated as a duty of the board to further this wider purpose. This could also be the case for the multi-stakeholder co-operative where various stakeholders co-operate towards a common purpose. In approaches that shy away from the formulation of a wider purpose of the corporation (like the approach to reduce shareholder rights and the co-determination approach involving employees in the governance) a duty of societal responsibility of the board would have to be formulated to explicitly include the concerns of society and the usages of the various forms of capital by the corporation. This duty of societal responsibility to ensure the corporation is a responsible corporate citizen, would go much further than the enlightened shareholder approach. Under this duty the board does not only have to regard other interests to the extent doing so would further the interest of the corporation and its shareholders. The various interests and forms of capital in a sense are at par: the responsibility of the corporation extends to all of them and it would be for the board to determine in every instance how they should be treated. It would also go further than the approach to focus on long-term value creation, seeking to avoid short-termism. A duty of societal responsibility would entail that also in the long term not only or primarily financial capital are rewarded but that being a responsible citizen is the first objective and rewarding financial capital is instrumental to that objective.

5. Elaborations of the Duty of Societal Responsibility in Corporate Law and Corporate Governance

A duty of societal responsibility of the board of directors would complement the duty of loyalty and duty of care that are generally recognized as core director duties, in different ways in different jurisdictions. Such a duty should be elaborated upon in corporate law and corporate governance practices. Law and governance regulation cannot prescribe in detail what this responsibility would entail in the vast variety of corporate practice and reality. A detailed regulation in corporate law could never be complete. Particularly as diverging considerations and interests will have to be balanced, we will have to rely on the people that lead corporations as

¹³ This does not mean that board members therefore face personal liability for everything the corporation is doing. Liability may follow from such responsibility, but typically follows only if certain threshold conditions have been met.

¹⁴ See for the full code <https://www.adams/africa/wp-content/uploads/2016/11/King-IV-Report.pdf>.

directors to make judgements. Core principles of fair decision-making can be applied to give the duty of societal responsibility solid ground. One such principle is that in executing their duty of societal responsibility directors should act as can reasonably be expected of directors in similar circumstances. This standard of behaviour is often used by courts when conduct of directors is assessed. It allows for a marginal review of the decision-making or conduct in light of what is reasonable in the circumstances. The standard presumes that judgement and reason are indeed applied when balancing the interests and concerns for which responsibility exists (Van Schilfgaarde, 2019). A second principle is that in balancing the various interests, no relevant interest may be disproportionately harmed. Unnecessary harm is always disproportionate and therefore to be avoided. A third principle is that the board needs to apply procedural fairness. The concepts of reasonability, proportionality and procedural fairness will help courts who ultimately have to assess the conduct and decisions of boards and directors. A judicial assessment may lead to declaring decisions taken by the board null and void or to upholding a decision to dismiss a director who breached the duty. Under circumstances it may also lead to liability of individual directors.¹⁵ Consequences of breaches of the duty of societal responsibility need to be thought through and standards need to be developed.

If a duty of societal responsibility of the board is introduced in corporate law, this should be further elaborated in corporate governance practices. I see at least five corporate governance elaborations.

- a. *Corporate decision-making*: boards should develop a decision-making practice to explicitly review how the decision furthers the purpose of the corporation or otherwise how the corporation in a responsible way addresses societal concerns, in particular how financial, human, social and natural capital are used and affected. This will fundamentally change the deliberation and decision-making practices in boards. It will require very different information that is discussed in the board, information that not only sets out financial aspects of the decision, but also clarifies the impact of the decision on the well-being of employees, the impact on the wider community in which the corporation operates and the impact on environment and climate. Corporations will have to learn to at least in part measure the use of human, social and natural capital, making them internalities that need to be included in decision-making. Boards will have to learn how to make sense of all of this information and how to take decisions that best further the purpose of the corporation, given the various interests and uses of different forms of capital. The very same principles of fair decision-making (reasonability, proportionality and fair process) should guide boards to their decisions. It is likely that deliberations of this kind will also provide insights into heretofore unknown uncertainties. The shareholder primacy theory has led to a dominant corporate practice of simplification of reality by reducing it to measurable, predictable financial outcomes (Ritzer, 2007, who calls this aspect of the rationalization process McDonaldization). This creates an illusion of control that ignores the role that unpredictability and chance play in a reality that consists of historical combinations of factors, interdependence of individual actors, feedback patterns and emerging knock-on effects that make it impossible to predict any future trajectory (Winter, 2019b). I would not be surprised if the new way of deliberating and decision-making, taking into account a much wider set of societal factors and challenges, would bring us closer to the reality the corporation is actually faced with.

¹⁵ See fn 13.

- b. *Board composition*: because of the very different nature of board deliberation and decision-making the composition of the board must change as well. Following the dot.com and financial crises of 2002 and 2008-9 the (regulatory) emphasis was put on directors that should have a thorough understanding of financial reporting, control and risk. In recent years understanding and experience of the digital world and opportunities is in vogue. A board that is to seriously consider wider societal concerns, in particular how human capital, social capital and natural capital are used and should be rewarded, needs to have the capabilities to understand and assess these wider aspects of the corporate reality. A concern may arise that boards become too large to allow for effective deliberation and decision-making if all relevant forms of expertise have to be included in its composition. To avoid this, a new form of distributed leadership at board level could be developed. In the concept of X-teams leadership in an organization is distributed in teams rather than exercised by a single person. Team members each connect to other teams inside the organization and to expertise outside of the organization, making flexible use of all relevant internal and external information and expertise (Ancona, Backman, Bresman, 2008). In a similar way, an *X-board* could consist of a core group of members and could be extended with additional members that can advise on specific matters. Such additional members can help the board to make sense of specific areas of societal relevance in which the corporation has to navigate. In its most simple form, not requiring any change in corporate law, in an X-board the core group of board members would constitute the formal board, carrying a collective responsibility. Additional members could be advisory members, who participate in board meetings when their specific expertise or knowledge is required. Advisory members would not share in the collective responsibility of the board. Over time new concepts of roles and responsibilities may be developed adapting to possible new realities in board leadership, board dynamics and decision-making that the X-board could create.
- c. *Executive remuneration*: a duty of societal responsibility must have consequences for the way in which executives are remunerated. The current practice of substantial short term and long term variable remuneration has been developed since the early 1990s in order to align the interests of executives with the interests of shareholders. It is a cornerstone of the shareholder primacy corporate practice. This practice must change if a duty of societal responsibility is to have any real effect. There is a wide spread belief that variable remuneration based on target-setting in advance generates effective incentives for executives. I do not share that belief, substantial variable pay with target setting in advance puts a complicated behavioural strain on people that is not effective and potentially very damaging (Winter, 2010). However, if variable pay is to continue, than targets for short and long term remuneration must be set very differently, not only dealing with the financial interests that shareholders have but focusing instead on the achievement of the corporation's purpose in society and how the various sources of capital are used and affected by the corporation. That undoubtedly is going to be a complex affair, given how complicated remuneration schemes and target setting and measuring achievement already have become in the current context in which the incentives only seek to align with financial capital. There is a good case to be made for simplification of executive remuneration to just fixed pay and to not use remuneration as a tool to stimulate responsible corporate behaviour.
- d. *Governance of the organization*: boards are ultimately responsible for the conduct of the corporation. In reality most corporate conduct arises through the acts of many

employees in different roles throughout the organization. The board has the ultimate responsibility and authority to guide the actions of all employees towards the objectives of the corporation, whatever they may be. Over the last two decades we see that this responsibility has been strengthened in two different ways. The dot.com crisis led to detailed regulation focused on internal control in order to avoid mistakes and fraudulent behaviour in financial reporting. Boards were made ultimately responsible that the corporation is in control and complies with the reporting requirements. The financial crisis added a stronger focus on risk management and compliance, in particular for the regulated financial industry. Again boards are ultimately responsible for ensuring the corporation and its people comply with the rules, processes and standards. In practice this is typically done by building large compliance bureaucracies that seek to control people, which come at the cost of human inspiration, human morality and human judgement (Winter, 2019a). A duty of societal responsibility would entail that the board ensures that the corporation and its people work towards the purpose of the corporation or otherwise act responsibly with regard to the interests of society. Building new compliance type of bureaucracies to secure this will fail. If anything, societal responsibility requires human judgement at all levels of the organization. The board's role is to ensure that this judgement is not random, but adheres to general principles and values it has determined in light of its purpose and responsibility towards society. The way people in the organization adopt these may lead to actions and commitments that were never explicitly formulated by the board itself and can start to influence the general interpretation of these principles and values, guiding the actions of the corporation going forward (Hess, 2017). To ensure that the organizational conduct is in line with the stated principles and values the board should install both inspiration, discipline and psychological safety in the organization and the people.¹⁶ This requires different forms of leadership, at executive and non-executive level and often radically different ways of organizing (Laloux, 2014). Rather than strengthening individual autonomy and empowerment, this may require a strong focus on the collective, on collaboration. Trade-offs and negotiations at all levels of the organization will have to be made explicit in order to generate a deliberative culture (Battilana, Muerstein, Lee, 2018). This is very different from the organizing and decision-making in the shareholder primacy paradigm that seeks to avoid and externalize multiple dimensions and considerations in order to serve one-sided effectiveness. True governance innovation throughout the organization requires becoming good at precisely that: inclusive, multi-dimensional reflection, deliberation and decision-making.

- e. *Transparency*: living up to a duty of societal responsibility entails transparency on how the purpose of the corporation in society is served and how various sources of capital are used and affected by the corporation. Corporations should report on the impact in society they have and on the various sources of capital they use and affect. This will require new ways of measuring impact in society and on sources of capital beyond financial capital. It will take integrated reporting to a next level. The International Integrated Reporting Council (IIRC), a broad coalition of regulators, investors, corporations, standard setters and the accounting professionals and NGOs, already includes accountability and stewardship for various sources of capital as an explicit aim

¹⁶ See on the difference between control and compliance on the one hand, and stretch and discipline on the other, the brilliant talk of Sumantra Goshal on the Smell of the Place at the World Economic Forum, <https://youtu.be/UUddgE8rIOE>

of integrated reporting.¹⁷ Reporting on societal impact and use of various sources of capital still is early days. So far, where it is practiced it is often an add-on to financial accounts geared to accounting for investor capital. Over time, when we learn more, one should expect this to become part of the regulated accounting process geared to account for the impact of corporations in society. Gathering and truly understanding information on the wider impact of the corporation in society will also be crucial for the board itself to be able to further the purpose of the corporation in society. To fulfill its duty of societal responsibility a board should be able to show how it has come to certain decisions, given the corporation's purpose in society and use of and impact on various sources of capital.

When corporate law and corporate governance elaborations as these are anchored in the duty of societal responsibility of the board this will bring to life a veritable and human commitment from within the corporation to act as a responsible corporate citizen in society.

6. Conclusion, an Emerging Duty of Societal Responsibility

The problem of the lack of moral responsibility of the corporation can be solved by introducing a duty of societal responsibility of the board and the directors. This duty would generate the human commitment that is needed for us to escape the impersonal forces of a corporate context that we have created ourselves, that has become amoral and that we conform to as a matter-of-fact, as Weber and Fromm have described. A human commitment that is generated from within the corporation. To make it work in real corporate life, corporate law and corporate governance must provide for the necessary elaborations. Whether or not we introduce an explicit duty of societal responsibility of boards and directors of corporations is not a question of law, but a societal, if you wish a political question (Van Schilfgaarde, 2019). I am in favour of the introduction of such a responsibility in corporate law. In the midst of all the crises we find ourselves in today (climate change, economic inequality, precarious work, deteriorating biodiversity) and the shock that COVID-19 adds to all of this we need a corporate context that actively contributes to solving them and refrains from aggravating them. This is a human, a societal need that should guide us in determining what corporate context we desire and design. I do not mean to say that all way of business, that profit making itself is inherently bad, not at all. Corporations can, through their ability to raise financial capital that is rewarded through profit making, muster a capacity that is forceful and often cannot be matched by governments or individuals. We need to decide that the forcefulness of business should be turned to the good, to what society needs. Only imposing responsibility externally, through regulation, on an otherwise amoral corporate context will not suffice for the multitude of societal challenges we face today (Mayer, 2018). The commitment to further societal needs must also come from within the corporation, as a human commitment. It should start with the duty of societal responsibility of the board and the directors.

As a final thought, I would argue that a duty of societal responsibility under circumstances may also emerge from law itself. When the Dutch Corporate Governance Code was first adopted and imposed on listed companies on a comply-or-explain-basis, a discussion arose on the legal status of this new phenomenon. In various court cases activist shareholders sought to enforce application of elements of the Corporate Governance Code. The Supreme Court allowed for the

¹⁷ IIRC, The International <IR> Framework, https://integratedreporting.org/wp-content/uploads/2013/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK_2_1.pdf

possibility that the manner in which the corporation has understood and endorsed principles of corporate governance, for example by statements of the board in the annual accounts, may lead to specific obligations of the board towards shareholders¹⁸ (Van Schilfgaarde-Winter-Wezeman-Schoonbrood, 2017). A similar reasoning could be applied to voluntary statements made by the board on the purpose of the corporation within society and specific societal needs the corporation claims it should address. Such statements could create obligations for the board to live up to them, which can be enforced by shareholders and possibly the works council and employees as parties who by law and articles of association may be involved with the corporation. Outside the corporation, such statements may be construed as unilateral obligations towards third parties, or alternatively, breaches of such statements may constitute an act of tort towards third parties. In different jurisdictions different legal techniques can be applied to this end. The conditions under which such obligations can be enforce, can be debated. But the principle stands: law can and in my view should ensure that a voluntary statement of a board endorsing some form of societal responsibility does not remain weak, with little or no consequences, but constitutes an enforceable obligation, generating a commitment to truly assume this responsibility.

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¹⁸ HR 21 February 2003, JOR 2003, 57 (HBG)

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