CECP ISSUE BRIEF

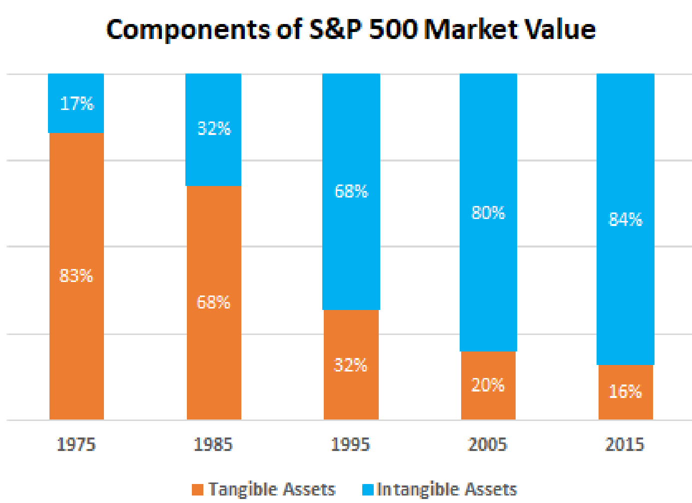
Corporate Purpose: The New Dimension to the Calculus of M&A Transactions

CECP Overview: The COVID-19 pandemic ground the global economy to a halt. Understandably, the priority of many CEOs in the wake of this crisis had been to weather the proverbial storm to ensure their companies survive the crisis. However, a broader, more enduring crisis challenging the status quo of business's role in society had been brewing for years. One of the few silver linings of the COVID-19 global pandemic has been the earlier-than-anticipated arrival of stakeholder capitalism and the emergence of the new purpose-driven economy. The implications of this new paradigm will impact the decision making for every corporate executive, including the new dimension to the calculus of M&A transactions.

CECP Insights

M&A has been part of the corporate strategy playbook since the late 1800s. Historically, business combinations and divestitures had been justified to the capital markets by focusing on shorter-term, tangible financial benefits associated with a transaction including an increase in overall competitive advantage, revenue growth, business growth, entry into new markets, and cost reductions.

However, over the past few decades, the capital markets have been adjusting how they assign value to companies. For example, in 1975, approximately 85% of the stock market's value was based on tangible assets like equipment, machinery, and real estate. Fast forward to 2015, when the market attributes 85% of the value to intangible assets including human and intellectual capital. This shift in how investors value the stock market requires a broader set of information beyond standard financial statements to effectively value companies today.[1]



Source: Ocean Tomo, *Ocean Tomo Intangible Asset Value Study, 2018*

Regardless of the motivation behind Corporate America's decree through the Business Roundtable Statement on Purpose of a Corporation in August 2019,[2] the 181 CEOs' commitment to consider *all* stakeholders can also be viewed as an acknowledgment of the out-sized impact that intangible assets, i.e., how companies engage with their stakeholders, have on the valuations of their companies. Corporate purpose will be a company's North Star, especially during the due diligence process for companies in M&A-mode on the other side of the COVID-19-induced economic crisis. Not only will an acquiring company need to be confident in its own corporate purpose, but it will also need to evaluate the corporate purpose of its target company to determine whether there is enough alignment to generate additional intangible value (i.e., how companies engage with their stakeholders). Specifically, during the due diligence process of a potential M&A transaction, corporate executives and their teams should be measured in their approach and look beyond the immediate tangible cost synergies or revenue growth opportunities. They should also be able to answer the following questions about each of they company's new potential stakeholders to improve its prospects for generating long-term intangible value.

Evaluating the Corporate Purpose of the Target Company:

- **Employees**: Will we be able to invest in our employees? How will we determine how to compensate them fairly and provide important benefits? How will we support their professional growth through training and education that help develop new skills for the purpose-driven economy? What will be our strategy on diversity and inclusion?
- **Customers**: How will we effectively communicate how our customers will be impacted by this transaction? How will this transaction deliver value to our customers? How will we lead the way in meeting or preferably exceeding customer expectations?
- **Suppliers**: How will we ensure that we are dealing fairly and ethically with our suppliers?
- **Communities**: How will we continue to support the communities in which we operate and protect the environment by embracing sustainable practices across our businesses?
- **Shareholders**: How will this generate long-term value for shareholders who provide the capital that enables us to invest, grow, and innovate? In the spirit of transparency, will we be able to communicate more forward-looking, long-term disclosures to investors to allow for more effective engagement with shareholders?

Once the transaction is complete, companies should follow three practical steps as suggested in a recent Harvard Business Review article[3] by Professor Robert Eccles, former Chief Justice Leo Strine, and Tim Youmans entitled, "3 Ways to Put Your Corporate Purpose into Action."

- **Step 1**: The board of directors should publish a stakeholder-inclusive "Statement of Purpose" that defines the positive contribution to society the company will make, and the steps it will take to eliminate its negative impact on society.
- **Step 2**: The company should publish an integrated report that will enable shareholders and other stakeholders to evaluate the company's success in achieving its purpose.
- **Step 3**: In order to make the company's commitment to purpose enforceable, the company needs to adopt a new form of governance, such as becoming a Delaware Public Benefit Corporation.

FOOTNOTES AND LINKS TO EXTERNAL RESOURCES

[1] **Ocean Tomo:** https://www.oceantomo.com/intangible-asset-market-value-study

[2] **Business Roundtable Statement on Purpose of a Corporation:**
https://opportunity.businessroundtable.org/ourcommitment

[3] **3 Ways to Put Your Corporate Purpose into Action"**
https://hbr.org/2020/05/3-ways-to-put-your-corporate-purpose-into-action