THE GOVERNANCE INSTITUTE
A SERVICE OF nrc HEALTH

October 2019
System Focus

New Focus on the Corporate Purpose of the Health System

By Michael W. Peregrine, Esq., Partner, McDermott Will & Emery LLP

Parent companies of non-profit health systems may want to review their statement of corporate purpose given several recent developments. The first of these is an evolving business model, leading the health system away from its core inpatient focus and towards an emphasis on outpatient delivery and application of technology. Second is the current public debate on corporate social responsibility (CSR) and the relationship of the corporation to a broader set of stakeholders. This article provides further insights on these developments and the board's role in reviewing the mission and purpose of the health system.

Key Board Takeaways

- Recognize the importance of the company's purpose statement.
- Monitor the ongoing public dialogue on the role of CSR.
- More closely connect strategic decisions to mission goals.
- Consider whether the current purpose statement is sufficient.

The Basic Board Responsibility

A major responsibility of the governing board is to monitor the long-term sustainability of the organization and its mission. Part of this responsibility is to monitor satisfaction and performance of that mission and its component parts. This includes ensuring, by its oversight of management and the compliance program, that the health system operates in a manner consistent with its non-profit status under state corporate law and the scope of its tax-exempt status under the Internal Revenue Code.

The Risk of Mission Drift

Attentive health system boards are certainly familiar with what *The Wall Street Journal* has described as "the fading of the full-service hospital"—i.e., the shift away from traditional inpatient facilities and the increasing investment by providers in outpatient clinics, same-day surgery centers, freestanding emergency rooms, and micro-hospitals. This new strategic direction of health systems is also prompting pursuit of a broad array of less traditional healthcare-related investments, including drug research and development, inventions by staff members, and funding outside health-tech startups, all designed to proceed under the system's core non-profit mission to improve the healthcare of its patients.

Such a direction is logical and appropriate for health systems, across multiple dimensions. But it's important that boards monitor the strategic shift and confirm that its orientation remains consistent with the core charitable mission. Indeed, there are significant non-profit corporate law and tax implications of a business model that evolves from its primary charitable purposes. These have been demonstrated in several recent state attorney general enforcement actions involving prominent non-profit organizations.

The term "mission drift" describes the circumstances when the business affairs of a non-profit corporation begin to shift from its stated purpose, to some alteration or derivative thereof, without proper state/judicial approval. The relevance to non-profit health systems arises from their strategic diversification, prompted by the increasing obsolescence of the inpatient healthcare facility business model. To the extent such diversification carries the organization away from its original (e.g., inpatient) mission focus, close board oversight becomes necessary. In consultation with the

A major responsibility of the governing board is to monitor the long-term sustainability of the organization and its mission.

general counsel, the board should monitor the continuing vitality of the original corporate purpose and periodically consider the need for amended purposes (that may require appropriate state, judicial, and IRS approvals).

The Impact of CSR

Consistent with their mission oversight responsibilities, health system boards should also monitor the current policy debate on the purpose of the corporation and on the application of principles of corporate social responsibility (CSR). This broad debate has both direct and indirect implications for system strategic direction and related board oversight responsibilities.

The concept of corporate social responsibility is that companies should serve a wider societal purpose beyond (but in addition to) their direct economic performance. This concept is grounded in the perception that government is no longer capable of fully addressing the future needs of society (e.g., on issues such as retirement and infrastructure, automation and worker retraining, and the environment). As a result, the public is increasingly turning to private corporations to "fill the gaps" and help respond to these concerns.

Concepts regarding CSR have been part of mainstream commercial discourse for a number of years. However, the discourse has increased in the last several years through several highly publicized initiatives. These include the public advocacy of BlackRock CEO Lawrence Fink (and BlackRock's application of CSR to its portfolio oversight), the Business Roundtable's release of its "Statement on the Purpose of a Corporation," and corporate accountability proposals offered by several progressive presidential candidates that would require large corporations to adopt public benefit-directed provisions to their purpose statement.

As a notable illustration, the Business Roundtable's statement is framed as a commitment from its signatories (CEOs of 181 major corporations) to lead their companies for the benefit of *all* stakeholders: customers, employees, suppliers, communities, and shareholders. Specifically, they commit to 1) deliver value to customers, 2) invest in employees, 3) deal ethically and fairly with suppliers, 4) support the communities in which they work, and 5) generate long-term value for shareholders, "who provide the capital that allows companies to invest, grow, and innovate."

This is an important movement in American commerce, from which large non-profit health systems are not exempt. (For example, Senator Elizabeth Warren's controversial "Accountable Capitalism Act" does not exclude non-profit organizations from its scope.) While it may be a long-term conversation, the non-profit health system board should absolutely monitor the evolution of CSR principles and their possible implications on the system's charitable mission. To what extent does our statement of corporate purpose need to be revitalized to speak more directly to the healthcare challenges of today? Should the mission be "tweaked" to recognize a broader set of stakeholders? These and other questions are worthy of boardroom discussion; to ignore this movement would be a strategic mistake.

Summary

Given these new developments, the board should make room on its agenda for a broad review of corporate mission and purpose. The sustainability of the mission and purpose of the health system are absolutely within the scope of board oversight responsibilities, and board leadership may profitably team with executive management (including the general counsel) to best project how such a review should proceed. System boards should not be particularly concerned about the effort associated with reshaping the charitable mission. They should be concerned with the risks associated with failing to evaluate the need to do so.

The Governance Institute thanks Michael W. Peregrine, Esq., Partner, McDermott Will & Emery LLP, for contributing this article. He can be reached at mperegrine@mwe.com.