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BUSINESS AFTER THE FINANCIAL CRISIS AND THE GREAT RECESSION: ITS PURPOSE AND ROLE IN SOCIETY

Executive summary/abstract

The purpose of this paper is to examine a number of initiatives that seek to redefine the purpose of business, its ethics and values and its role in society in the context of the financial crisis and the subsequent recession. Some of these initiatives are of long standing but others have arisen as a response to the events of 2007/8. Many business leaders have expressed concern about the collapse of public confidence and trust in business, especially financial services business. The initiatives examined in this paper attempt to address these issues by opening dialogues between stakeholders and by issuing statements of principles for business managers.

In this paper we analyse each of these initiatives, identifying a number of common themes. These initiatives come from different traditions and perspectives and express themselves in different ways but their statements of principles cover a good deal of common ground. They each seek to change attitudes and behaviours among business leaders in particular ways. Notably, they develop the concept of the 'Common Good', with the implicit challenge to the idea that the sole purpose of business is to increase 'Shareholder Value'.

Although the principles outlined in these initiatives appear to have wide acceptance, our analysis suggests that there are institutional constraints that will deter managers from adopting and adhering to the principles. These constraints arise from the form of the limited liability company, the relationship between capital and labour, and the legal relationship between employer and employee. We examine alternative proposals for the structure of the business corporation and for its relationship with the individual worker. Also, the current concept of a 'Free Market' is an impediment to the adoption of the idea of the 'Common Good' and the objective of reconnecting business with society. The initiatives are therefore implicitly challenging a fundamental concept that has shaped ideas about the functioning of business over the last 30 years.

Introduction

The responsibilities of the corporate executive were, it seems now, much more straightforward before the events which began to unfold in 2007. As Milton Friedman (1970) taught us, the social responsibility of business is to increase its profits; the corporate executive is an employee of the owners of the business and has a responsibility to conduct the business in accordance with their desires which generally will be to make as much money as possible, within the rules of law and ethical custom[1]. According to Friedman, therefore, the purpose of a business is to maximise its profits. He adds that *the doctrine of "social responsibility" involves the acceptance of the socialist view that political mechanisms, not market mechanisms, are the appropriate way to determine the allocation of scarce resources to alternative uses.* The Friedman doctrine of maximising profit has been subsequently developed into the broader concept of maximising shareholder value, recognising that there are other ways in which the corporate executive can serve the interests of shareholders.

[1] Friedman's reference to ethical custom suggests that his views were much more nuanced than he is generally given credit for. But his advocacy of the view that the purpose of business is to maximise profits is clear and has been generally followed; and his condemnation of what he refers to as the doctrine of "social responsibility" is unequivocal.

Within this view of the purpose of business, companies should only undertake initiatives under the heading of corporate social responsibility (CSR) if there is a business case, i.e. if they lead to an increase in shareholder value. Alternatively, if doubt exists about the positive role of CSR in profit-making, it can be seen as an important insurance strategy to minimise risks from negative government intervention, adverse media coverage and consumer or stockholder backlash to corporate behaviour (Broomhill, 2007)[2].

However, the Financial Crisis of 2007/8 and the subsequent Great Recession have led to some serious questioning of the above principles. A huge volume of books and articles have been written, analysing the causes of the crisis and the recession and making recommendations for business leaders, politicians and others. A large number of initiatives have been started to engage interested parties in a debate about what needs to be done to address the so-called crisis of capitalism (as the Financial Times termed it in a series of articles in January 2012). Many business leaders have expressed concern, in particular, about the collapse of public confidence and trust in business.

Inevitably the banks have been subject to the most criticism for their behaviour leading up to the crisis and, indeed, beyond. As Antony Jenkins, CEO of Barclays, observed, there are some who believe the current storms will blow over, that regulatory pressures and demands for changes in behaviour will melt away. Jenkins thinks, however, that this is not a cyclical shift that we are witnessing but a permanent, fundamental, change (Daily Telegraph, 9 February 2013).

One common theme among the many words that have been written and spoken on this topic in recent years is a call for a reappraisal of the purpose of business, its ethics and values and its relationship to society in general. The purpose of this working paper is to review the various writings and initiatives that fall under this general heading. Our aim is to identify common ground among the initiatives, areas where there is agreement, and where there are differences and potential gaps; and also to identify issues that need to be addressed in implementing new ideas.

The structure of this paper is as follows. We begin with the question of business purpose: what is a company for? We then move on to review a number of initiatives that address that question more widely and in the context of the ethics and values that should underpin business activity and the need to reconnect business with the wider society in which it operates. We then address some consequential institutional issues: the form of the corporation and the legal relationship between the corporation and the individual worker. We review proposals for alternative organisational forms and consider the question of how these organisations might be financed in the absence of shareholder owners. We then examine the idea of the 'common good' in the context of the concept of the 'free market'. We conclude with a summary of the issues that the initiatives raise.

What is a company for?

Well before the events of 2007, Charles Handy (1990) raised this question, challenging the Friedman doctrine. The principal purpose of a company, he said, is not to make a profit – full stop. It is to make a profit in order to do things or make things, and to do so even better or more abundantly. Profit is a means to other ends and not an end in itself.

Handy's lecture led to an inquiry and to a report published in 1995 "Tomorrow's company: the role of business in a changing world". Among its recommendations was: *the job of leaders is to create clear purpose and values and strong relationships with shareholders,*

[2] There are of course other views of CSR which Broomhill outlines, but it is fair to say that the neoliberal view has been dominant in the last 30 years, at least in the UK and US.

employees, communities, suppliers and customers. Following this report, the organisation "Tomorrow's Company" was born. It now describes itself as *a London based global think tank delivering value for business leaders and owners by addressing the systemic and behavioural questions of the business world.* Tomorrow's Company counts among its achievements the definition of the inclusive duties of directors for the UK's Companies Act 2006, its work on financial markets which informed the creation of the UN Principles for Responsible Investment and its contribution to the heart of the UK Stewardship Code and of the integrated reporting movement. Stewardship is defined by Tomorrow's Company as *the process through which shareholders, directors and others seek to influence companies in the direction of long-term, sustainable, performance that derives from contributing to human progress and the well-being of the environment and society.* Shareholders have a stewardship role alongside that of directors in protecting the long-term health of the company and promoting the long-term value of the investment.

Other initiatives also preceded the financial crisis. For example, The Caux Round Table was founded in 1986 as a means of reducing trade tensions. Subsequently it began focussing attention on the importance of global corporate responsibility in reducing social and economic threats to world peace and stability. Today, it describes itself as an international network of principled business leaders working to promote moral capitalism. Caux Round Table has drawn up a set of seven Principles of Responsible Business, including *respect stakeholders beyond shareholders.*

The seminal work on stakeholder theory is generally regarded as that of Edward Freeman (1984). It is interesting however that Handy, in his lecture of 1990, said that he did not see the stakeholder concept as providing a sensible answer to the question 'what is a company for?' Handy saw the company as operating in bounded space, surrounded by competing pressures from financiers, employees, customers, suppliers, the environment and the community. Companies will try to manage competing pressures but inevitably, one or other of the stakeholders has priority and, given our current system, it is going to be the shareholder. Handy had a much more radical proposal which involved a different structure for business, abandoning the concept of the ownership of a business and limiting the powers of the shareholders. We return to this below.

Developing business purpose, with ethics and values, and reconnecting with society

Since the advent of the financial crisis a number of new initiatives have emerged variously addressing the purpose of business, its ethics and values and its relationship with society. Notable among them are (not in any particular order):

- A Blueprint for Better Business: Uniting corporate purpose and personal values to serve society
- The Spiritual Capital Foundation: Bringing the whole person to work
- The Lord Mayor of London's Conference on Trust and Values: Reconnecting the robust search for profit and financial incentives that is core to a free market economy with the moral values that are its foundation
- St Paul's Institute: Engaging the financial world with questions of morality and ethics
- Havard Business School's MBA Oath: Responsible value creation
- Corporation 20/20: Designing for social purpose
- Henry Jackson Initiative for Inclusive Capitalism: Improving the ethics of the business world
- World Economic Forum Global Agenda Council on Values: A New Social Covenant

These initiatives have opened a dialogue between business leaders and other communities to address the issues of concern about the way that the capitalist system is currently functioning. Particular among those concerns is the apparent or perceived lack of moral and ethical principles guiding some business behaviour in recent decades. Common themes among the initiatives, explicit or implicit, are the need to *restore* or *rediscover* business purpose and the moral and ethical principles underpinning business behaviour; to *restore* or *rebuild* trust in business among the public; and to *reconnect* business with society.

Most of these initiatives are on-going. Some have issued statements of principles to guide decision making and business behaviour. Three particular themes emerge from a comparison of these statements. The first concerns business purpose and what is referred to in a number of initiatives as 'the common good'. The second relates to the individual and to human dignity. The third refers to the need to have regard to future generations. The following quotations from each of these initiatives serve to illustrate these themes:

Business Purpose and the Common Good
- The purpose of the corporation is to harness private interests to serve the public interest
- Aim for a better pie, rather than a bigger share
- Identify and communicate a higher purpose and value
- Do not advance personal interests at the expense of your enterprise or society

The individual and human dignity
- Each person is a someone, not a something
- Allow people to develop
- Every human being is multi-faceted, complex and unique
- Protect human rights and dignity of all people
- Corporations shall distribute their wealth equitably among those who contribute to its creation

Future generations
- Protect the right of future generations to advance their standard of living and enjoy a healthy planet
- Acknowledge and seek to measure the impact the business has on people, values, resources and the environment
- We all have a responsibility to leave the world a better place than we found it
- Corporations shall operate sustainably, meeting the needs of the present generation without compromising the ability of future generations to meet their needs

The statements of the various initiatives reflect a great deal of common ground. The initiatives also share some common ground with the ten principles of the United Nations Global Compact, which refers to the protection of human rights and the rights of labour.

These initiatives may come from different traditions and perspectives and express themselves in different ways but they reflect a wide agreement on the principles under which business should operate. They each seek to change attitudes and behaviours among business leaders. They do not, at least at the moment, seek to change the institutions of capitalism, for example the structure of the company and the legal relationship between company and employee.

Other contributors to the debate do raise institutional issues. As mentioned above, Handy (1990) saw a limitation to the stakeholder concept if we continue with the shareholder owned corporation. He described the concept of limited liability as a piece of Victorian invention and he thought that we are today 'victims of our ancestors creativeness'.

Another key legacy of the Victorian era is the concept of an employment as a master-servant relationship, which is deeply embedded in English employment law. The company is the master and the employee is the servant. Closely related to this is the economic concept of a labour market, a market in which people sell their time and expertise. Labour is a commodity to be bought and sold. In traditional neoclassical economic theory, the corporation combines capital and labour to produce outputs. But capital and labour are regarded in fundamentally different ways in a shareholder owned company. Profit, the return to capital, is to be maximised. Labour is a cost, to be minimised. This sets up the perennial conflict between capital and labour in the Anglo-Saxon economy.

These Victorian legacies sit uneasily with the principles outlined above about the dignity of the person, and this is illustrated in the current debate in the UK about the increasing use by companies of zero-hours contracts. We therefore turn to consider these institutional issues and outline proposals that have been made to address them.

The institution of the corporation and its relationship with the individual worker

In his 1990 lecture, Handy questioned the concept of a company as being owned by shareholders and he noted the extent to which companies in the UK and US are bought and sold. He saw a company as a community of people and as such he argued that it should not be bought and sold. Also, communities have members not employees; or rather if they have employees they are people outside the community not inside. He contrasted the Anglo-American tradition unfavourably with the German and Japanese traditions where businesses are thought of more as communities than properties. Handy said that we can try to operate within existing rules and exhort managers to work as if they were part of a community, paying proper heed to the various stakeholders. But his feeling was that managers would forever be looking over their shoulders. He argued that we need a wholesale review of the governance of our companies and that asking managers to work despite the rules was unfair. His call has been heeded to some degree and a great deal of change has taken place since 1990, developing for example the concept of stewardship (as defined above by Tomorrow's Company), but we still retain the underlying institutions of the corporation and its legal relationship with the employee. Is this a limiting factor? To what extent can the ethical principles outlined above be effective in changing behaviour if managers still have to work within the constraints of existing institutional structures?

Schweickart (2009) provides a more recent contribution to this debate. He begins by asking whether capitalism can be sustainable in its current form. He identifies a key weakness in current capitalism, namely its need to grow continuously to remain healthy. This arises because a capitalist economy relies upon private investors for its investment funds; and if investors do not foresee a healthy return on their investments, commensurate with the risks they are taking, then they will not invest. When GDP falls, investment falls. For GDP to rise there needs to be a steady expansion of consumption. But the problem is not simply the need for growth, not simply the need for ever-increasing consumption, but the need for a steady *rate* of growth, which implies *exponential* growth. If an economy grows at 3% each year, consumption doubles every 24 years. On a finite planet this is problematic. To this Schweickart adds the evidence that increased consumption, beyond a certain point, does not increase human happiness (or what we might more generally refer to as human wellbeing).

Schweickart then considers alternative structures that could be economically viable, not dependent on growth for stability but at the same time conducive to entrepreneurial innovation. In this alternative conception, the competitive market place remains but both the workplace and the financial system are 'democratized'.

In his democratized workplace, Schweickart follows Handy in regarding businesses as communities and not legal entities that can be bought and sold. Managers are appointed by a council, democratically elected by the workforce. Workers do not receive wages but a specified share of the firm's profit. All workers therefore have a stake in the firm's success (cf. Handy's concept of members not employees). Schweickart further argues that this structure has an important difference from the current model: the present corporation aims at maximising total profits whereas this new form will aim (roughly) at maximising profit-per-worker. Whereas the traditional corporation needs to expand, this new form does not. An economy of democratized businesses does not rely on a steady rate of (exponential) growth. And labour is no longer a cost to be minimised, fundamentally changing incentives in the workplace, and indeed, relationships between managers and workers. Workers are no longer servants.

Structures along these lines do exist in the UK, notably the John Lewis Partnership and Baxendale Ownership (formerly the Baxi Partnership), which is now in the business of promoting employee ownership. But they are rare. In January 2010, a minister in the UK government commissioned a study into ownership structures. This reported in March 2012 under the title *The Ownership Commission: Plurality, Stewardship and Engagement.* This report noted that the private sector in the UK is dominated by one institutional form, the PLC; but while this form has advantages that should be celebrated, it has disadvantages, notably its tendency to short-termism. The report advocated greater plurality of ownership structures in the economy. Thus, the issue of institutional structure is not a question about which form should dominate: there is a place for different forms. In addition to the employee owned company, the UK has a tradition of the mutual company, owned by customers. This was very common until relatively recently in the financial sector, in the form of building societies and insurance companies. Also, there is a not-for-profit sector and a social enterprise movement where businesses are not shareholder owned and where financial surpluses are recycled to meet social purposes. There is scope for this sector to expand, especially in areas where shareholder owned companies rarely engage and invest.

Marjorie Kelly (2012), co-founder of Corporation 20/20, argues that *the multiplying crises we face today are entwined at their root with the particular form of ownership that dominates the world – the publicly traded corporation* ... *Ownership is the gravitational field that holds our economy in its orbit, locking us all into behaviours that lead to financial excess and ecological overshoot.* Kelly distinguishes between 'extractive ownership' which is about maximising physical and financial extraction (e.g. fossil fuels and short-term profits) and 'generative ownership', which is about creating and preserving real wealth in the long term. For Kelly therefore, developing alternative forms of ownership are key to long term sustainability.

Any new form of corporate structure has to address the question of how it is financed, in the absence of shareholder owners. There are other models. Handy (1990) noted that in Japan shareholders are effectively preference debenture holders, paid a dividend related to the par value of the share. Germany has a different model, with regional banks having a strong relationship with their customer companies. Schweickart offers a new model of democratized capital, but it is not well developed. These examples suggest however that there could alternatives to the current institutional structure of corporate finance.

Any new model of finance needs to address the weaknesses of the current system. These weaknesses are identified in a number of studies, for example, by John Kay in his report to the UK government published in July 2012. Kay identifies short-termism in UK equity markets, the principal causes being the decline of trust and the misalignment of incentives. The chain of intermediation between the ultimate owner of the investment funds and the company in which those funds are invested is, in Kay's opinion, excessively long and there is far too much trading. The current system prioritises transactions over trusting relationships. Kay says that t*rust and confidence are the product of long-term commercial and personal relationships: trust and confidence are not generally created by trading between anonymous agents attempting to make short term gains at each other's expense.*

It is possible, if Kay's recommendations (which include improving stewardship) are adopted, that the system will improve but the question will remain whether the current form of 'equity' investment is the most appropriate one for the future, or at least whether some alternative mechanisms could, and should, be developed. John Kay has, subsequent to his report, expressed concern that little progress has been made, particularly on his call for a simpler financial system and a fund management industry more focused on investing for the long term. Kay is now writing a book on what the ideal financial services system might look like (Financial Times, 9 June 2013).

The UK and the US are heavily dependent on their respective financial services industries. The commitment to the current institutions means that there is likely to be considerable resistance to fundamental change. The recent crisis provides the opportunity for reform, but with the passage of time that opportunity could (and may already) be lost.

In this section we have examined the institution of the corporation and its relationship with the individual worker and with the equity investor. We note that these institutional issues could act as a barrier to the adoption of the principles outlined by the various initiatives referred to above. There is however another issue that these initiatives will face in promoting their idea of the 'common good' which implicitly challenges the current concept of a 'free market' a market free of government and also separate from society. We now turn to examine this issue.

The so-called 'free market': another Victorian invention

The idea, widely supported in the political economy of Anglo-American capitalism today, is that a 'free market' is an efficient, stable, self-correcting institution that optimises human welfare. The argument continues that any attempt to regulate a free market by government is therefore inappropriate. Likewise, as we saw with Friedman's comment above about what he refers to as 'the doctrine of social responsibility', directing business for social purposes is also inappropriate; effectively this suggests that markets should not only be free of government regulation but also free of social control. In this view of the world, individuals and corporations should be free to trade unimpeded by external control. Free markets are regarded as the natural state of affairs.

Gray (1998) argues, however, that the concept of a free market is an artificial creation. Gray says that *mid-nineteenth century England was the subject of a far-reaching experiment in social engineering. Its objective was to free economic life from social and political control and it did so by constructing a new institution, the free market, and by breaking up more socially rooted markets that had existed in England for centuries. ... The rupture of England's economic life produced by the creation of the free market has been called the Great Transformation (Polanyi, 1944).* Maucourant & Plociniczak (2013) agree that Polanyi's analysis of the economy as an institutionalised process reveals that the market is neither a natural nor a spontaneous phenomenon – a conclusion that runs counter to conventional economic thinking.

Gray continues by arguing that the achievement of a similar transformation is the overriding objective today of transnational organisations such as the World Trade Organisation, the International Monetary Fund and the Organisation for Economic Cooperation and Development. Gray describes this process as a utopian dream that can never be realised. In a very prescient comment for 1998, he said that today's regime of global *laissez-faire* will be briefer than the *belle epoque* of 1870 to 1914.

A number of initiatives, summarised above, now seek to *reconnect* business with society, and therefore to reverse the process of recent decades that has created the separation. Business needs to be under social control, guided by the ethics and values of managers who are members of the society in which the business operates. Arguably, the natural order is of business activity intimately connected with the society in which it takes place. The idea of an economic system divorced from society (and the state) is artificial.

The role of government is of course another issue, and not considered in detail here. It suffices to say that the idea of a market being free of government is unrealistic. Among other things, government underwrites the operation of the market by guaranteeing property rights, by enforcing contracts, by prosecuting fraud and not least by providing the legal framework for creating and managing a company with limited liability (Slattery & Nellis, 2011). It is interesting to note also that in two recent reports (Cox, 2013 and UN Global Compact-Accenture Study on Sustainability, 2013) a large majority of CEOs interviewed called for greater government action to deal with perceived problems.

It must be stressed, however, that those who challenge the notion of a free market are not questioning the validity of the competitive market itself; nor are they suggesting that the market mechanism should be replaced by socialist political mechanisms. The challenge is to the idea that the market can somehow exist in isolation from the state and society in general. But those who propose that managers of businesses should have regard to the common good, and that business should reconnect with society, will need to overcome some fairly well established views about how businesses and markets operate.

Conclusion

In this working paper we have summarised a number of contributions to the debate about the purpose of business and the ethics and values that should underpin business behaviour. There is a widely held view that change is required to restore public trust in business and to reconnect it with society. There is a good deal of common ground about the nature of the values and behaviours that are now required in business leaders and managers. Similarly, there is agreement about some key concepts, such as stewardship, that need to become embedded in business and the investment chain.

Some contributors go further and argue for more systemic change in, for example, the structure of the corporation and the nature of the relationship between the corporation and the individual worker. The argument is that current structures will act as an impediment to the adoption of new business principles, to acceptance of the concept of the common good and to the objective of reconnecting business with society. Also, the prevailing concept of a free market will be a barrier to change.

The initiatives reviewed in this paper make a substantial contribution to the debate about the future direction of the capitalist system, but much remains to be done to embed the proposed principles in the system.

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