The Economist

Working for a Purpose

An academic calls for an overhaul of the conventional company

The modern company has morphed into a "money monster" enslaved to the doctrine of shareholder value. That is the thesis of a new book* by Colin Mayer, a professor at the Saïd Business School in Oxford. It is the latest challenge to the principle enunciated by Milton Friedman, an economist: namely, that "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." An influential paper** by Oliver Hart and Luigi Zingales last year argued that profitability is not the only criterion that should apply and that shareholders' welfare is affected by a broad range of factors, including social and environmental conditions.

Mr Mayer takes a similar line, arguing that companies have relationships with many more people than just shareholders. As well as financial capital, they use several other types—human, intellectual, material (buildings and machinery), natural (the environment) and social (public goods like infrastructure).

He also notes that the original conception of a firm was quite different from now. The *societas publicanorum* were Roman bodies that performed public functions such as tax-collecting or maintaining buildings. They raised finance from shareholders and their shares were traded. The medieval idea of a company revolved around a family business. The founders were people who took bread together (hence the term *cum panis*). In the early-modern era, firms such as the Dutch and English East India Companies` were set up in order to pursue national trade objectives.

This mix of family and state-linked businesses still exists in many developing nations. The countries with a really narrow focus on shareholder value are America and Britain, and this is where Mr Mayer concentrates his criticism.

Mr Mayer thinks that companies should find a purpose that is broader than the amassing of profits. They should be “doing well by doing good”. With that principle in place, the law should then require firms to demonstrate how their governance, leadership and incentives are organised so that purpose can be realised. Financial accounts should be redrawn to reflect the company’s effect on human, social and natural capital, as well as its financial performance. He also proposes (along with other proponents of “long-term” capitalism) that interest payments on debt should no longer be tax-deductible and that the voting rights of shareholders should reflect the length of time that they have owned their certificates.

Mr Mayer’s riposte to the charge that his ideas are overly idealistic is that the current system is simply not working according to conventional measures of economic success. Britain has a corporate model that is very friendly to investors, with dispersed share ownership, an active takeover market and strong creditor rights. The result, he posits, has been a poor national record on investment, productivity and innovation.

He also notes that firms which pursue approaches that come under the heading of “sustainability” or “social responsibility” enjoy higher returns, lower risks and lower costs of capital. (A recent paper by Robert Eccles, Ioannis Ioannou and George Serafeim showed as much.***)

Yet this line of reasoning also raises some objections to the author’s broad thesis. If sustainability is profitable, then shareholders should push more companies in that direction without the need for an overhaul of the current system.

And the change of financial accounting that Mr Mayer recommends would create all sorts of headaches. Social and environmental costs would be tricky to calculate. Financial profits form the basis for corporate taxation and for the distribution of dividends. It is hard to see a new, lower figure being used for tax purposes (government receipts would fall) or dividend calculation (cash would pile up on companies’ balance-sheets). So the main use of the number would be as a benchmark for incentive plans. And that would give scope to senior executives to game the new measure. Mr Mayer’s prescriptions may be laudably virtuous overall, but there would be lots of devils in the details.

* “Prosperity: Better Business Makes the Greater Good”, Oxford University Press

** “Companies Should Maximise Shareholder Welfare Not Market Value”,*Journal of Law, Finance and Accounting* 2017

*** “The Impact of Corporate Sustainability on Organisational Processes and Performance”, *Management Science*, Vol 60, No 11