The Future of the Corporation and the Economics of Purpose

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Abstract

This article examines the economic underpinnings of the concept of corporate purpose, which has gained increasing attention from business academics, practitioners and policymakers. It argues that there are fundamental reasons for reconceptualizing the purpose of business in the future which derive from the changing nature of business and the market failures to which it gives rise. It suggests that regulation is proving increasingly inadequate at correcting market failures, and the traditional separation between economic efficiency and distribution that underpins policy formulation is untenable. Instead, the article sets out how appropriately defined notions of corporate purpose can help to promote not only better social outcomes but also enhanced functioning of firms and markets. It describes a set of principles that provide a comprehensive framework for reforming business around credible commitments to corporate purpose. The reformulation of the corporation has profound implications for the macromechanic performance of economies as well as the microeconomics of firms and markets.

Keywords: Purpose, efficiency, distribution, market failures, regulation, macroeconomics

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Abstract

This article examines the economic underpinnings of the concept of corporate purpose, which has gained increasing attention from business academics, practitioners and policymakers. It argues that there are fundamental reasons for reconceptualizing the purpose of business in the future which derive from the changing nature of business and the market failures to which it gives rise. It suggests that regulation is proving increasingly inadequate at correcting market failures, and the traditional separation between economic efficiency and distribution that underpins policy formulation is untenable. Instead, the article sets out how appropriately defined notions of corporate purpose can help to promote not only better social outcomes but also enhanced functioning of firms and markets. It describes a set of principles that provide a comprehensive framework for reforming business around credible commitments to corporate purpose. The reformulation of the corporation has profound implications for the macroeconomic performance of economies as well as the microeconomics of firms and markets.

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1. Introduction

The last few years have seen an intensified debate around the future of the corporation. Underpinning this is a growing concern around three sets of issues – rising environmental degradation, inequality and mistrust in business. This has been exacerbated by the recent experience of the coronavirus pandemic and prompted a reconsideration of both the nature of our capitalist system and the role of business in it.

Business and policymakers have responded to this growing concern by seeking reforms to existing models that encourage a greater degree of ethical business practice and stronger enforcement of the rules of the game. In this article, I argue that these reforms are insufficient on their own. Instead, in considering the future of the corporation, we should start from a more fundamental question about why business exists and is created, what it does and aspires to become, namely its purpose, and then consider the resulting changes to business practice, policy, education and research that are required to deliver it.

There is a growing realization of the fundamental nature of business purpose. In a matter of just 18 months from the beginning of 2019, many of the largest corporations have discarded the conventional Milton Friedman (1962; 1970) doctrine that there is one and only social purpose of business to increase profits so long as it stays within the rules of the game in favour of a view that corporate purpose should reflect the interests of stakeholders as well as shareholders (see Business Roundtable, 2019, and Freeman, 1983 for a discussion of stakeholder theories). This has provoked a mixture of admiration, cynicism, scepticism and opposition (Council of Institutional Investors, 2019).

In particular, Bebchuk and Tallarita (2020) have recently critiqued stakeholder theories on the grounds that they are either irrelevant or impractical. Their irrelevance stems from an “instrumental” interpretation of stakeholder theories that they are part of a “win-win” in which promoting stakeholder interests contributes to the success of the company for the benefit of all of its parties, including its shareholders. In other words, stakeholder theories are just a form of “enlightened” shareholder capitalism in which a recognition of the importance of stakeholders is beneficial for shareholders as well as for stakeholders. There is therefore no inconsistency between stakeholder theory and shareholder primacy.

The impracticality of stakeholder theories comes when one goes beyond this and suggests a “pluralistic” approach in which the interests of stakeholders should be furthered in their own right, potentially at the expense of shareholders. Bebchuk and Tallarita argue that this creates impossible trade-offs for companies in trying to balance, for example, the interests of employees against customers in raising the wages paid to the former and the prices charged to the latter, current versus future employees in purchasing new equipment that benefits the latter at the expense of the former, and societies that suffer environmental harm from productive activities that create new jobs for employees.

Milton Friedman in addition asserted that companies have no legitimate basis on which to make such trade-offs because they are not elected or empowered to do so. Instead, underlying the Friedman assertion is an economic concept of the economic efficiency of
companies maximizing profits and governments setting the rules of the game within which companies pursue this goal. It underpins the liberal economics position regarding free markets, competition, privatisation, deregulation, taxation and public expenditure and it is the basis of the so-called Washington Consensus (Williamson, 2003).

This paper argues that the stakeholder-shareholder debate is vacuous and misses the point. It is the wrong framing of the question. We need to start by defining what we are trying to achieve. Once we have clarity on that then the contribution of different parties to the firm and the basis on which their interests should be determined and traded-off becomes evident. In particular, the separation between business on the one hand as being solely concerned with financial performance and the state with broader matters of social welfare emerges as fundamentally flawed. It cannot be justified from either a position of political legitimacy and accountability, or a view about the inefficiency of conflating the objectives of companies. The efficient functioning of markets requires that the business of business is not just business and the governance of business is the business of government.

2. Purpose

In critiquing traditional views of the firm, Ghoshal, Bartlett and Moran (1999) argue that efficiency focused management engage in a zero-sum game of value appropriation and static efficiency in which profits come at the expense of employees and wider society. In contrast, they promote collective action coordinated by companies’ purposes, which they see as a source for value creation, both for corporations and for society as a whole, and the starting point of a new moral contract between them. Ghoshal wrote extensively about the importance of purpose in recognising companies’ moral responses to their broadly defined responsibilities as against solely pursuing commercial opportunities (Bartlett and Ghoshal, 1994). He was highly critical of management scholarship for its “pessimistic view of human nature” and the potential for developing purposeful, goal oriented behavioural theories of the firm (Ghoshal, 2005).

Henderson & Van den Steen (2015) consider purpose as “a concrete goal or objective for the firm that reaches beyond profit maximisation”. Purpose is the reason for being, “not what you do, but who you are” (Leider, 1998), and the reason for the organisation to come together as the intersection point between ‘hard’ elements such as vision, strategy and operational priorities (Mourkogiannis, 2008), which drive performance, and the ‘soft’ elements such as brand, values and culture, which work to create a distinctive organisational climate (Ready and Truelove, 2011).

Inspiring though these notions of purpose may be, they lack precision. Purpose should be neither mundane nor aspirational. It is not purely descriptive of what a business does – a mission statement - nor unrealistic about what it seeks to do – an aspirational vision statement to save the world. It is about solving problems, “to produce profitable solutions to the problems of people and planet” and “not to profit from producing problems for people or planet” (British Academy, 2018; Mayer, 2018).

Purpose is therefore about finding ways of solving problems profitably where profits are defined net of the costs of avoiding and remedying problems. By defining purpose and
profits in this way, purpose is associated with enhancing the wellbeing and prosperity of shareholders, society and the natural world. It does not disadvantage any party because profits are only legitimate if they are not earned at the expense of other parties and corporate purposes are only valid if they are profitable in this sense.

Any purposes that satisfy these two conditions are therefore beneficial. They can vary from those that deliver maximum profits for shareholders, since profits are not earned at the expense of others, to those that deliver maximum benefits for other parties and minimal returns for shareholders. In Bebchuk and Tallarita’s (2020) terms, purposes can support both instrumental stakeholder concepts that correspond with shareholder primacy and stakeholder plurality where parties other than shareholders are the primary beneficiaries. In neither case, does any party benefit at the expense of another and therefore the complex tradeoffs that concerned Bebchuk and Tallarita about stakeholder plurality do not arise.

A purpose is precise about what problems it is seeking to solve, whose problems, how it will solve them, when and why the company in question is particularly well suited to solving those problems. This can be illustrated with a specific example. It comes from the pharmaceutical industry. It is the Danish company, Novo Nordisk, which manufactures insulin that is used in the treatment of Type 2 diabetes (Jackson and Ouarzazi, 2020)). A few years ago, Novo Nordisk recognized that its purpose was not simply to produce insulin. Its purpose was to help people treat Type 2 diabetes, which might involve them taking insulin, but might not. So, it started working with doctors, hospitals and universities around the world to identify the best treatments for diabetes in different circumstances and locations. Then it appreciated that its purpose was not even to treat Type 2 diabetes but to help people to avoid getting diabetes. So, it partnered with health workers, local communities and national governments to identify the changes in lifestyle in different parts of the world that would help people avoid diabetes.

You might think that this is all very noble and worthy, but does it not undermine Novo Nordisk’s business model? The answer is no; it did exactly the opposite. Novo Nordisk has flourished on the back of it. This is because in the process of committing to this corporate purpose it has become a trusted supplier of health products and advice. The Novo Nordisk example illustrates two important points. The first is the significance of having clarity about a company’s purpose. The second is the reason why a commitment to it is potentially beneficial for the company as well as the parties who benefit from it.

Where both these conditions prevail then companies enjoy the trust of others which manifests itself in the form of greater loyalty on the part of customers, more engaged employees, more reliable suppliers and more supportive societies and shareholders. These in turn generate greater revenue, lower costs and more profits. But they only occur where there is sufficient clarity about corporate purposes and demonstrably credible commitments to fulfilling them. In Novo Nordisk’s case the trust did not derive from a purpose to produce profits but from an intrinsic purpose to eradicate type 2 diabetes and a clear commitment to achieve it by building extensive global partnerships.
How in practice do companies bring clarity and commitment to their purposes? It is here that the interrelation between business and government is critical and the business of business is governance and the governance of business is the business of government.

3. Governance

Let's stay with pharmaceuticals to illustrate the point. One of the most complex areas of public policy has been the pricing of pharmaceuticals. It reflects a classic public good problem. The upfront fixed costs of pharmaceutical research and development are astronomical but in comparison the marginal costs of supplying drugs are minimal. The optimal price of drugs is close to zero but pricing at marginal cost then yields no returns on the initial investments, implying that they will not be made in the first place. The favoured resolution of this problem is to confer a patent on a company for a particular period of time during which producers earn monopoly rents. However, the resolution of the investment problem comes at the expense of patients, insurers and national governments in private and public health systems, in some cases rendering them unaffordable during the patent period. Indeed, Novo Nordisk has recently come in for criticism for the pricing of its insulin products (Ewen et al, 2019; Herkert et al, 2019; Ramsey, 2016).

Pharmaceuticals are illustrative of what is becoming an increasingly pervasive public good problem. Social media, news, entertainment, and communication involve large upfront expenditures and very low marginal costs of supply. While it is in general possible to exclude customers and therefore set prices above marginal costs, it is undesirable and often, for example, in social media, detrimental to do so because of the network benefits of promoting customer interactions. As a result, other methods are employed to establish viable business models, using for example, advertising and resale of customer data instead of direct charging. However, these raise problems of their own, not least in terms of unauthorized use of personal data.

Public good problems are particularly closely associated with utilities and infrastructure provision. The response has been the imposition of either public ownership or private ownership with regulation. Public ownership had a bad press after its failures in western economies in the 1970s and the fall of the Soviet Union in the 1990s. It gave way to a wave of privatisation around the world (Bishop, Kay and Mayer, 1994). However, the performance of privatisation and regulation has increasingly come under scrutiny as their record in regard to financial systems, public private partnerships, private finance initiatives, infrastructure provision and utilities has come been viewed as at best mixed (Estrin and Pelletier, 2015; Palcic and Reeves, 2019).

There are good reasons for this growing disillusionment. The first is that regulators are inevitably less well informed than the companies they are regulating. This allows companies to circumvent regulations and turn them to their competitive advantage by using them as barriers to entry to new firms entering their markets. These problems have intensified as technology has accelerated leaving regulation increasingly far behind corporate innovations (Birkinshaw, 2018; Hamdani, Hashai, Kandel and Yafeh, 2018). Second, the composition of company assets has become more intangible in the form of brands, reputation and knowledge (Haskel and Westlake, 2017). This has made the traditional tools of economic
regulation based on valuations of physical assets and investments in plants, buildings and machinery progressively more unreliable and irrelevant. Third, companies’ impact and dependence on their supply chains, societies, environment and natural assets have increased. In response, the scope of regulation has had to broaden beyond its traditional focus on consumer protection to incorporate human, social and environmental concerns, for which traditional tools of economic regulation are ill-equipped. Finally, economies of scale associated with such company products as social networks, communications, data and information have grown to global proportions. This has rendered nationally based regulatory systems ill-suited to cope with the markets they are regulating (Armour, Enriques, Ezrachi and Vella, 2018).

There is therefore a void between market efficiency and regulatory effectiveness, which is increasingly becoming a chasm as technology accelerates, assets become more intangible, corporations affect wider segments of society and the natural world, and economies of scale grow to global proportions. As a consequence, governments and regulation are proving to be increasingly incapable of rectifying the growing market failures they confront. But so too is business – at least as it is currently conceived.

4. Ownership

One of the reasons for business’s failure to tackle market failures is the way in which we conceive of its ownership. The legitimacy of ownership derives from an analogy between the ownership of firms and personal property (Mayer, 2020). Shareholders invest in companies in a similar fashion to the way in which they purchase cars, washing machines and their homes. Since they fund company investments, they have property rights over them just as they have over their personal assets. These rights include appointment and removal rights of directors of firms, approval rights over major transactions, and rights to propose resolutions at shareholder meetings.

However, even if the analogy was ever appropriate - and it is doubtful whether it was - it is increasingly not so. First, while physical assets funded by shareholders play an important role in manufacturing firms, they do so to a steadily diminishing extent as companies depend increasingly on human, intellectual and social assets, as exemplified by food and beverage companies, high technology and social media firms. These assets typically lie outside the legal boundaries of firms and are not financed by investors. Second, as the dependence of firms on external parties intensifies so too does their impact on them. The impact of firms on their supply chains (for example, Amazon and Uber), societies (for example, Facebook and Google), and environments (for example, airlines and energy companies) has grown markedly.

These developments are turning the traditional notion of legitimacy of corporate ownership on its head. Far from being a right that derives from shareholders investments in their companies, it is an obligation and responsibility to respect and uphold the interest of external parties on which they depend and impact.

This reconsideration of the legitimacy of ownership not only has profound moral implications for rights and responsibilities of investors but also for the functioning of
markets. It means that in the absence of the obligations and responsibilities as well as rights of ownership, competition intensifies not alleviates market failures by exacerbating the costs it imposes on other parties. At one level this is just a traditional association of market failures with externalities. But it is more than that because it suggests that the existence of those market failures is a reflection of a failure to identify the nature of ownership. In other words, externalities are not, as they are currently regarded, extraneous given facts of life which it is the responsibility of governments to solve. They are inherent features of the form in which the ownership of firms is defined. It so happens that we have defined ownership in such a way that it places many, and increasingly most, of the consequences of firms outside the legal boundaries of the firm; but there is no reason why that should necessarily be so.

Ownership is conventionally viewed as a right to exclude. It imposes boundaries around property that confers rights on their possessors to exclude others from access to it. That might be justified in regard to personal assets where the impact on others of their “responsible” use is modest. However, that is not the case for most corporate entities. Even a corner shop can have a substantial impact on its local community and that is orders of magnitude truer of a national, let alone a multinational, corporation. The scale of responsibilities of owners of businesses is far greater than that of personal property.

At present, corporate ownership does not seek to define those responsibilities. On the contrary, it draws the limitations on those responsibilities at the same point as the rights of ownership, namely in relation to the legal boundaries of the firm. We have therefore by construct not by necessity made much and increasingly more of the activity of the firm external to it. That has been the source of the growing extent of market failures and our inability to rectify them.

But before suggesting a remedy to this problem, it should also be understood that this has not only imposed intolerable and increasingly unsustainable burdens on individuals, societies and the natural world, it has also led to substantial underperformance of firms. This is because it has not only resulted in the failure of business to internalize what are currently regarded as externalities, it has also prevented firms from committing to respect the interests of parties on which they increasingly depend. As firms become progressively organizations that do not own but coordinate human, social and natural assets, they increasingly need to forge partnerships with these other parties.

Some of those relationships can be structured around formal contracts, but the very nature of those assets makes it hard to do so. As noted above, many of them are intangible in nature. Others are inalienable in the sense that, in the absence of slavery, they cannot be bound to the contracting party. Others – social assets and the environment – are public goods which are subject to the whims of popular sentiment and voting that cannot bind future generations. Instead, for the most part they rely on relations of trust rather than contracts and that trust depends on the trustworthiness of those involved in the relationship. In other words, the owners of firms wish to commit to parties external to the firm in non-contractual forms because it is in their commercial interests but, at present, their rights of control prevent them from doing so.
This problem of commitment has been intensified by competition not just in product, labour and financial markets but also in the ownership and control of firms. One of the reasons why corporate problems have intensified over the last sixty years is that this has coincided with a period during which markets for corporate control have emerged, in the form of, first, hostile takeovers and, more recently, hedge fund activism (Franks, 2020). In both cases, parties external to the firm can impose changes in policy against the wishes of the target company’s board of directors. The difference between the two is that hostile takeovers involve acquiring target companies in their entirety whereas hedge fund activists are institutional investors that exert control over target firms through buying blocks of shares in firms and encouraging other institutional investors (so-called “wolf packs”) to support them in their engagements (Coffee, 2017).

The consequence of the emergence of markets for corporate control has been to undermine the ability of board of directors to sustain particular policies and strategies and thereby to commit to other parties that depend on them. It has therefore intensified the commitment problem of corporations.

In summary, the analogy between personal and corporate ownership has been inappropriate in failing to recognize the far greater responsibilities as well as rights of ownership of the latter in comparison to the former. This has come at considerable expense not only to humanity, society and the world at large but also to the performance and productivity of business itself.

5. Reform

How can business be reformed to internalize its externalities and align the future of the corporation with its purpose to provide profitable solutions to the problems of people and planet, and not profit from producing problems for either? The answer is remarkably straightforward. Since the corporation is a product of the law, the law can define the nature of the corporation. There is no law of nature that states that the corporation must be as it is. On the contrary, for nearly all of its 2000-year history, the corporation has taken a very different form from how it is today (Davoudi, McKenna and Olegario, 2018).

The British Academy Future of the Corporation programme produced a first report in November 2018 (British Academy, 2018) that sets out a reconceptualization of business around its corporate purpose. In November 2019 a second report (British Academy, 2019) proposed a set of eight principles to guide reform of business. These eight principles included: company law to make purpose the firm’s objective and the fiduciary duties of directors; regulation to align purpose with social licenses to operate in regulated sectors; ownership to be responsible for the determination and enactment of purpose; corporate governance to make the board responsible and accountable for delivering it; measurement to evaluate the resources required by the firm’s purpose and its impact on other parties; performance to report profits in relation to a company’s purpose; finance to provide funding of the required scale, duration and risk bearing to resource purpose; and investment to be made in the partnerships needed to deliver it.
Company law should require firms to specify and implement whatever purposes they deem appropriate. Provided that the second part of the purpose statement – namely not profiting from producing problems – is respected then any purpose is beneficial, even if it emphasizes profits over other considerations. One should encourage as many flowers as possible to bloom and promote innovation and experimentation in corporate purpose. One of the main merits of this approach is that it enhances the successful functioning of competitive markets and “runs to the top” in both the identification of beneficial purposes and commitments to their fulfilment.

However, there are some areas where private purposes of companies should be aligned with the public interest. Regulation is not just about determining the rules of the game and their enforcement but also the alignment of corporate purposes in regulated firms, such as utilities, banks, auditing companies, and public service providers, with their social licences to operate. The current malaise from which regulation suffers of promoting public interests in companies which are predominantly interested in their private benefits for shareholders is addressed by aligning private with public purposes. One illustration of this is the “public benefit corporation” which has now been adopted in more than 35 states in the United States. Public benefit corporations require companies to identify a public purpose in addition to their commercial interests in profits and impose a fiduciary responsibility on directors to uphold those public purposes (Alexander, 2020).

The third set of principles relates to ownership. As described above, corporate ownership is not just about the rights of shareholders but also their responsibilities to other parties affected by and dependent on the firm. Together with the boards of firms they should establish corporate purposes, values and cultures that embed them throughout organizations. That role falls initially on the founders of companies and then moves to their descendants. Where it is sold to other holders of blocks of shares, it becomes the responsibility of those block holders.

Credible commitment to corporate purpose therefore requires identification of corporate ownership that promotes and supports its fulfilment (Villalonga, 2018)). An example of this, commonplace in Denmark and Germany, are “industrial foundations”, which are foundations and trusts that are not simply philanthropic in nature, but also own companies. (Børsting and Thomsen, 2017), such as Bertelsmann, Bosch, Carlsberg, Ikea, Tata, and Velux. Those foundations were established by founders who decided not to pass on their companies to their descendants. The foundations are responsible for upholding the purposes and values of the founders and ensuring that they are embedded in the organizations they own (Thomsen, Poulsen, Børsting and Kuhn, 2018).

In many cases, family and foundation owned firms are listed on stock markets around the world and indeed families are the most widely observed holders of blocks of shares in the largest listed global companies (Villalonga, 2020). The listed companies combine “free floats” of widely dispersed shareholdings that are actively traded on liquid stock markets with blocks of shares that provide long-term anchor shareholdings. It is these anchor shareholders that should be responsible for the determination and adoption of corporate purposes.
This relates to the fourth principle regarding corporate governance. Conventionally, corporate governance is viewed as being about the role of boards of companies in promoting shareholder interests. Its most recent manifestation is in the form of what is termed “enlightened shareholder interests” according to which, as the UK Companies Act 2006 states, boards of directors promote the success of the company for the benefit of its shareholders and have regard to the consequences for other parties, including customers, employees, suppliers, communities and environment. The focus should therefore be on “long-term value creation” and the promotion of interests of other parties in so far as they are associated with enhancing long-term value for the benefit of shareholders.

Corporate governance is not therefore simply about aligning managerial interests with those of their shareholders but with their corporate purposes. This has been recognized in recent revisions to the UK Corporate Governance Code. In July 2018, the Financial Reporting Council issued a Corporate Governance Code which stated that: “the board should establish the company’s purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture……..The board of directors should ensure that the necessary resources are in place for the company to meet its objectives and measure performance against them” (Financial Reporting Council, 2018).

This summarizes concisely what is required of directors: they should determine their company purposes, ensure that their values and strategy are aligned with them, embed the values and strategy throughout their organizations, allocate the necessary resources and investments required to support them, and measure performance of the company and its people against them. Conventionally, the board is accountable to its shareholders at shareholder meetings but, in the context of corporate purpose, its accountability extends to a wider body of beneficiaries in line with the firm’s overall impact and resourcing not just the financing of its activities.

This takes us to the fifth principle. Measurement is currently reflected in accounting for the financial and physical assets of a company. However, a growing proportion of companies’ assets are intangible rather than tangible, human, social and natural rather than physical assets, outside as well within the legal boundaries of the firm. Accounting to date has not kept pace with these developments and distorts reporting of the allocation of resources and investments as a consequence (Barker, 2020).

In particular, there is insufficient recognition of the investments associated with expenditures on people, societies and environments outside as well as within firms in their supply chains, local communities and natural world. These are assets over which companies do not necessarily have legal claims in a traditional sense but are nevertheless essential to the successful functioning of a company and fulfilment of its purpose. A failure to recognize them as assets rather than current expenditure leads to an overstatement of their costs and an understatement of their productive potential. In other words, it results in a deficient allocation of resources to these activities.

It is also relevant to the sixth principle on performance measurement. Currently, performance is measured in relation to profits net of the costs of maintaining physical
assets of firms. However, the growing significance of other non-physical assets implies that profits should be measured net of the costs of maintaining human, social and natural as well as physical assets. The maintenance of their productive potential is as important to the firm as its physical assets (Eccles and Laurent, 2020; Eccles and Stroehle, 2020). More generally, performance should be measured in relation to the company’s success in fulfilling its purpose. Failure to do so should create a requirement to provide for the expenditures needed to remedy the deficiency. By so doing, the company reduces its stated profits and its earnings available for distribution to its shareholders. It therefore creates a reserve to rectify underperformance.

This is particularly relevant to the final two principles regarding finance and investment. Much of the focus on finance is on the interests of the providers of finance – that is reflected in the emphasis of company law on directors’ fiduciary duties to their shareholders, and of financial regulation on investor protection. There are less clearly defined requirements in relation to the asset rather than liability side of financial institutions’ balance sheets. Recently there has been a growing recognition of the importance of the “stewardship” function of institutional investors in stewarding the assets that institutions manage on behalf of their beneficiaries (Financial Reporting Council, 2020). Furthermore, where investors have interests in the impact of investments on their health, environment and descendants, i.e. their wellbeing rather than just their wealth, then institutions should align their investments in companies with considerations that go beyond financial returns (Hart and Zingales, 2018).

Respecting the intrinsic interests of customers, suppliers, communities and environment requires firms to work in close partnerships with and invest in other organizations in the private, public and not-for-profit sectors (Ouarzazi, 2020). Public-private partnerships and private finance initiatives have a chequered history, reflecting a misalignment of interests between the different parties. Public benefit corporations offer the potential for addressing this commitment problem. They impose duties on directors to uphold both private and public purposes and can be used to promote an alignment of interest between private and public organizations. They can be combined with the multiplicity of forms of ownership and governance that are observed around the world in state, industrial foundation, employee benefit trust and family owned firms.

In sum, the eight principles of law, regulation, ownership, governance, measurement, performance, finance, and investment can therefore be as consistently and coherently aligned with problem solving purpose as with shareholder primacy.

6. Capitalism

Capitalism is conventionally viewed as being an economic system of private ownership of the means of production and its operation for profit. Ownership in this context is a bundle of rights that confers strong forms of authority on their possessor. And firms are nexuses of contracts managed by boards of directors for the benefit of their owners. This is a coherent, consistent view of capitalism in which capitalism is private ownership for profit with other parties engaged through contracts.
This article presents an alternative view of capitalism in which it is an economic and social system of producing profitable solutions to problems of people and planet by private and public owners who do not profit from producing problems for people or planet. Ownership is then not just a bundle of rights but a set of obligations and responsibilities to uphold those purposes. And firms are not just nexuses of contracts but nexuses of relations of trust based on principles and values enshrined by boards of directors. That too is a coherent, consistent view of capitalism in which it is about solving problems profitably by owners and directors who engage other parties through relations of trust as well as contracts.

The conventional concept sees capitalism as producing products and profits. The view expressed here sees it as producing profitable solutions. It provides others with the capacity and capabilities to fulfil their purposes. While the focus of the article has been on microeconomic implications in the context of individual firms, it also has significant macroeconomic consequences. In the process of facilitating the fulfilment of other parties’ purposes, it allows them in turn to assist others to achieve their purposes. It is therefore a means of relieving constraints on productive capabilities and creates multiplier increases through enhancing productive potential and allowing progressively more people and organizations to fulfil their purposes. It is a supply side equivalent of the Keynesian process of allowing notional demands to be made effective by making notional purposes effective in solving problems of others.

Furthermore, since companies do not profit from imposing problems on others, it addresses questions of distribution in the course of production. In conventional capitalism, the attainment of economic efficiency is separated from distribution, with competitive markets delivering the former and governments the latter through taxation and public expenditure. In its alternative formulation, distribution is part of the problem to be addressed by companies and achieving fairer opportunities and outcomes a component of corporate purpose. The greatest difficulties in realizing their purposes will be encountered by those people and organizations for whom capability and resource constraints are the most serious (Sen, 1999). They should therefore be the focus of purposeful companies’ objectives. Companies may need to partner with governments and philanthropic organizations in delivering distributional benefits, but their objectives will be aligned not in conflict with their realization.

Novo Nordisk provides an illustration of these ideas. The unaffordability of insulin in low- and middle-income countries where most type 2 diabetes is found could in principle be addressed through international redistributions. However, in the presence of national governments accountable to their domestic citizens, such redistributions inevitably fall short of what is required. Alternatively, Novo Nordisk can address the issue itself by cross-subsidizing customers in developing from pricing in developed countries, through promoting alternative forms of treatment that are better suited to low income countries, by advocating changes in life styles to avoid contracting type 2 diabetes, and by channelling resources through its foundation to programmes of research on new treatments for diabetes.

The focus of this analysis is therefore on allowing individuals and organizations to achieve their potential in realizing their purposes. It moves away from utility and profit as the driving force of individuals and organizations to private and public purposes to solve the
problems of others. People need sufficient income and earnings to be able to fulfil their purpose potentials of assisting others in attaining their purposes. The notion of a “right” level of income or profit does not therefore derive simply from seeking to achieve greater utility for oneself or shareholders but from what is required to allow each person and organization to achieve their purposes.

In a utilitarian framework, economic and technological progress results in increasing levels of but diminishing increments to utility, and convergence on states of the world where few further marginal benefits remain to be extracted. In contrast, where purpose is the driver of both human and corporate endeavour, there are always more and potentially intensifying problems to be solved. For example, solutions to transportation problems were modest without wheels, limited without engines and have become extensive with satellites. In other words, the process of enhancing viable solutions creates new challenges to be solved, and as transportation illustrates, extends the range of people whose problems it is feasible to address.

7. Conclusion

The significance of purpose is in many respects tautological. As the reason something is created, exists, is done and what it aspires to become, it follows that purpose is the fundamental determinant of our conduct and behaviour. However, to recognize the importance of purpose is only the beginning. It raises questions about what purpose means, how it is implemented, and how it gains legitimacy and credibility. This article has suggested a definition of corporate purpose that lends it considerable economic as well as business and social significance in terms of improving the functioning of markets, addressing market failures and internalizing what are otherwise externalities. Its adoption has important macroeconomic consequences in alleviating constraints on supply in relation to individual and organizational purpose potential, thereby enhancing productivity and economic performance. Finally, it encourages the resolution of distributional as well as market efficiency failures during rather than after the productive process has inflicted damage.

Given that it would appear self-evident that our economic system should be structured in such a way as to do what we want it to do, namely promote individual and corporate purposes that solve problems and not create them, why did we ever take a different course? The answer is that when freedom of incorporation emerged during the 19th century it was against the background of companies that were predominantly small, family owned over several generations, and local. Where that was not the case then, in many instances, companies were chartered by the state. Furthermore, intellectual thought promoted concepts of markets over governance, and consumption and saving over production and investment.

It was around the turn of the century and during the course of the 20th century that problems of size and monopoly, dispersion of ownership and deficient governance, globalization and national regulation, and financialization and short-termism became acute. We then experimented with various forms of government intervention – public ownership
and regulation – to address the problems, but ultimately what emerged was a deficiency of the corporate model itself.

Refocusing corporate objectives on purpose is not simply a modest extension of conventional managerial tools but a profound reconceptualization about the nature of economic activity and the way in which economies can contribute to human wellbeing. We flourish from having the capabilities to achieve our purposes and from assisting others to do the same, and business has a major role to play in that process because of its capacity to mobilize substantial resources. By conferring meaning on others, we provide meaning to ourselves and the world around us.

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