The new responsibilities of companies in a time of increasing inequality and climate change

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The Business Roundtable's Statement on the Purpose of a Corporation (August 2019), and other similar manifestos published over the last two or three years have, inevitably, opened the floodgates of a debate, which has now raged for a hundred years, over what the aim (or "purpose" as it is fashionable to call it nowadays) of a corporation is. For many the change, which merely *appears* to be innovative, in the manifesto signals the end of the mantra of maximising shareholder value, guiding businesses towards an era focusing more on safeguarding stakeholder interests. Among these, first and foremost, has emerged the global environment, an element which appears to be more highly ranked than the others. In other words, stakeholders no longer take into account just the social groups represented in and by the company, such as the employees, the suppliers and the customers, but also the surrounding reality, ranging from that which is most restricted and consists of the local and regional community, to the widest of all, i.e. nothing less than the future of the planet in the current context of climate change.

It is clear that this new normal is turning the debate over "classic" positions, that has prevailed for a long time, on its head. Here, I'm not talking about a comparison of the objectives of business and entrepreneurs according to the Marxist economic vision, where the objective is defined as the surplus obtained from the exploitation of employed labour paid at a level below the "value" produced, and the neoclassical view, where profit is essentially a premium on entrepreneurial courage linked to the contribution of capital and the assumption of risk. In the current debate it is more useful to compare the visions which, from a certain moment onwards, emerged during research on modern managerial capitalism and the aims and responsibilities of businesses and their representatives.

As Roger Martin emphasised in 2014, modern capitalism has lived through two principal epochs, in which two seminal academic studies are rooted. The first was that of managerial capitalism. This began in 1932 and was distinguished by the notion, radical at the time, that businesses should be managed professionally. The second, shareholder value capitalism, began in 1976. Its central premise was that the goal of any business should be to maximise the wealth of its shareholders. If companies follow this objective, it was affirmed, then both the shareholders and the company will derive a benefit.

Neither of these two epochs paid particular attention to the stakeholders and the conditions surrounding the company, let alone the natural environment, except for the indisputable assumption that when a business and its representatives fulfil their duty to create wealth through profit and employment in the marketplace they are meeting their objectives. These include, however, guaranteeing the satisfaction and well-being of citizen-customers by selling the right products and services at the right price.

As previously mentioned, the first two epochs were heralded by significant academic research. In 1932, Adolf A. Berle and Gardiner C. Means published their well-known essay, *The Modern Corporation and Private Property*, in which they affirmed that the management of a company should be separated from its ownership. The business world should no longer be dominated by owner-managing directors such as the Rockefellers, the Mellons, the Carnegies and the Morgans. Instead, companies should be guided by external figures – in other words by a new class of professional CEOs. Change should not be feared, as it would generate a new courageous era of economic expansion (postponed, however, by some years due to the Great Depression).

The "vision" certainly appeared to be convincing and, while owner-shareholders continued to exist, it was the professional managers who were starting to run the "control centre". Entrepreneurs were

welcome to launch new business activities but, once the business had grown to a significant size, it was seen as wise to delegate these activities to the more reliable and less fickle management professionals. This idea was successful, and for around half a century the management professional was established and evolved, without there ever being clarity over the reciprocal responsibilities between the board, the shareholders and the management, and without any clear demarcation between entrepreneurs and professional managers, in a concealed but continuous competition for leadership which has never been fully smoothed over.

The second phase began in 1976, when managerial capitalism was subjected to harsh criticism in the article "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure" by Michael C. Jensen and William H. Meckling, which is among the most quoted business academic papers of all time. The authors referenced what was known as the "theory of agency", according to which professional managers who, although they should be acting in the interests of the owner, actually look after their own interests. In this regard, in fact, the two scholars observed that, normally, companies' management tended to pay little attention to the interests of the owners since it basically focused on improving its own economic advantage to the detriment of the economic-financial benefit of the shareholders. Jensen and Meckling argued that this constituted harm for the shareholders and was a source of waste for the economy: management would be able to steer the business and its resources in a way that supported its own interests. A process of realignment was therefore required.

Their criticism initiated the era of shareholder value capitalism, which was authoritatively supported by Milton Friedmann and the Chicago School. CEOs quickly understood the need to pledge loyalty to "maximising shareholder value", encouraged by eminent consultancy companies (first and foremost Mckinsey) and by boards of directors that were eager to reassert their prerogative to align the interests of management with those of the owners, linking management remuneration to shareholder value. Martin summed it up: "No longer would the shareholder be abused: the shareholder would be king".

And, until a short time ago, that is how it was. At least most of the time and not without noteworthy exceptions, even in Italy, where the Olivetti model is still little known and, even though admired, little used in practice. It is difficult and misleading to try to identify the moment the era of shareholder-before-all started to show cracks. However, one important turning point was clearly the 2007-2008 subprime crisis, and the subsequent economic crisis. But this point, although important, is not the only one. It is clear that the crisis led to an impoverishment of the middle classes and a widening of the income gap. However, since the beginning of this century, the digital "fourth industrial revolution" (or the third, according to some), has also carried increasing weight in terms of its profound modification of the labour market, pressure on wages and salaries, a demand for new skills that is often not met by the education system and, therefore, an increasing misalignment between new job opportunities and the capacity of many workers to match these effectively.

In other words, over the last twenty years the conditions have been created, for various reasons, for the "pauperisation" of large segments of the labour force, in a context of great change and, often, general economic crisis (Piketty, 2018; Collier, 2018). Other components of this pressure, defined generically as an "increase in inequality", have been the strong and barely controlled migration flows and their economic – as well as social and political – consequences, and the crisis related to climate change. Last but not least, the current health crisis whose effects are starting to be seen and which will have increasing impact in the future.

And it is in this context that it would seem to be a good moment to consider the turning point, real or imagined, represented by the Business Roundtable manifesto. When in 1989 Fukuyama expressed the concept of the "end of history", given that the fall of the Berlin Wall and the end of communism would unfurl a golden future under the banner of a triumphant capitalism, this did not cause much damage because, basically, few believed this. However, it did create *some* damage

because, along with other trends, such as, for example, those that had already been expressed at the highest political level by Reagan in the USA and Thatcher in the UK, many reached the conclusion that the capitalist system had indeed triumphed and now had no adversaries. It could now express itself with neither limits nor obstacles in the area of production as well as in the area of finance. Friedman certainly sang its praises, as did Arthur Laffer and the other gurus of supply-side economics in the late 1970s and early 1980s.

The last ten years have, in fact, seen a prevailing trend of managing companies with a view to maximising shareholder value. Although we are not talking about a predominance that has been uncontested or absolute. At the same time, doubts over the wisdom or appropriateness of this approach have emerged, both with regard to the management of companies by professional managers whose aim is to reward shareholders – thereby increasingly rewarding themselves – and with regard to the wider context of greater emphasis being placed on the interests of stakeholders.

These are the years in which there is growing sensitivity to a company's social responsibility. Initially, this challenged the simple and simplistic notion that paying a little attention to society through more or less generous acts of philanthropy could be sufficient. Gradually, there has been a move towards a new conception of greater involvement of the company as a key player in society with a specific duty to share the value created. This conception has become well known thanks to Porter and Kramer through the expression "shared value".

One might ask, before enquiring if the representatives of the Business Rountable actually intend to put into practice the intentions they have expressed in the manifesto, whether Porter might expect that, quite apart from corporate social responsibility, businesses of the world might end up embracing the idea and objective of shared value with regard to the *purpose* of a corporation. Even for the sceptics, little willing to acknowledge that organisations have the capacity to express ethics or morals, the response appears to be broadly positive. Despite much proof to the contrary, there are many companies, entrepreneurs, shareholders and professional managers who place, if not at the centre, at least in a pre-eminent position, the idea that creating value should go beyond generating and maximising profit, before dividing it up in various ways according to various negotiations, between the shareholders and the managers themselves.

The point is that, as has been the case since the times of Adam Smith, we are not talking about an objective or a moral conscience (or at least, not only that), but of a need to react both to pressures relating to the business or its various stakeholders, and to the company's real interest in the new context in which it is carrying out – and most of all will continue to carry out – its business activities in a global and a local context. An interest that, as may be clearly shown, cannot be met by making short-sighted or short-term choices, and even less by adopting sly marketing and communication measures. Instead, strategic choices are required of great and growing significance.

Perhaps it is not possible – and may never be possible – to compare the Business Roundtable manifesto with the great turning points of 1932 and 1976 that spring to mind, but it is certain that it cannot be underestimated. At least, for now, it is a document that expresses a strong desire for change on behalf of almost 200 major global companies. These include companies headed by some of the highest earners in the world, generally from the digital revolution, with personal wealth that is in line with the GDP of some countries. It is worth repeating that the appeal that has been launched has not appeared suddenly out of the blue, but it would be silly to claim that it is not having and will not have a significant impact.

The change asked of the business world is set within a context of general change throughout global society, and trying to avoid it would be as futile as it would be dangerous. The emphasis placed on these change processes does not seem excessive. The reasons are multiple.

The signatories to the manifesto are best placed to take note of the enormous pressures that are growing on businesses. Until not so long ago, it was possible to pay attention to and control public

opinion, for each individual organisation as well as for a group of organisations, in a partial or incomplete manner. Lack of information, or rather information asymmetries, was the order of the day. This no longer holds true in companies in which information is global and instantaneous. Social pressure on business, often from the new generations, is continuously increasing – even faster than the already great and intense forces of transformation.

For companies, from an internal point of view, another type of pressure is rising. This regards less the strategic purpose of a business and more certain management practices applied more often in the recent past, and still dominant today, that result in additional disparities in incomes and relationships between top management and employees in general. Most of all, the well-known tendency of management to privilege short-term objectives over long-term objectives and practical ways to implement the relevant choices. Short-termism, more common than in the USA than in Italy and the rest of Europe (and found more in listed companies than in family-run businesses), often leads to company leadership that is, in practice, in conflict with the long-term interests of the stakeholders. Even though it is best not to underestimate the complexity of the task faced by responsible management in reconciling the pressure to reach short-term market objectives from analysts and hedge funds, and the expectations of shareholders and the board to achieve results that are sustainable over time. Managers need to have the talent to be almost cross-eyed and have acrobatic ambidexterity to marry together objectives that seem to be in conflict with one another.

It is well known that an obstacle to developing that healthy squint and that desirable ambidexterity comes from the consequences anticipated by Jensen and Meckling, which have produced two significant effects. These were the adoption of stock options as the basis for management remuneration, often leading to short-term choices in order to maximise share value in the short term, and the practice, less analysed and debated, of resorting increasingly to widespread buy back, essentially for the same reasons. Taken together, these two practices had the effect of artificially inflating share value, rewarding both shareholders and management in the short term, while at the same time reducing resources available to dedicate to sustainable investment in the long term and to the well-being and professional development of employees.

Companies, in particular larger ones, that wish to follow the prescriptions of a purpose-oriented manifesto should, therefore, examine and review mechanisms for governance and manager incentivisation to create, in agreement with the shareholders and without penalising the market, shared and sustainable long-term value. Furthermore, this requires reflection on the stellar compensation paid to the “champions” of management, probably unjustified in relation to their actual contribution to the results of the business and fundamentally unjustifiable for most of public opinion (not just those who adopt obvious and unpleasant demagogic positions).

But the emphasis placed on the change generated on a global scale would seem excessive if limited to the type of pressures described. The much wider question is that, in relation to the great changes under way, the actions of the vast majority of companies and their leaders still seem to be totally insufficient, if not irrelevant. And these changes primarily involve two factors. The first consists of the growing gulf that has been created between those who have benefited from the great economic and technological transformations of the last few decades, deriving from the great push towards globalisation, and those who have remained excluded or penalised. The second refers to what previously referred to itself as an overarching factor compared to others, in other words the global environment or, to be precise, climate change.

The economic aspect is a determinant. Over the last few years the mechanisms of the market and, at times the same mechanisms of democracy, have come under fire from growing criticism, on the back of those which, rightly or wrongly, have been called the “effects of globalisation” (Stiglitz et al). The various causes mentioned previously have generated discontent and mistrust in large swathes of the population in all major countries, including Italy. There followed growing calls for safeguarding and protection that, in a context of fast technological transformation and economic

crisis, have only partly been answered, leaving space for a protest reaction whose political expression has often moved in the direction of either right-wing or left-wing populism (Judis, 2016), as may clearly be observed both in Europe and in the United States.

Without going further into the merits of these phenomena, what stands out is that the business world and, most of all, the financial world, has been and still is the object of strong criticism, often amplified by unscrupulous media coverage of incontestable realities such as widening inequality. It is clear that, on top of the pressures that have already been listed, further aspects should be added – these require increasing attention from business and its representatives. The Business Roundtable manifesto may, to a certain extent, be viewed as part of a wider reaction that sees business as central to offering an appropriate reaction to the difficulties expressed in various ways by various strata of the population. In this sense it could certainly represent a significant event, although for now it is still incomplete and insufficient in relation to the causes that induced it (Henderson, 2020).

The second factor – climate change – may not seem an obvious candidate for insertion into a discussion driven by the Business Roundtable statement, the contents of which are also fairly similar to the appeal launched by the World Economic Forum in early 2020. The two manifestos share not only the same objectives with regard to safeguarding stakeholders' interests, as has been explained in depth, but also the fact that neither take into consideration, apart from their widespread use of the term "sustainability", climate change and the change of direction that this is imposing, and will impose even more in the future, not only on government policy and individual choice, but also on the strategic choices made by companies (Serafeim).

This is a significant and fairly serious shortcoming if compared with a statement of no less importance and impact made in the same period: the letter to shareholders from the CEO of BlackRock, Larry Fink. The financial services company, which is the biggest private financial asset manager in the world, managing USD 5 trillion, makes what is now an unequivocal statement: "Climate change has become a defining factor for society and should be taken into account when developing long-term strategies.... Millions of people took to the streets to demand action on climate change; many of them emphasised the long-term impact that this phenomenon will have on economic growth and prosperity – a risk that markets to date have been slow to reflect. But awareness is rapidly changing, and I believe we are on the edge of a fundamental reshaping of finance".

He continues: "The data on climate risks oblige investors to reconsider the very foundations of modern finance (...). Investors are increasingly being forced to face up to these questions and, more and more, they are realising that climate risk means investment risk (...) We believe that sustainable investment is the solid foundation which will allow client portfolios to grow. BlackRock has announced that it is making sustainability an integral part of portfolio construction and risk management; exiting investments with high risks related to sustainability, as in the case of thermal coal producers; launching new financial products on the market that will explicitly take into account the use of fossil fuels; and reinforcing our commitment to sustainability and transparency in our investment management activities".

This is the position of the major private investors of the world, although it is not dissimilar to the positions that have been expressed for some time by large banks and financial institutions, as well as by big insurance companies such as Generali and Allianz – no longer prepared to insure businesses which are not committed to demonstrably sustainable activities. However, it is probably even more significant that from this point of view the decision taken by the large global pension funds, as has been well noted by Jeremy Rifkin in his recent book, *The Green New Deal,* which together manage the savings of company employees of the order of USD 40 trillion, as well as by certain sovereign wealth funds, in particular those from Norway. These funds have already decided to gradually divert their investments from companies that are excessively linked to the carbon economy, judging the risk of their progressive decline and loss of value (stranded assets) to be too

high. They are directing their investments towards companies that are committed to energy transition, in other words to lower and decreasing levels of CO2 emissions, until greenhouse gas emissions neutrality has been achieved.

It is becoming increasingly clear that climate change and the war against carbon emissions – decarbonisation – is under way. The EU has launched its Green Deal, in China similar colossal programmes are in progress and, even though it's a long way behind in federal terms, the United States has demonstrated great activism both at local level (e.g. New York City) and, in many cases, at state level (e.g. California). But, even more than laws and economic measures at national and international level, what could radically change the responsibilities, and therefore the purpose, of corporations, will be the new frontiers of global financial investment.

In the light of this one should ask oneself to what extent the perception of this phenomenon is widespread and, above all, to what extent it is shared. And, in the second case, to what extent companies, their managers and their shareholders are prepared for the change. The fate, not only of the current stakeholders, but also that of future generations, will depend greatly on the answer given.

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