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The Future of Capitalism

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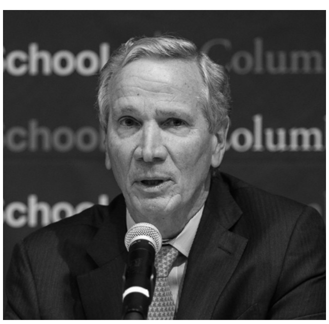
Sir Paul Collier

Blavatnik School of Government, University of Oxford

Colin Mayer

Peter Moores Professor of Management Studies, Saïd Business School at the University of Oxford



Alan Schwartz

Executive Chairman, Guggenheim Partners

Kristin Bresnahan

Executive Director, Millstein Center, Columbia Law School

Steve Pearlstein

Robinson Professor of Public Affairs, George Mason University's School of Policy

Kristin Bresnahan: Good evening, everyone. I'm Kristin Bresnahan, executive director of the Millstein Center for Global Markets and Corporate Ownership here at Columbia Law School. The Millstein Center is an organization dedicated to studying and improving corporate governance, the capital markets, and the way business operates in society. Earlier this year we launched our "Counter-narratives" Project, which is focused on exploring alternative narratives to shareholder primacy, to the idea that the purpose of business is solely to create profits for its shareholders.

We are very happy to be here today with leaders from the business community, journalism, and the academy to continue that discussion. In this session, which we're calling "The Future of Capitalism," we will be hearing from Sir Paul Collier, Professor Colin Mayer, Alan Schwartz, and Steve Pearlstein—and let me start by telling you a little about each of them.

Sir Paul Collier is professor of economics and public policy at the Blavatnik School of Government at the University of Oxford. Paul is also the former director of the research development department of the World Bank, and the author of many books, including the most recent one—*The Future of Capitalism: Facing the New Anxieties*—whose title we borrowed for this meeting.

Colin Mayer is the Peter Moores professor of management studies at the Saïd Business School at the University of Oxford. Colin is an expert in many aspects of corporate finance, governance, taxation, the regulation of financial institutions, and the role of the corporation in contemporary society. He is also a fellow of both the British Academy, where he is leading their Future of the Corporation Program, and the European Corporate Governance Institute.

Alan Schwartz is the executive chairman of Guggenheim Partners, which describes itself as a full-service global investment and advisory firm with three main businesses: investments, securities, and insurance companies. Alan is the former CEO of Bear Stearns, where he also served in a variety of senior leadership roles. Alan is one of the co-founders of the Robin Hood Foundation, which provides funding for other nonprofits working to reduce poverty in New York City.

Steve Pearlstein is a business and economics columnist for the *Washington Post*, as well as the Robinson Professor of Public Affairs at George Mason University's School of Policy. Steve was awarded the Pulitzer Prize for commentary in 2008 for columns anticipating or explaining the recent financial crisis and global economic downturn. In 2011, he won the Gerald R. Loeb Award for Lifetime Achievement in Business and Financial Journalism. He is also the author of a recent book titled *Can American Capitalism Survive? Why Greed Is* Not *Good, Opportunity Is* Not *Equal, and Fairness* Won't *Make Us Poor*.

Paul and Colin will start us off by each talking for 25 minutes or so about their recent books. Paul's book, as I mentioned, is called *The Future of Capitalism*. Colin's book is *Prosperity: Better Business Makes the Greater Good*. After Paul and Colin, Alan and Steve will each spend ten or 15 minutes responding to what they've heard. When they're finished, I will moderate a discussion among the four of them—and we'll close by opening things up to the audience for Q&A.

Without further ado, I'm going to turn things over to Paul.

Capitalism: Past and Present

Paul Collier: Thanks very much, Kristin. As Kristin just told you, my book is called *The Future of Capitalism*. And the most common question about the book I'm asked by people who've seen nothing more than the title is, "Does capitalism have a future?" My response is that I very much hope so, because in 10,000 years of human history, it's the only system we've found capable of raising mass living standards fairly consistently. And that's because it's the only system that has managed to combine the benefits of scale with the benefits of decentralized decision-making. It's a system that relies on some degree of competition as a discipline—but it's competition that is moderated by plenty of scope for collaboration. And I think that combination is the magic cocktail.

Nevertheless, for almost all of those 10,000 years, instead of trying big, we tried small. And small was not beautiful; small was unproductive—which meant mass poverty. Then for about 70 years, we tried *really* big—that was communism. What communism didn't do was to decentralize decision-making, and that was a disaster. So, both small and big without decentralization, the discipline of competition, and scope for collaboration have proved to be disasters.

But if capitalism is the only system we've got that can work, it doesn't work on autopilot. Periodically throughout its 250-year history, capitalism has derailed. And when that happens, it's been up to public policy to get it back on the rails—public policy and the efforts of private citizens, of firms and families. Each time capitalism derails, it plunges people into a new range of anxieties, and that's why the subtitle of my book is "Facing the New Anxieties."

We are now living in what I tend to think of as the third big derailment of capitalism. Everybody knows about the second big derailment, which was the Great Depression and mass unemployment of the 1930s. I'm going to start by talking a little about the first derailment, both because it's less familiar to people, and because I think it's especially revealing.

The First Big Derailment—and the Birthplace of Both Capitalist and Cooperative Economic Activity

The first big derailment kicked in during the 1840s in the places where industrial capitalism had been born. As it happens, capitalism was born ten miles from where I was born, in one of the big industrial cities of the North of England called Sheffield. Ten miles from Sheffield is a World Heritage Center that marks the first industrial factory on earth. In fact, there were a bunch of very fast-growing cities in the North of England at that time. People flocked to these cities from other places because they found ways to make people far more productive than they were before. Not only did you get the scale economies provided by an individual factory, you got the scale benefits of clusters of factories in nearby cities, which meant that factories could coordinate their activities—and so they could cooperate as well as compete with one another.

One of the many people who flocked to these Northern English cities was my German-born grandfather. He moved from a village in Germany to the most booming city in the whole of Europe, which was Bradford. By the 1840s, Bradford was very productive and fast growing. But at the same time, Bradford and the other cities of Northern England became about as close to a living hell as seems possible outside the conditions of warfare. As people crowded together, diseases that didn't spread rapidly in rural areas suddenly started to spread through contagion, and housing conditions were terrible. And life expectancy collapsed, falling to as low as 19 years.

So, for the average person in those northern cities, you were dead at 19. And that produced some very sobering and practical anxieties—about things like, are you going to get a funeral? Even with all the economic activity and growth, people were still very poor.

Let me take you closer to the Bradford of the 1840s, in particular the year 1849. What happened in Bradford in 1849 was cholera. The sewage got mixed up in the drinking water because there were no proper pipes for sewage, and cholera spread like wildfire. And people were dying, hundreds and hundreds of them at a time.

Now, let's move from these happenings to the life and circumstances of Bradford's "Master Big." His name was Titus Salt, and he owned the majority of the mills. And he was also very influential in politics. In 1849, he was the mayor of Bradford as well as the city's one member of Parliament. So he was both the big industrialist and the big political guy.

But the experiences of 1849 seem to have seared his soul, because he then became the first industrial philanthropist on earth. And he didn't do it by halves: he gave away his entire fortune, which was very considerable.

First, he recognized that he had obligations to his workforce. His workers were dying because they were living in poor conditions. Nobody knew at the time what was causing cholera, but it was obvious to him that they needed better conditions. So he built the first *purpose-built* industrial town on earth—and it was called Saltaire. It too was the first of its kind and is now a World Heritage Center.

Then he gave away the rest of his fortune to the citizens of Bradford, because as the biggest employer in Bradford, he recognized that he'd got obligations to the community. So he endowed the cities with parks. And both his workforce and his fellow citizens repaid his gifts and deeds with loyalty and affection. When he died, the town held a huge funeral. And he's still very fondly remembered. There's a big statue of him in the center of the city.

So that was business encountering the first big derailment and the accompanying anxieties; and the takeaway from the story is that business recognized and made good on its obligations both to the workforce and to the community. Titus's solution to the crisis was a dramatic one—but so of course were the events that drove him to it.

But now let's move just a few miles away from Bradford, still in the 1840s, to another northern town called Rochdale. The conditions were much the same in Rochdale as in Bradford, but this time it was the families of workers who decided to do something

So bringing productivity and jobs to places where people belong is half of the task. The other half is to equip people to be able to do those jobs—to be productive, to bond with the community where they grew up, and to want to contribute to their family and to their community. I think of that as a chain of interventions that starts at conception and takes you all the way through your career. Both Britain and America handle that chain atrociously. We're brilliant for the …cognitively gifted; but for the other half of young people, both Britain and America are terrible. We do an awful job of vocational training, to take just one example. How do we change all that? Above all, we need to get back to widely distributed moral load-bearing. – Sir Paul Collier

about the conditions. So the families banded together, and that was the birth of the cooperative movement, which then spread around the world as families have demonstrated that by showing mutual regard—by taking on mutual obligations—they could address these anxieties. So if you were worried, first and foremost, about whether you were going to get a funeral, the cooperative movement in Britain became the biggest funeral director in the whole country.

Now, if we go just a few miles further north from Rochdale, we come to the little town of Halifax, where families banded together to answer a different question: where are we going to live? And their response was to found a building association, or what in America is called a savings and loan, and that grew to become the biggest bank in Britain, the Halifax.

So that was then. The derailment produced new anxieties, and in response to those anxieties we saw the emergence of what I like to call widespread "moral load-bearing." It was not just leaving things to government, but both companies and families recognized their obligations and rose to the occasion. They proved themselves to be morally load-bearing, and the structure they adopted was this recognition of the mutuality of obligations, of concern and care for one another.

The Third Derailment

But now let's move forward to the third derailment, and this includes not just Britain and America, but all the advanced countries of the world starting around 1980. Since that time, two new social rifts have opened up in nearly all these countries to varying degrees, with Britain and America as the extreme cases.

One of these divergences has been spatial—big changes in where people live and work. The divergence is between the metropolis—or the "metropoles" as I like to call them—and the provincial towns and cities. The underlying economic force for that is fairly straightforward; it's globalization. More and more markets have become global, leaving room for fewer but bigger winners. You see that clearly in Britain, in the spectacular growth of productivity in London and the decline of provincial cities—and of course you see it in America as well.

Then there's a second social divergence, and that's the new class divide based on differences in education. If you get a decent tertiary education, you're able to build "fancy" skills that have become progressively more valuable over the last 40 years. But if you haven't got a fancy tertiary education, and you've invested in manual skills, you've found that the value of those manual skills has been gradually falling over those 40 years. And these two divergences have worked together to produce an even more dispiriting outcome: if you're a bright kid in a provincial city that's on the decline, the smart thing for you to do is to move to the metropolis, and that creates a new narrative—one in which the provincial cities keep losing more and more of their bright young people.

So the new divergences are creating new anxieties, but this time it's not clear what can be done about them. And so the divergences have continued and their effects accumulated—gone from bad to worse—for the past 40 years.

As it happens, my own life straddles these two divides, and so I'm very conscious of them. I'm a fully paid-up member of the well-educated metropolitan class, if you like. I was the last academic to buy a house on my street, which is now filled up with bankers and their families. As I mentioned, I grew up in Sheffield, and if you've seen a film called "The Full Monty," you know that the breaking of the Sheffield steel industry in the early 1980s was a devastating event. This 700-year-old industry—it was described by Chaucer in the late 1300s—cracked and broke in about five years as the whole steel industry moved from Sheffield to East Asia. And this collapse of income in Sheffield coincided with the start of the rise of the legal city nexus in London.

And the same divide took place within my own family in terms of education: I'm the only member of my extended family to have gone beyond grade school. Both my parents left school when they were 12—and a cousin born on the same day as I became a teenage mother. So, as a first-generation educated person, I'm very conscious of this random-seeming social divergence and division that has set in between the provincial cities, which have been on this downward escalator for 40 years, and the highly successful metropoles.

And because these divergences have been largely neglected by policy makers for some 40 years—and this has taken place in the U.S. as well as Britain—the responses have eventually turned into what I view as "mutinies." We're all aware of them. In Britain, they've taken the form of Brexit. Every region of England and Wales other than London is voting for Brexit. And this is not really a protest against Brussels and the EU; it's a protest against London. In America, you've got Trump, whose supporters and detractors reflect very much the same demographic profile of divisions in the U.K. electorate. And both these mutinies are clearly driven by rage, not by a serious search for solutions. They're not forward-looking strategies; they're backward expressions of anger.

Why the Failure?

The puzzle is, why did we get that prolonged neglect during this past 40 years? Why unlike the first and second derailments wasn't there a rapid and rather pragmatic attempt to find and implement solutions? I think the neglect was the result primarily of ideology displacing pragmatism, and it did so on the political left as well as the right. Both sides are equally culpable.

On the political right, we saw the rise of the Friedman doctrine, which Colin will be talking a lot more about later. The essence of the Friedman doctrine is that the primary goal of the firm is to maximize its profit and value for shareholders; and apart from upholding the law, companies have no obligations other than those to their owners. And so the companies themselves are no longer morally load-bearing.

The other doctrine, which sort of straddles both the right and the left, is individualism, which sort of does for families what the Friedman doctrine did for firms. It takes away the notion of obligations to others. The ideology of individualism says that your primary obligations are to realize your own potential through achievement—and those who have succeed have very much bought into that idea, having decided that they've been successful because they're brilliant and deserving.

Underpinning both of these doctrines is the prevailing notion in economics of "economic" man. Economic man is seen as the evolutionarily inevitable, fittest survivor—and, as portrayed in much economic thought, he is basically selfish, greedy, and, in some versions, even lazy. Now that poses a problem both for firms and governments—because they have to employ people who are selfish, greedy, and lazy. How do you get these employees to do what you want? The answer is that there's only one way to do it if your employees are economic man: You provide incentives and then monitor their performance. You scrutinize what they do. You write down and specify in contracts what they're supposed to do, and you reward good behavior—compliance. So you monitor and you reward the performance you want. And although this model was invented by economists and first applied in the business community, it has been copied in the public sector, especially in Britain. I'm less familiar with what happened in America, but in Britain it's been very much adopted.

So the structure is the same in the business and the public sector, and we see its consequences. There's an annual survey being done in Britain called the Jobs and Skills Survey that has asked the same question for 25 years: do you have enough autonomy in your job to be able to do it to your own satisfaction? Twenty-five years ago, most people said "yes." Since then there's been a 40% drop in those yes responses. Now most people say "no." They see themselves as automatons in a system of incentives and monitoring of performance. That produces a huge drop in job satisfaction.

What's wrong with all that? What's wrong is we aren't like that as human beings. We are naturally morally load-bearing. I haven't got time for summarizing lots of evidence, but let me instead suggest a little thought experiment—this is something you can all try yourselves at night, though if you're like me and over the age of 60, I don't recommend it. It's a questionnaire constructed by social psychologists, and they ask you just to write down the three biggest regrets in your life. And you have to do it honestly.

Now, it's quite clear what should be the responses if we were all economic man. If only I'd got the job at Goldman Sachs, if only I'd bought that house—these sorts of material concerns. We all have these kinds of material regrets, of course—but they don't make it into the top three. That bucket of regrets is pretty empty. The bucket that's overflowing is the regrets for letting people down—I let my mother or my spouse down; I let my colleagues or friends down. When we breach these obligations, they really hurt. So we learn to try not to breach obligations. We're naturally geared to being obligation-bearing—morally load-bearing.

What can we do to heal these rifts? I'm going to leave that very largely to questions, but me just sketch the two parts of what I think is the answer. (And, by the way, the second half of my book is devoted to answering this question.)

The first part of my solution is to bring jobs to people where they belong instead of just having them go to the metropole. And it is perfectly possible to bring productivity to places—not every place, but to a number of places in each region so that each region becomes a hopeful place. So the first commitment is to bringing jobs and productivity to places that don't have them. It's not enough to transfer consumption. That argument is part of the utilitarian fallacy: because people are greedy, lazy, and selfish, all that they care about is consumption. But people are not like that; they want to be able to contribute both to their family and to society—and to do that they need to be productive.

So bringing productivity and jobs to places where people belong is half of the task. The other half is to equip people to be able to do those jobs—to be productive, to bond with the community where they grew up, and to want to contribute to their family and to their community. I think of that as a chain of interventions that starts at conception and takes you all the way through your career. Both Britain and America handle that chain atrociously. We're brilliant for the people who are cognitively gifted, like the people in this classroom; but for the other half of young people, both Britain and America are terrible. We do an awful job of vocational training, to take just one example.

How do we change all that? Above all, we need to get back to widely distributed moral load-bearing. We can't have a structure with a few saints at the top of society who are then tasked with bullying and cajoling the sinners into conforming with good behavior. We need widely distributed moral load-bearing.

And on that note, I'll turn it over to Colin, who I think will direct my message towards firms. Thank you.

Commitment to Corporate Purpose

Colin Mayer: Thanks, Paul. I'm going to pick up from where Paul left off by talking about a particularly important part of the capitalist system, and that is the part that employs us, invests our savings, feeds us, and clothes us. And it's the source of much of the prosperity that we talk about within our capitalist systems. I'm talking about the business sector and the world of corporations—and in so doing I'm also going to be talking about a program of research that's now being undertaken in London at the British Academy on the Future of the Corporation.

The aim of this program is to look at how business needs to evolve over the coming decades to address the environmental, social, and political problems it faces—and to take advantage of the remarkable scientific and technological opportunities and advances that are currently happening. This program has brought together people across the humanities and the social sciences to try to answer that question and put them together with business leaders to ensure that the program is not only academically excellent, but also practically relevant.

What has emerged from the program is the need to rethink and reconceptualize business around three notions: the purpose of business, which I'll say a little bit more about shortly;

the trustworthiness of business; and the appropriate values and culture of business for creating that trustworthiness and delivering those purposes. And since I last spoke to you in March, there have been a couple of remarkable developments in the direction of what the British Academy program has been proposing.

At the beginning of this year, we had the open letter to the CEOs of large U.S. companies by Larry Fink, the CEO and president of BlackRock, which urged every business to formulate and state its purpose—not just a strap line or a marketing campaign, but a statement of its fundamental reason for being, and for what it does on a daily basis.

Then, in August of this year, 181 U.S. companies signed the Business Roundtable statement that discarded the 1997 assertion of shareholder primacy in favor of the notion of corporate purpose as delivering value for customers, investing in employees, dealing fairly with suppliers, looking after communities in which they work, sustaining the environment, and delivering long-term value for shareholders.

And last month, the *Financial Times* launched its own campaign on capitalism, which is called "Time for a Reset." The *FT*'s editor Lionel Barber has written to his readers that the health of free enterprise capitalism depends on business delivering profits with purpose.

Now, these statements by investment and business leaders, and by leading journalists, are indicative of the significance and the speed of change that's taking place around the notion of why business exists, what it aspires to become, and why it's created in the first place—that is to say, the purpose of business. And everything should follow from that purpose—what business leaders do, and business practices, policies, and training, including the business school curriculum.

Underpinning this proposition are a number of the ideas that Paul was talking about in relation to capitalism more generally, and that is the need for companies to commit to their corporate purposes, and to the people who in turn help them deliver on those commitments. And these commitments are expected to give rise to reciprocal relations, the mutual benefits that are conferred both on the various parties to the firm and on the firm itself in the form of more loyal customers, more engaged employees, more reliable suppliers, and more supportive shareholders and societies. But underlying and supporting all this is the trustworthiness of business to actually deliver on those purposes, which in turn depends on the strength and genuineness of the companies' commitments to those values and corporate purposes.

What Is Corporate Purpose?

One of the questions that frequently arises in this context is, what does one actually mean by a corporate purpose? It's important to recognize that it is neither simply descriptive of what the company does, nor is it purely aspirational in terms of thinking about saving the world. It should be very clearly focused on what problems a company is seeking to solve, for whom, when, and how they're going to do it—and, critically important, why that company is particularly well-suited to solving those problems.

Let me try to illustrate what I mean by corporate purpose with an example. It's a Danish pharmaceutical company called Novo Nordisk, one of the most successful producers of insulin in the world. The company went through a process over the last few years of discovering what its purpose is. It started by thinking that its purpose was basically about producing insulin, but then it gradually came to realize it was failing in what it should really be doing: namely, delivering insulin to those people who most need it.

Insulin is used for treating type 2 diabetes, and 85% of the world's type 2 diabetes is found in low- and middle-income countries, many of which cannot afford to purchase the company's insulin. So the company began to work with a whole range of medical practitioners, doctors, hospitals, and universities to identify the most appropriate way of treating type 2 diabetes in different parts of the world. While that might involve taking insulin, in many cases it didn't.

Eventually the company came to the realization that its purpose wasn't simply to treat people with type 2 diabetes, but to prevent them from getting it in the first place. And its stated purpose is now to eradicate diabetes around the world. So it then began working with health workers, local communities, and national governments to identify the changes in lifestyles that could help people avoid getting type 2 diabetes.

Now you might say, "That is all very noble, but doesn't it undermine Novo Nordisk's business model?" The answer is absolutely not; instead, it became the source of great growth and commercial success in the company. Why? Because in the process of working with those various partners and recognizing that its purpose was actually to solve problems, it became a trusted partner, a trusted supplier for medical practitioners, local authorities, and governments.

A coherent, consistent view of capitalism…says that it's about private ownership for profit by owners and directors who engage the rest of us essentially through contracts. The alternative I've been proposing that emphasizes purpose says that capitalism can also be conceived of as producing profitable solutions that address the problems of people and planet—and by private and public owners who do not profit from producing problems for people and planet. In this view, ownership is not just a bundle of rights, but also a set of obligations and responsibilities to uphold those purposes. And companies in this view are not just nexuses of contracts, but webs of relations of trust based on principles and values that are enshrined by the boards of directors. – Colin Mayer

Four Sets of Policy Changes

So, what we are trying to do in the current stage of the British Academy Program is to go from our notion of corporate purpose to thinking about how one can in practice help companies move beyond the idea that their purpose is predominantly or solely about making money to a focus on solving social problems. And with this goal in mind, we've identified four sets of policies that are likely to be critical, if not essential, to companies in achieving this shift: the first concerns law and regulation; the second is about ownership and governance; the third concerns measurement and performance; and the fourth is about finance and investment.

The conventional view is that the law emphasizes the fiduciary responsibilities of directors of companies to their shareholders, while regulation focuses on the rules of the game and their enforcement. Ownership is concerned mainly with the rights of shareholders, and corporate governance with solving the agency problem of aligning managerial interests with those of their shareholders. Measurement typically focuses on corporate returns on physical and financial capital, with performance measured by profits net of the depreciation of physical capital. And corporate finance and investment are generally designed to provide adequate returns to investors, with the aim—at least in the best-run, most farsighted companies—of maximizing long-run shareholder value.

What's happened recently, however, as reflected in the statement by the Business Roundtable a month or so ago, is a recognition that things are not quite as straightforward as the conventional view suggests. In essence, there is a function companies have to perform that goes beyond just thinking about maximizing returns for shareholders; in particular, it involves thinking about how one promotes the interests of a company's other, non-investor stakeholders—those parties who are either involved in the delivery of a company's performance or are affected by the company's decisions and performance. Companies should take care of these parties if only because serving their interests actually increases the performance of the company and its shareholder returns. This approach has been called "enlightened value maximization" or "doing well by doing good"—and Jim Collins has described it as "the genius of the *And*." But whatever you call it, it amounts to creating benefits for society while also delivering competitive returns for your shareholders.

The importance of this recognition is its bearing on what companies actually can and should do within the current context and legal structure. For example, the law both in the U.S. and the United Kingdom permits companies to promote the interests of their non-investor stakeholders. The UK Companies Act states that the directors of a company must act in a way they consider most likely to promote the success of the company for the benefit of its "members"—that is, its shareholders; but in so doing, they must also consider the likely consequences of any decision on the long-term viability and success of the company. In other words, it's about *long-term* value for shareholders; and that means it's obliged to consider the interests of a number of other, specifically mentioned stakeholder groups—namely, employees, communities, suppliers, the environment, and the companies' reputations.

In the U.S. context, the Delaware Court emphasizes not just the importance of shareholder interests, but the importance of promoting the success of "the company." And the business judgment rule gives directors of companies the latitude to act in a way they consider designed to promote the long-run success of the company.

Responsible ownership has increasingly been viewed as not just insisting on the rights of shareholders, but also as taking the form of more active and engaged stewardship and oversight of companies by investors. And corporate governance has embraced the notion that governance is not only promoting the interests of shareholders, but also recognizing the importance of non-financial, or ESG—environmental, social, and governance—factors.

In relation to measurement, ESG has become an increasingly important element of what both companies and investors are seeking to measure. Performance is evaluated in terms of the extent to which companies succeed in improving their ESG measures, as well as increasing their profits. And corporate financing and investment are increasingly viewed as important contributors to the long-term success of companies, not just their short-term returns.

Changes in the Current Legal Framework?

But if there is a growing recognition of this need to shift the focus towards the role and importance of stakeholders in the delivery of the success of a company, there may be limits to the extent to which this is really helping to solve the problems that we face—and thus limits to relying on the enlightened self-interest of corporate shareholders and directors. Today's directors have a right to take account of those other parties and interests to the extent that this ends up benefiting their shareholders. But taking measures beyond that point is, for managers and boards, an uncertain and potentially risky proposition.

So if we want to go beyond that point in thinking about business as a powerful instrument for solving problems, we need to recognize that not everything can be done within the current framework of the law. And the importance of this stems from the fact that the rights to incorporate or form companies are not rights in the way we traditionally think about them. They are not something we receive as a given when we are born. It's rather something that we have to earn. It's in essence a privilege for which we incur a responsibility to deliver a mutual benefit to others. And this way of thinking about business as having obligations beyond just conferring benefits even in an enlightened sense on their investors is what supports the notion that business can play a role in delivering benefits that go beyond just shareholder value.

For business to play that role, one needs to recognize the ability of companies to be able to commit to the delivery of those corporate purposes, and that's where law can play a critical part. The law can act as a strong enabling force to allow companies to make those commitments. What's required for that to happen is to make purpose a central component of the law by recognizing company directors' *duty* not just to promote the success of the company for its shareholders, but also to promote the purposes of the company—*and*, equally important, to hold the directors accountable for their success in carrying out those purposes.

Regulation in this regard should be viewed as being not just about the rules of the game, but also the alignment of those corporate purposes with the social problems meant to be solved, particularly in those cases that involve important public functions. And by this I mean companies such as utilities, the banks, auditing firms, and companies that perform public services and infrastructure projects. In all of these cases, companies perform important public functions where the alignment of their corporate purpose with the public interest is critically important.

Ownership in this regard, as I suggested earlier, should be viewed as concerning not just rights, but also responsibilities. There are good examples of all of the things that I've just been talking about. In relation to law, for example, the *public benefit corporation* in the United States has purposes that go beyond just their financial performance and commit to providing some external public benefit.

Regulation, at least in the U.K., is increasingly reflecting the idea that there should be an alignment of the purposes of companies with the public social licenses that utility companies operate under. And the view of ownership as having responsibilities as well as rights is reflected in many types of ownership structures that one observes around the world. Among the most notable are "industrial foundations" in Denmark, which are companies owned by foundations and trusts whose primary responsibility is to uphold the purposes and values of the founders of those companies. Some of the largest and most successful companies in the world, including Bertelsmann, Carlsberg, and Bosch, are industrial foundation companies with professed commitments to delivering their founders' purposes.

The Case of Handelsbanken

In looking for models to guide us in moving beyond enlightened shareholder interest, it's useful to think about how companies can commit to providing benefits for their customers, employees, and the communities in which they operate. And I want to illustrate this using another example—an institution that operates in one of the least successful sectors of the economy, namely the financial sector and banking in particular. It's a bank that's done extremely well for its shareholders in terms of its financial performance—and that has also had a remarkably stable financial structure and required no help during the financial crisis.

The bank is a Swedish Bank called Handelsbanken, and one of its most distinctive features is a governance structure with highly decentralized decision-making. It has devolved decision-taking throughout the organization to the point where the company's mantra has become "the branch is the bank." Empowering the managers in the branches has allowed the bank to build very strong relationships with its customers. And these relationships of trust have in turn given rise to greater levels of satisfaction and loyalty on the parts of customers, which in turn has increased the overall revenue and financial stability of the bank.

What underpins the commitment in the case of Handelsbanken is that its owners, though not an industrial foundation, are large, long-term, reputable and engaged shareholders. And the resulting stability has allowed the bank to provide the degree of commitment to the managers who run the branches, who in turn commit to serving the customers of the bank.

In Closing: A Plausible Counter-Narrative

I want to end by bringing my call for purposeful commitment by companies to social goals beyond value maximization—and to the role of law, ownership, and governance in reinforcing those commitments—back to Paul's arguments about the responsibilities and future of capitalism. We typically think of capitalism as an economic system of private ownership of the means of production. And ownership in this context is viewed as a bundle of rights conferred on the owners of those assets, which gives them authority over other parties. Public companies in this conventional view are nothing more than "nexuses of contracts" that are overseen and managed by boards of directors on behalf of their owners.

Now that's a coherent, consistent view of capitalism—one that says that it's about private ownership for profit by owners and directors who engage the rest of us essentially through contracts. The alternative I've been proposing that emphasizes purpose says that capitalism can also be conceived of as producing profitable solutions that address the problems of people and planet—and by private and public owners who do not profit from producing problems for people and planet. In this view, ownership is not just a bundle of rights, but also a set of obligations and responsibilities to uphold those purposes. And companies in this view are not just nexuses of contracts, but webs of relations of trust based on principles and values that are enshrined by the boards of directors.

The importance of thinking about this alternative view of capitalism is that the traditional view relies on a combination of competition, product markets, capital markets, and labor markets—and in cases where markets fail, of regulation. But what this alternative view brings out is that between market efficiency and regulatory effectiveness, there is a void that, as technology accelerates, is becoming a chasm where both markets and regulation fail. And in the presence of that void, we depend increasingly on business to uphold our interests in promoting a common purpose and transforming our individual self-interest into the delivery of those common purposes. To that end, we have to rely on the trustworthiness and the commitment of companies to the creation of those common purposes, because the trustworthiness of companies is ultimately one of the most important assets of companies. Trustworthy companies are commercially successful companies, and the competitiveness of nations depends on the trustworthiness of our companies to ensure the prosperity of the many, not just the few, and for the future as well as the present.

Thank you very much.

Bresnahan: Thank you so much, Paul and Colin. Now we're going to hear from Alan Schwartz, who as I mentioned is the executive chairman of Guggenheim, and who has had a long and distinguished career in the private sector.

A Corporate View of Corporate Purpose

Alan Schwartz: Thank you, Kristin. I found it fascinating to listen to both Paul and Colin. And I confess I'm a little nervous being here in the Millstein Center, with my co-chairman Jim Millstein sitting in the room.

Let me start by telling you that I recently fell off the wagon as a recovering economist and research director—a job I had when I first joined Bear Stearns in the early '70s. After finally putting some of my thoughts down in writing, I just published a piece that's called "The Rise of Populism: How Capital Went Global But Politics Stayed National." My reason for writing this is that, for the past 15 years or so, I've been doing some lecturing at different events about a wave I saw coming through the developed world that I thought was clearly going to create some major problems of inequality in those countries. My thought was that if we anticipated and got in front of this emerging problem, we could do some things to offset the impact. But I ended up very frustrated at the end of those 15 years to find that nobody really wanted to pay attention to or do anything about this problem. Instead, all I heard was two sets of extreme views—one side insisting the system was perfectly fine and leave it alone, and the other telling us to blow it up and start over, as if there were nothing in between.

So what I tried to do in the article was to articulate as an economist where this polarization of views is coming from. And I think the place to start would be with the political swings in the late 1970s and early 1980s, especially in the U.S. and the U.K.—from political moderates like Jimmy Carter to free-market reformers like Ronald Reagan and Margaret Thatcher, with their emphasis on privatization and deregulation of industries and their pressure on public unions. These movements were a response to a scary set of events that occurred in the late 1960s and 1970s, when we saw both high unemployment and inflation at a significant and accelerating pace. That was really the first time in all of U.S. peacetime history that we experienced sustained inflation and unemployment—something novel enough to get its own name, "stagflation"—and it really scared policymakers.

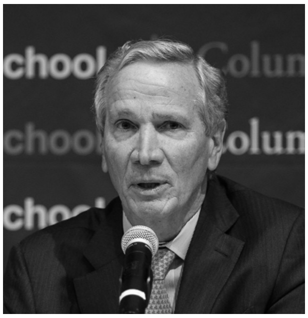
The pendulum often swings too far, and so we saw new policies that essentially threw out all the rules of the Bretton Woods agreement that we had operated under in the post-World War II environment. In so doing, we basically agreed to allow capital to flow all over the world in an unfettered way. And that seemed to be working by restoring competitive balance among the world's developed economies.

But then an event occurred that I think was a major factor in what we're talking about today, which was the collapse of communism. What the collapse of communism accomplished was to unleash a giant influx—on the order of billions—of new, mostly very low-wage, workers from places like China, Eastern Europe, and India into the free world economy. And thanks to the end of Bretton Woods, capital could flow without restriction from and to almost anywhere on earth to support operations employing those workers. Many people viewed these developments as great for the global economy; it's going to grow much faster, and those businesses and individuals that can participate in the growth of the global economy will do much, much better. But as I was warning people 15 years ago, this mass of low-wage workers also represented a wave of competition for workers in developed economies that was bound to make their lives much tougher. And that's what's been happening over the last 15 to 20 years.

So, thanks to globalization of capital and business, we've seen more people rise out of poverty more quickly than ever before—and that means that *global* income inequality has been reduced. So, if your job is running the world, you can say, "Things are fine; we're doing okay." But if you go back inside the countries themselves, the inequality has gone up dramatically—and it's of course that kind of inequality that people experience firsthand and pay attention to.

To see what's been happening as a result of globalization, think about it in these simple terms. Throughout most of the post-World War II period, for every dollar of corporate profits generated by U.S. companies, a little over $5 of salaries and wages was paid to workers. But if you look at things today, every dollar of corporate profits is now produced with only $3.50 to $4 in salaries and wages. And those salaries and wages are now much more unevenly distributed across the workforce than they were years ago. At the same time, much more of those salaries and wages go to two-worker than one-worker families, which changes the dynamic

People are asking, "How much shareholder value are you willing to sacrifice to deal with these social problems?" And I think it's because of this confusion, or lack of clarity, that most people, both on the left and the right, view the idea with skepticism. …The companies are not saying that they are going to sacrifice shareholder value to take care of all these constituencies. They are saying that, as business leaders, they recognize that the only way to create sustainable shareholder value is to take care of all their important stakeholders. – Alan Schwartz



and lifestyle those salaries and wages can support.

And this reduction of labor's share relative to capital's share of national income has been growing for quite a while. I remember thinking 15 years ago, "Wouldn't it be ironic if it took the collapse of communism to bring about the unequal outcomes in capitalism that the Marxists said would destroy capitalism?" Well, we now have a situation that has been well represented by Paul as a "derailment"—a situation that suggests the need for capitalism to adjust. I'm very fond of a saying by the Durants in their book *The Lessons of History* that goes something like, "Throughout the centuries when the masses think the elites have too much, one of two things has regularly happened: either legislation to redistribute the wealth, or revolution to distribute poverty."

As Paul also said at the start of this session, capitalism is what we need. But contrary to those who view capitalism as a fixed and unchanging system, not only the success but the survival of capitalism depends on its ability to make adjustments *all the time* to changing circumstances. And I think we've now reached one of those points where capitalism either becomes more inclusive or it collapses.

I also think that the recent statement by the Business Roundtable reflects this state of affairs. I was involved somewhat in groups of people talking to the Roundtable about coming out with a statement like this. Now, I would have phrased the statement a little differently, because I think there's some confusion. People are asking, "How much shareholder value are you willing to sacrifice to deal with these social problems?" And I think it's because of this confusion, or lack of clarity, that most people, both on the left and the right, view the idea with skepticism. Most people seem to be saying one of two things: the companies are not serious about doing it—or if they do mean what they say, it will turn out to be disastrous for the economy.

So I would have said things a little differently. The companies are *not* saying that they are going to sacrifice shareholder value to take care of all these constituencies. They are saying that, as business leaders, they recognize that the only way to create sustainable shareholder value is to take care of all their important stakeholders. And in fact, if you look at organizations like JUST Capital—which measures how different companies perform on a variety of issues, such as worker safety and satisfaction, and the environment—the shares of companies that rate high on the scale of taking care of stakeholders consistently and significantly outperform the shares of the companies that don't. On top of that, we are on the verge of a wave of new technologies coming into our economy that have the potential to create business plans designed to address social problems and so do well by doing good, as Colin was telling us earlier.

The Role of the Public Sector?

But having said all that, I don't think we can rely on business alone to solve these problems. I believe ineffective government has long been a big part of today's problems. We need better-designed regulation and some changes in policies that will encourage companies to make these changes—and to fine or tax them when they don't. And there seem to be some obvious areas of policy overlap. The corporate sector would greatly benefit from infrastructure investment, yet policy progress has been very limited at the federal level. And even though many companies find it difficult to find qualified candidates for hiring, more aggressive financial support for community colleges that can train many prospective employees has also been limited. These are two areas where cooperation could have growth-sustaining outcomes.

The problem with government, of course, is that politicians' main interest is not delivering better outcomes for the public, but rather ensuring that they get reelected—which they do by focusing on narrow or special-interest issues that excite and mobilize their supporters. This set of incentives contributes greatly to the polarization of the electorate that Paul mentioned earlier, the divide of interests that has now made it almost impossible for government to do anything constructive.

So we have to make some adjustments of capitalism. And we have to change our political system, too. If we don't, capitalism is likely to collapse.

Bresnahan: Thank you, Alan. Steve, what do you think?

Reviving the Morality of American Capitalism

Steve Pearlstein: Colin, Paul, and I essentially all had the same idea at the same time. I think we were frustrated with the debate about inequality and corporate purpose, and we realized that that conversation was sort of stuck in a rut—a rut that was created by economists and the kind of economic analysis they do, and that they're trained to do. It's analysis that totally ignores other important features of human beings, particularly the moral sensibilities that I like to think we all have—or at least most of us.

In a sense, we were trying to deal with what had become a stifling consensus among people who talked and wrote about this subject. I'm going to paraphrase this consensus as follows: we were continually asked to suppress our moral instincts when thinking about the behavior of businesses and the economy to suppress the outrage that we feel when we hear about companies bamboozling their customers, about companies that go to elaborate lengths to dodge their tax obligations, and about companies squeezing their workers. We were told to repress these beliefs, particularly in countries like the United States and the United Kingdom, because if we didn't, our companies would lose their competitiveness. They'd lose their ability to compete in global markets. And by the way, in the 1980s, that was not a fanciful concern; it was a very real concern—one that was used to make us ignore other concerns about how the pie was divided so unequally. If we didn't ignore them, we were warned, we'd wind up with a smaller pie.

So, I think that what we're all trying to deal with is that we understood that this belief was wrong both economically and morally. It was wrong morally because it runs counter to the sort of innate, hardwired instinctive beliefs we all have: that nobody should live in degradation and despair, particularly in an advanced economy; that huge wealth can be justified because of equality of opportunity when we all know in fact there is no equality of opportunity; that huge concentrations of wealth can be justified because people play by the rules of the game, when we all know that the rules of the game are rigged.

And this consensus belief was not only morally wrong, it was wrong on economic grounds. There is no absolute trade-off between the size of the pie and how equally it is divided. There is some trade-off, but no absolute trade-off. And we came to the recognition that at some point, when the inequality becomes large enough, it erodes social capital; it erodes worker productivity; and it erodes the political harmony that we need for our governments to be able to respond to changing conditions and technology. It was wrong because we came to understand that a growing pie doesn't mean that all the pieces get bigger; that a rising tide doesn't necessarily raise all boats. And once we're freed from these economic and moral fallacies, this opens up a pretty wide range of possibilities for how companies can be run and what rules or norms we should have to manage market competition in order to create a more satisfying society and a better compact between business and society.

We're now at the very beginning of that conversation of figuring out what this different kind of capitalism should and needs to be—and I think there's still a lot of fuzzy thinking going on, as we saw in last night's Democratic debate. We know that inequality at these levels is bad, but if you were to ask all the people who criticize inequality, "Okay, tell me what level of inequality you'd be willing to accept?" they don't have a very good answer. And I can tell you that because I've asked them. Their answers are not at all satisfying or useful.

We know that Wall Street and finance has too much power over the real economy and skims too much off

So, when people ask me what are the solutions, what laws would you pass or change, I always say: "I'll give you a list of things, but my most important suggestion is this: to solve these problems, you need changes in social norms, and that comes from the bottom—it doesn't come from the top. Norms change laws; laws don't change norms. – Steve Pearlstein

the top. But if we know that's true, at the same time I don't think any of us is prepared to say that managers should never be able to be challenged by investors who think they're doing a bad job and should be made to do a better job. We know that a 30% effective tax rate on the richest households is too low, but we don't really know what's the right number—one that doesn't begin to reduce their willingness to invest, work hard, and take risks. The answers to those questions are not obvious, and anyone who says they are is blowing smoke. What I'm happy to say today is that the answers to those questions won't be decided by Colin, Paul, Alan, and me. They'll be decided by you, and I look forward to watching how you figure out how to do that.

And before I stop, I'd like to respond to one thing Colin said. I absolutely agree that companies need to think much harder about their purpose, but I think we should in some sense let 1,000 flowers bloom and not give into the instinct that society should decide once and for all what those purposes are. If a company wants to be a ruthless, profit-maximizing company, they should be able to do so; but they should then have to compete in the market for customers, investors, and employees, many of whom won't want to do business with that company. And that's fine. At the same time, other companies should be able to do all the kinds of things that Colin has held up as models. But, again, we should resist the instinct to try to make companies follow one of those models or the others. In fact, the competition among the different models, among the different senses of purpose, may be the most reliable way to experiment with and then come to some new consensus about what the right model is.

The important thing, then, is to set up a set of laws—and I'm not a lawyer—that would allow companies to make that decision and protect them from Wall Street or financiers who want to impose their model on the company. And here I want to disagree with Colin's characterization of the shareholders of the company as its "owners." In American law, as the late Lynn Stout, law professor at Cornell, taught us, "Nobody owns a corporation." The corporation owns itself in the same way that nobody owns you—and we should build our legal notions around that idea. The shareholders have certain rights, including the rights to elect directors. Shareholders are the "residual claimants"—they're entitled to what's left over after the claims of all the other stakeholders have been taken care of.

So the shareholders don't own the company, and I think we should try to build our legal and regulatory notions of companies around the idea that they own themselves. They can define their own purposes, and they can be protected from shareholders or any other entity as long as they are pursuing the purposes that they have stated ahead of time and that they can change. But that said, we don't need to have a single model for all companies. And let me stop with that.

Bresnahan: Great. Thank you, Steve. All right, now I'll ask Colin to respond briefly to your and Alan's comments. And then I'll ask a few questions myself.

More on Purpose and the Business Roundtable

Mayer: Let me start by saying that I agree completely with Alan's point that the Business Roundtable was really talking about companies delivering both value for society and competitive long-run returns for shareholders—and that there's no real fundamental conflict between those two goals.

And, Steve, on your point about many flowers blooming, that is precisely the point that I'm making; we're not seeking to prescribe. We want to allow and encourage companies to structure themselves in such a way that they're able to pursue all kinds of purposes, in all kinds of ways. And those purposes may indeed be predominantly towards promoting returns for their shareholders. So when I talk about producing profitable solutions for the problems of people and planet, if you interpret that as being to produce the maximum profits, then we're essentially back to a shareholder view. But if it's primarily about producing the best solutions to a social problem, then the company's near the opposite end of the spectrum.

And I would argue that this spectrum of opportunities enriches the corporation. It allows companies to achieve a much wider set of outcomes than is possible at present. That's the sense in which it actually enhances the performance of economies—by increasing the range of opportunities for companies to serve society in ways that are not limited to enriching their shareholders.

Bresnahan: Paul, do you have any thoughts you'd like to share?

Collier: I'd like to respond to Steve's point about experimentation with corporate forms and approaches. When capitalism derails and policymakers are faced with major uncertainty about what to do, it's time to look for solutions. There isn't a guidebook that says that we now have the solution for all time. It wasn't written by Marx or anyone else. And if you don't know what to do, and you're faced with a new range of problems, the answer is to experiment and evaluate.

But there's a problem with just experimenting and evaluating; what's missing is commitment. You need some kind of overarching political commitment that says that we as a society are going to do something decisive, and stick with it. Mario Draghi, when he was president of the ECB, came up with exactly the right commitment—though, unfortunately, it was for the wrong thing—when he said, "We're going to do whatever it takes to save the euro." I'm not sure the euro is worth saving, but I am sure that that the words "whatever it takes" are exactly the right ones—because Draghi didn't really know what to do then. But as soon as the market heard that, it understood that he was making a political commitment; he was going to use whatever powers he had to salvage the situation. And it worked: the market responded, and expectations were changed dramatically.

In the case of broken provincial cities, the first thing we need to change is the expectations, because spatial narratives and spatial expectations are self-fulfilling. If Detroit is generally thought to be doomed, then sure enough it becomes doomed. So you need this overarching political commitment; Draghi's statement "whatever it takes" has the salutary effect of licensing policymakers to admit we don't know for sure what needs to be done. We're going to try several things, and as we try, we'll learn. And when we find something that works, we'll scale up.

So I agree with you, Steve, that we probably need the freedom to allow 1,000 flowers to bloom. But we also need a political commitment to make sure there are 1,000 flowers left, and we can learn from them.

Bresnahan: Alan, your thoughts?

Schwartz: Paul said earlier that when we've had these derailments, we've adjusted very quickly. I want to take issue with that. In the paper I just published, what I found really remarkable was how much the turn of the 21st century resembled the turn of the 20th century. If you think back to around 1900, the world was experiencing another great wave of globalization—of the magnitude we're seeing today—and we were also seeing political turmoil. William Jennings Bryan's famous "cross of gold" speech was made at the end of the 1890s. And the rise of the socialist party took place in the early 1900s. So there was a lot of contention and unrest over the treatment of the average person at the hands of capitalists, of the "robber barons" as they were called in those days.

But then came World War I, which had the effect of reuniting the country—and stimulating the economy. The economy experienced a strong recovery during the 1920s, but then we collapsed back in the 1930s. As the 1930s progressed, Roosevelt took the socialist agenda and pushed it as far as he could. There's no telling how far he would have gone. At one point, Roosevelt proposed a 99% marginal income tax rate. And he wanted to put five extra judges on the Supreme Court in an attempt to limit their interference.

But then we got World War II, which once again brought a politically divided and economically desperate country back together—along with a boost of investment and productivity that reinvigorated the economy going forward.

So my point in telling you all this is that things aren't that easy to just turn around; it doesn't happen quickly. In the present situation, I think we have some momentum building behind us. But it's not going to be either quick or easy to reestablish "shared prosperity" to the degree that will bridge the divide that exists within the country.

Collier: I agree with you, Alan. And I think the starting point for any effective action is restoring that sense of collective purpose, of working toward a common goal. As you pointed out, we had two ghastly wars that worked to pull us together. But I think we've got to find a better way of pulling people together.

Schwartz: We agree on that, Paul.

What Can Corporate Governance Accomplish?

Bresnahan: For those of us living in the governance world, we don't often get to see the bigger picture, to learn what's happening in the social sector, and to get much historical perspective on these important social problems. Let me ask each of the panelists to give us his sense of how far making adjustments to corporate governance is likely to get us in solving problems like climate change and inequality? Is better governance really going to move the needle?

Pearlstein: Well, I think that protecting managers and directors from self-styled activist investors is really important. You don't need a lot of public hangings for people to get the idea of how they need to behave. A lot of the problems that we see in business behavior today date to the 1980s, and it dates to the period in which hostile corporate takeovers began. So, in that respect, I think that changing corporate governance is potentially quite important.

Mayer: I agree that the emphasis on corporate profitability has intensified rapidly since the 1970s, when Milton Friedman came out with his statement about the social purpose of business. And the changes in corporate ownership and the market for corporate control have really driven companies in those directions.

In many cases, business leaders are set on doing what we're talking about here, but then find it very difficult to carry through. The one leader who's really distinguished himself in this regard is Paul Polman, the CEO of Unilever. At the end of the day, he had the rug pulled out from under his feet by the threat of a takeover by Kraft, which undermined the strategic direction he was pursuing for Unilever. And there are numerous instances of similar effects of external pressure, in some cases good effects in terms of improving the functioning of companies, but that also had the effect of preventing companies from being able to commit to their corporate purposes.

Schwartz: Especially since we've agreed on so much this evening, I think it would be fun to disagree a little. Kristin's question was, "How much impact could changes in corporate governance alone have on today's social problems?" I think the answer is, very little. I agree with Colin and Steve that the pendulum started to swing in the 1980s, but I also think the cause was something much more fundamental than Milton Friedman's statement.

The main cause of the shareholder activism of the 1980s was the bear market of the 1970s, and things like the collapse of corporate profitability and the weakness of the dollar that either contributed to or reflected the bear market. Public corporations had become bloated and unfocused. General Mills proudly called itself "The All-Weather Growth Company." And like so many other conglomerates of that period, it pursued growth for the sake of growth—mainly by buying other companies in businesses they knew little or nothing about. All this conglomerate activity ended up dragging down stock prices to the point where, during the ten-year period from 1972-1982, the Dow Jones average, when adjusted for inflation, actually *lost half its value*. In fact, things looked bad enough at the end of the '70s that Harvard's Michael Jensen wrote an article called "Can the Publication Corporation Survive?" in which he described shareholders as the *only* corporate constituency with no serious representation in boardrooms.

So then the pendulum began to swing, shareholder forces began to mobilize, and we saw the rise of corporate raiders, hostile takeovers, and LBOs. Among the most important functions of these corporate control transactions was to pull apart the most inefficient conglomerates and squeeze capital—through large buybacks and all-cash mergers—out of industries that had come to have way too much capacity, in oil and gas, steel, tires, broadcasting, you name it. And globalization has been a big force in all of this process, creating huge overcapacity in some industries, and forcing companies to streamline their operations.

The good news, though, is that having now gone through nearly 40 years of more or less continuous restructuring of most of our industries, our companies have performed remarkably well and are today in a strong competitive position. And given our current position of economic strength, I think we now have a chance to recover in ways that end up addressing at least some of our social issues. As I said, we have these amazing new technologies coming on line and, along with them, lots of promising new business and investment opportunities. And so what we really need now are business leaders with the courage and the understanding of what it takes to create long-term shareholder value while serving other social purposes as well.

But, as for the changes in, or need to reform, corporate governance, I'm okay with the Business Roundtable's new precepts if they help corporate managements do what's right; but in and of themselves, I don't think they are going to move the needle. What the Business Roundtable statement says to me is something like this: "We can now look our shareholders in the eye. We have gone through a period of shareholder activism where a lot of activists' proposals and changes turned out to be stopgaps, short-term solutions to longer-run problems. Today we are fortunate to have a lot more longer-term, if not in fact permanent, shareholders who are viewing activists' proposals with more skepticism. When faced with activist proposals, these shareholders are now telling themselves, "Some of these guys have turned out to be right, and others have proved to be shortsighted; and before we think about casting our vote with them, we want to make sure they have the long-run interests and value of the company in mind."

But that said, I think it's going to take a whole movement to get even more investors and companies thinking in these terms. This will be particularly difficult for the small companies that drive much of the growth in employment. And because this is a controversial set of issues, I think government has to play a role in encouraging this process, and ensuring that the right kinds of discussions and changes take place.

Mayer: Yes, I think that's absolutely right. The shareholder activism that has emerged in the last 15 or 20 years in response to some managerial failures has had some significant deficiencies or problems associated with it. And what we're seeing now is some recognition that we need a form of governance that does not rely as heavily, and uncritically, on that process.

The Role of Investors (and Employees and Customers) in Social Change

Bresnahan: Alan, your framing of the question provides a nice lead-in to my final question before opening things up to the audience. What is the role for investors in encouraging companies to address environmental and other social problems? We've undergone a sea change in the ownership of public companies during the last two or three decades, with representatives of as much as 75% of the stock ownership of our largest companies today being able to fit into corporate boardrooms. And Larry Fink's open letter to U.S. CEOs that Colin mentioned is a great example of one large investor urging companies to create long-term shareholder value for universal investors that are "permanent" owners with significant positions in the stocks of virtually all large companies in their index funds. How do such investors move to the next level of actually saying what kinds of change they want to see?

Pearlstein: I'm not optimistic about changing the views of investors as a way to change the behavior of companies. If you were to look at the key stakeholders, I see the major thrust for better corporate behavior coming from employees, and mainly younger employees. The competition for talent among companies is intense, and they know they cannot attract people who graduate from the best schools if they are perceived to be ruthless profit-maximizers.

And I think there's also pressure coming from customers. One example: You may remember Amazon recently announcing its intent to raise its minimum wage to $15 in response to a lot of criticism. Now, the company may well have had to pay $15 anyway, given trends in the labor market; so maybe that was inevitable—and so an easy decision to make. But one thing I happened to note is that Amazon was receiving incredible signals from some of its best, upper-middle-class, suburban, housewife customers—people who get to know the UPS people who come every week. And when a lot of these customers stopped doing business with Amazon, I think the company got the message loud and clear.

But of all the stakeholder groups that can exert pressure on companies, I think that asking or expecting the pension fund of company X, or Vanguard or Larry Fink of BlackRock to act as an enforcer of corporate good behavior is a long shot. I think investors are probably my third choice among the major stakeholders, well behind employees and customers.

Schwartz: I completely agree with that. But let me go back to the JUST Capital rankings I mentioned earlier. This kind of pressure on companies from non-investor stakeholders is already happening in the market. Customers and employees are reacting to the social behavior of companies, seeking out those businesses that behave in what they view as the right way. And that's why those businesses are outperforming their competitors—and so are their investors, as the JUST rankings show. And recognizing all this, Larry's statement to CEOs is really a call to focus more on long-term goals, and to resist the pressure to meet quarterly earnings targets when those targets get in the way of doing the right thing.

I once worked with a company where work rules and their effects on employees became a major problem. After talking this over with management for a while, we reached a mutual understanding: the fact that we all know a lot of people who will pay a premium for salmon we treat nicely before we kill and eat it contains the interesting suggestion that those same customers might buy more product from a place that treats its employees well.

So after making some adjustment of its work rules, this company saw a big boost in productivity, which is of course what businesses want, and often need, to stay competitive. Businesses everywhere are realizing that employees are not widgets, and that skill sets are important. And I think trends like the standardization and interchangeability of operations probably went too far as we came out of the '80s. Employees are not widgets, and making employees feel good about the company they work for and wanting to serve their customers is an important way to gain market share.

Mayer: I agree with all of that, and it seems clear that the next generation of employees is looking for more meaningful, fulfilling work that they can be proud of. And I see that very much in terms of the people who are passing through our business school at present—a marked change in attitude in the graduating students.

But I also think it's necessary for institutional investors to change the way in which they interact with companies. I was talking earlier about a greater role for investors in terms of stewardship, a focus on longer-term investing, and greater recognition of the significance of other measures of performance beyond financial performance. Those are all very important ways in which institutions can recognize the benefits that those different parties bring to the firm. And even if a lot of the benefits come from outside of the financial sector, such benefits need to be expressed in terms that are consistent with the language of the financial sector, and that can be understood and processed by the financial markets. They need to do all this if only to raise the investor capital they need to be able to carry out their corporate purpose.

And in that sense, I think that there is a clear deficiency in financial markets. What we have today is an abundance of what are essentially long-term investors, in particular, index funds that are passive. At the same time, we have lots of short-term, highly engaged activist funds. What we are missing are *longer-term*, engaged investors. Now that's the area where I'm beginning to see change happening with more institutional investors recognizing the potential benefits from that sort of long-term engagement. It's been most visible in some Canadian pension funds—and some of the sovereign funds are increasingly moving in this direction. But we're also seeing some of the regular investment management firms, such as the Dutch fund PGGM. That's the area where I see a gap in the institutional market—but at the same time, I see promising signs of change.

Pearlstein: It would be nice if Larry Fink took two or three companies and said, "You know what? We used to invest in these companies, but we are no longer going to include you in our funds." It doesn't have to be a large number, but that would get a lot of people's attention. I haven't seen him or others who talk a good game—and I don't mean that in a negative way—they've said the right things, but it would be nice if they put a little muscle and threats behind their words. Carrots are nice, but sticks work too.

Bresnahan: Okay, we're now going to take questions from the audience.

The Meaning of the Hong Kong Protests

Unidentified Audience: Since we are talking about the future of capitalism, I think it's appropriate to talk about what's now going on in Hong Kong. After all, Hong Kong is a model of capitalism. It has a very successful international capital market, no capital controls, and very little regulation. When Milton Friedman's classic book *Capitalism and Freedom* was reprinted in the early 2000s, he wrote a new preface saying that the experience of Hong Kong caused him to have a new appreciation for the connection between freedom and capitalism.

So, I'm curious to hear what the panelists think about what's now going on in Hong Kong.

Schwartz: What's going on now with the protests is very important. I said before when I get pessimistic about our ability to sustain capitalism, I sometimes think that if I could flip out of my coffin at the end of the next century and see what the historians are writing about this century, it wouldn't shock me to learn that it was the decline and fall of liberal democracy. We tend to assume that democracy is the clear winner these days; but it hasn't been around for that long—and we're seeing lots of democracies going backwards these days, in Latin America, Eastern Europe, you name it. A lot of countries now appear to be accepting, if not even welcoming, despots.

Much of the success of liberal democracy I think can be attributed to the rise of the United States as the world's dominant economic power; and when you're the rising economic power, at least aspects of your governance model get exported to the rest of the world. So my question is this: if an authoritarian state like China can manage what everybody thought was not possible—namely, a capitalist-type economy under a controlled government—then is it possible that liberal democracy has seen its best days?

But capitalism is not really supposed to work without some political freedom. And I think that's what we may be learning from this Hong Kong situation, and watching how it plays out. If the protests in Hong Kong end up convincing the rest of the world that the Chinese are in fact oppressors to be resisted—or, better yet, the Chinese end up allowing limited freedoms not only in Hong Kong but in the mainland—then there's a chance the capitalist model comes out of this stronger than before. But if China is somehow able to show that they can produce better broad results for their population than a capitalist democracy, then you can see people in the future saying, "Well, the idea of letting voters decide clearly doesn't work, just as allowing shareholders to decide on corporate policy failed to work before it."

But however things work out, what's happening in Hong Kong right now is incredibly important for us to pay attention to.

Mayer: Hong Kong's a particularly interesting case, because the city flourished on the back of many of the things I was talking about in terms of the trading companies, many of them family-owned businesses that prospered over a long period of time thanks to owners with intense commitments to their activities and clients. Over time, those trading companies have given way to something very similar to what happened in the case of the U.K., where the merchant banks were in many respects the equivalent of the trading companies in Hong Kong, many of them family-owned. But, in the U.K., deregulation of banks shifted ownership away from families and other long-term engaged owners to publicly traded investment banks with more market-driven incentives and goals.

The Hong Kong system is now going through a very similar development in that the firms have become heavily dependent on the performance of the financial market and the stock markets of Hong Kong. And the question is whether or not these kinds of companies provide a stable base for a flourishing economy, even one that is relatively small at least in geographical terms. For a comparable case, think about Singapore and how it has tried to develop a broader spread of business activities. So, leaving aside the political issues, just thinking about the economic system that's developing in Hong Kong raises interesting questions about whether that particular type of finance-centered development offers enough stability going forward to support a strong Hong Kong economy.

Shared Value and Emerging Markets

Unidentified Audience: In the early '80s Michael Porter wrote a book called *Competitive Advantage* that addressed a lot of the issues we are talking about here—stakeholders, the environment, social responsibility, and corporate governance. After reading that book, I worked for several years in a number of large consulting firms, and in those days statements of corporate purpose—they were then called "vision" or "mission" statements—were also very popular. So, clearly, even back then, these ideas were shared at very high levels in large companies. But it was not enough. And my first question is, Why wasn't it enough? What stopped people from carrying this out?

My second question has to do with the fact that most of what we have discussed involves mainly Western companies operating in developed economies. One exceptional development in the early '80s of the Western countries was the experiment of France with socialism from 1981 to 1983. It involved a very sharp raise of government salaries, and a massive redistribution of wealth with large tax increases. It was a disaster, and France was probably the only country in Europe that attempted it.

But what is happening now in the less advanced countries—and though we've mentioned China, it's not just China—is they are making pretty much the same mistakes that the

Western countries made a century ago, but with one difference. They don't have elections—and so politicians do not bother about the short term. But what concerns me is that with each country trying to fight for their own national champions and support their own economies at the expense of others, don't we need more cooperation among national governments to make all this work?

Mayer: First of all, in response to your observation that we've been down this road before, and why didn't this happen sooner, my answer is that this is a set of issues that has to be addressed at the systems level as well as at the level of individual companies. The idea of corporate purpose has of course been around for a long time, but for a variety of reasons we've been talking about, the system has moved in a direction in which the promotion of purpose beyond profit has become increasingly difficult. And that's why we're reaching the crisis point now where so many people are saying, "The existing capitalist system is failing and has to be changed." So, we're now talking about how to restructure the system so it's able to deliver the objectives that Michael Porter and others have been talking about for some time.

Now, as for your question about the consequences of individual countries pursuing objectives on their own, and in different and in many cases undemocratic ways, I think the point you're making about the French experiment with socialism is very important. One of the strongest motives for reform in Britain today is the very real concern of many U.K. companies that if they fail to take some steps to help address these problems, they're going to end up with a Labor government that seeks to renationalize much of British industry—much along the lines of what you were talking about in relation to France. And a lot of the concern driving the Business Roundtable statement is essentially to head off what they see as the potential political reaction to America's perceived social and economic problems, however exaggerated such problems are by our politicians and media.

Schwartz: Well, the Democratic debates last night might certainly reinforce those concerns, right? But let me say a couple of things here. Michael Porter is a friend of mine, and he and his partner Katherine Gehl are coming out with a new book focused on the dysfunction of our political system. From their vantage point as business strategists, they view the U.S. political system as having achieved what in business would be called a *duopoly*. In this case, it's the duopoly of our effectively two-party system—an outcome, by the way, that our Founding Fathers always said was one of their worst fears, two dominant parties competing year in and year out to maintain power or unseat the other.

As Porter sees it, this U.S. political duopoly has constructed an elaborate ecosystem designed to preserve its own power and position. The two parties are doing what every duopoly would do to maintain its power, but their objectives and goals have nothing to do with delivering results for U.S. citizens, for the people who elect them and the constituencies they're supposed to serve. In the business world, duopolies are generally prevented by the potential entry of competitors promising to deliver better results. This outcome is the expected one in business because there is a set of rules that promotes competition, allowing and even encouraging competitors. But in the political world, our two-party duopoly constantly resets its own rules in ways that stifle any competition.

Now, when it comes to this question of global coordination of national economies, it's very hard to accomplish that when basically every country is forced to contend with both the right- and left-leaning divisions within their own political economies. And you can see that happening right now in the U.S. with trade. To me, our best policy option was to join TPP. Though we clearly need to change some of the rules of our trade with China, I think the best solution would be to get 14 different countries to come together and rewrite the rules. And having done that, we would all turn to China and say, "If you want to be part of this global economy, you're going to have to play by our new rules."

The problem, though, is that people inside each country are tired of global solutions. They want somebody who's telling them he's going to fix what's going on in their country right now.

In Closing: The Role of Culture (for Better or Worse)

Pearlstein: But let me add that, in looking for solutions to these problems, culture also matters—and the reason it matters is that the problems can't be fixed through government rules and regulations alone. In fact, I would argue that social norms are probably more important than regulations, and social norms exist in a cultural context. So, what might work in South Korea doesn't work here for all sorts of historical and cultural reasons. I would resist the idea of saying that there is one model that's going to work everywhere at all times. What we need to do in our country, though probably similar for all Anglo-American countries, is likely to be different than what would work in France or Northern Europe—because of the importance of social norms.

So when people ask me what are the solutions, what laws would you pass or change, I always say: "I'll give you a list of things, but my most important suggestion is this: to solve these problems, you need changes in social norms, and that comes from the bottom—it doesn't come from the top. Norms change laws; laws don't change norms.

Audience Member: While listening to those last comments, I was thinking of the famous quote, "Culture eats strategy and processes, including culture governance, for breakfast." What I'm hearing in the comments of Sir Collins and Professors Mayer and Pearlstein is a struggle between a Skinnerian version of humanity, which has to do solely with getting the incentives right—we don't really care to know more, just so we can get the organism to behave—and a Freudian version, whose aim is to engage the whole person, even the subconscious, and to improve our connections to others.

My concern is that, as we move too far from the Skinnerian extreme to the Freudian, we will end up tapping into a lot of the things we wished we hadn't. When you use words like "purpose" and "commitment" and "culture," you're bound to trigger tribalism, nationalism, and a lot of other things that have to do with how we relate to one other. And those can have very dark sides. Culture can be dangerous—think about the rise of intense nationalism in local areas and the growth of populism.

Think about some of the most aggressive corporate cultures—massive cover-ups on behalf of the corporation like what went on at Volkswagen. I'm guessing that a good number of German engineers and workers—and maybe even some of the regulators who were supposed to oversee their activities—thought that their manipulations were somehow contributing to the perpetuation of a great national institution, the company that, after all, aspired to be the world's largest automaker and employer. And it's no surprise to me that VW's stock was 20% owned by the local Saxony government, which also seemed very much to want to look the other way! So that's the dark side of culture that concerns me.

And think about another of the world's oldest institutions, the Catholic Church, a big part of whose mission is to get people to look out for each other within communities. When you start relying on those kinds of connections, those deep interpersonal ties can also become the roots of a cover-up of major problems. In that case, the intensity of those commitments by and to organizations can become a major source of the problem.

So my question is, when you insist that organizations and people make these deep commitments to each other, how do you keep us from going into some dark places, from producing the kinds of behavior that often come out of groups with an intensely held sense of purpose and mission? How do we save ourselves from purpose run amok?

Mayer: My aim in instilling corporate purpose is to take companies whose current ways of operating are harmful for other parties—and for society at large—and to transform them into organizations that provide net benefit both to those within the organization and the outsiders who are affected by it. What I'm talking about is, can we rethink the purpose of an organization in such way to bring about that transformation, to get more people to view themselves not as individuals opposed to or in competition with everyone else, but as cooperative parties with a larger common purpose. And I think that although many organizations have succeeded in instilling that sense of purpose, many others appear to be doing exactly the opposite. That's what a lot of the financial crisis was about. Building the right culture around the right corporate purpose is to my mind a key element in achieving the right outcome.

Schwartz: We're not talking about corporations taking over our government, or taking over our society. I think the question we're really asking is where corporates fit into a society, what role or roles do we want our companies to play. For most of the 20th century, we wanted them to provide jobs for people and pay taxes to help fund government while providing returns for their shareholders—and we expected them to abide by laws and regulation while applauding any other efforts they make to help local communities. But the world has changed, and the expectations for companies along with it. And the question is, what is the appropriate role for business within today's society? Do we want our companies to assume some of the tasks once performed by governments—and even by religious institutions?

It's not yet clear to me where we're going to end up drawing the line—and companies may end up deciding this stuff through their own experimentation. But it's not to become cult figures and start telling the world how we think it should operate.

What I think is clear is that the world now expects—and people are beginning to demand—a more inclusive kind of capitalism. For example, business can play important roles in dealing with social issues like climate change and diversity, things like that. But at the end of the day, what I think it really boils down to is that people need to feel the system is fair. Take the question about how much inequality is acceptable. I used to talk about *income* inequality. I now talk about *outcome* inequality. If the average person's quality of life in a system is improving, or at least holding its own at decent levels, and if they think their children have a chance to have a better life than they do, then they are more likely to embrace the system and think logically.

People keep asking, "How can Trump voters be so stupid to believe that this guy is actually delivering results?" At the same time, other people say, "Why are AOC's voters so stupid that they think she can do what she promises." And my response to all this is to think, "When I grew up, people were not a whole lot smarter than people are today—at least they weren't in my neighborhood. But they felt the system was working."

What we're seeing in today's politics is not the product of intelligence or thought; it's the expression of emotion. When 40% of families in this country can't come up with $400 for an emergency, when people say they can't pay off their college debt, or be able to afford retirement, there is a lot of fear. When your emotions rise, your brain shuts down, right? When your emotions settle down, your brain comes back. We're now experiencing fear and anger on a national scale. To deal with this fear and anger, the challenge for business is to keep doing what it's been doing for decades—that is, increasing its own efficiency and long-run value—but at the same time to find more ways to share that value with the rest of the population. And maybe one more thing: to do a better job of demonstrating the value that's being created and shared.

Bresnahan: All right, great. That's a good note to end on. Thank you everyone for participating, and for just being here.

The End

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