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Edgecliffe-Johnson, 2019

Beyond the bottom line: should business pu

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For 50 years, companies have been told to put shareholders first. Now even their largest investors are challenging that consensus

Andrew Edgecliffe-Johnson JANUARY 4, 2019

In 1974, Phillips-Van Heusen's pension fund sold its shares in International Telephone and Telegraph at a heavy loss in protest at the US conglomerate's political donations. It was, the Financial Times reported, the first known example of a company's "anti-social" actions triggering such an exit from an otherwise attractive investment.

The decision, taken by a corporate accountability panel comprised of the shirt company's middle managers, did not much impress the FT's New York correspondent.

"Of course, the idea of a conscience committee playing David to ITT's Goliath and forcing its will on the mammoth conglomerate is laughable," he wrote, because the job of a money manager was simply "to make money rather than subjective personal judgments".

That verdict captured a consensus that was relatively new at the time, springing from Milton Friedman's argument that for a company to pursue anything other than (legal) profit would be "pure and unadulterated socialism". Executives who spouted nonsense about social responsibility were the unwitting puppets of those who would undermine a free society, the Chicago economist had thundered in a 1970 essay.

The pension fund's protest did not catch on, but Friedman's argument did, setting out a doctrine of shareholder primacy that has defined Anglo-Saxon capitalism for almost 50 years and shaped a world that is increasingly driven by corporations.

The pursuit of returns to companies' owners at the expense of other stakeholders has undoubtedly led to greater profits, generating enormous wealth for investors and the executives whose rewards have been increasingly tied to shareholder returns. But it has come at a cost to employees, customers and the environment; incentivised boards to pay less tax; diverted cash to earnings-flattering share buybacks rather than investment; and — among those outside the privileged club of equity owners — eroded the trust on which companies ultimately depend.

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A decade after the financial crisis shook voters' confidence in capitalism, the challenges to Friedman's model have been gathering momentum. Now — even as US President Donald Trump pursues stereotypically "pro-business" policies such as cutting corporate taxes and regulations — they are starting to converge into something that looks like a new worldview, shared by leading executives and investors and shaped by an unlikely alliance of consumers, employees, campaigners, academics and regulators. Together, they could break a consensus that has governed business for two generations and offer a new model for capitalism based on the watchwords of purpose, inclusion and sustainability.

For this capitalist reformation to succeed, however, it will have to prove it has more substance than spin, survive the market's down cycles and persuade a public whose faith in corporate and institutional elites remains fragile.

Most of the capitalists an FT journalist meets in 2019 sound more like the protesting shirtmakers of the 1970s than the Nobel-winning economist. Over the past year I have had business leaders lament to me that no Wall Street analyst ever asks them about their efforts to tackle climate change; I have seen companies such as Merck and Johnson & Johnson remind investors that their pre-Friedman founders believed profits would only flow if they attended to other priorities first; and I have heard Unilever's outgoing CEO Paul Polman ask provocatively:

"Why should the citizens of this world keep companies around whose sole purpose is the enrichment of a few people?"

Strikingly, their arguments have been echoed by the world's biggest investors, the very people who seem most at risk in any shift from shareholders' interests.

If Friedman's article provided the intellectual underpinning for the idea that a public company's only social responsibility was to increase its profits, the catalytic text for the new era of purposeful capitalism was a letter sent to chief executives a year ago by BlackRock's Larry Fink, who with $6.3tn of assets under management counts as the biggest investor of them all.

With governments failing to prepare for the future, he wrote, people were looking to companies to deliver not only financial performance, but a positive contribution to society, benefiting customers and communities as well as shareholders. Without a social purpose, he contended, companies fail to make the investments in employees, innovation and capital expenditures needed for long-term growth — and above-par returns to the likes of BlackRock.

Fink is far from a lone voice in his industry. Assets in US funds that aim to produce social or environmental benefits alongside financial returns grew fourfold to $12tn over the past decade, driven in part by millennials who, surveys show, are twice as likely as older generations to want their pensions to be invested responsibly. That impulse has presented fund managers shaken by the rise of low-fee index trackers with an irresistible growth opportunity.

Fink is now drafting his 2019 letter and still sounds a little shocked, and pleased, at how much discussion last year's caused. The reaction was "90:10", he says: a vocal minority "hated it" but his message resonated with far more, producing a step-change in the number of companies spelling out their purpose in annual reports. "I believe the viral nature of the letter was because I think society was asking for this," Fink says.

"I can tell you not everybody agreed with Larry's letter," adds David Abney, chief executive of the parcel delivery company UPS, "but I'd say there's more people leaning in Larry's direction, or at least they say they are."

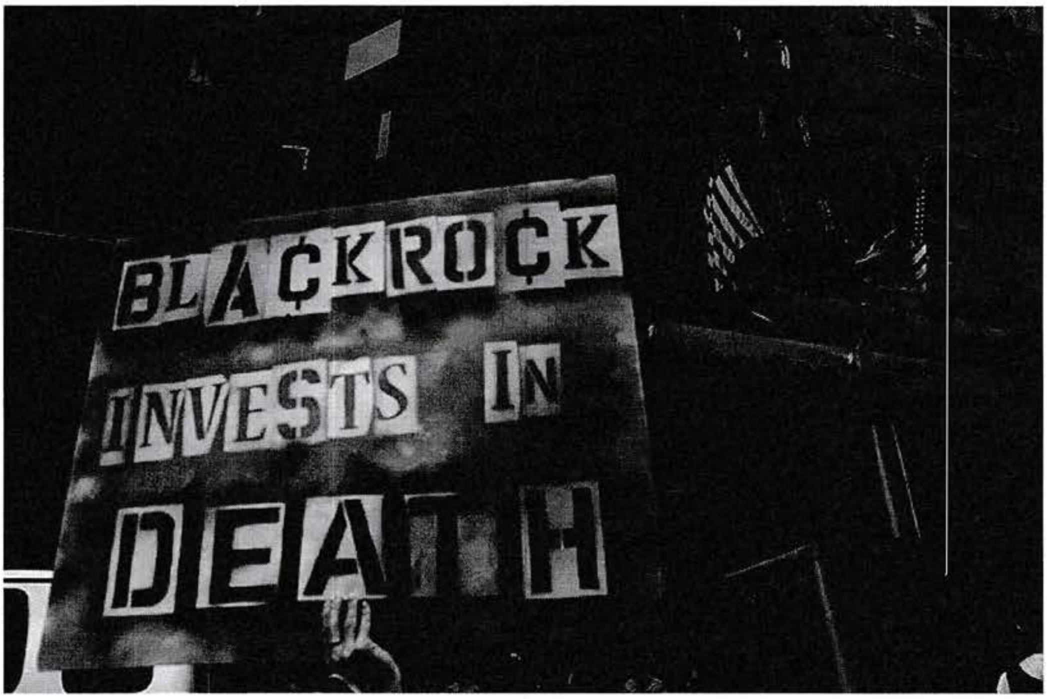
If there is a hint of caution in Abney's last remark, it may be because we have heard companies pay lip service to social virtues before now. Any regular on the CEO conference circuit already knows their triple bottom line from their circular economy and can talk fluently about impact and inclusive capitalism.

The acronyms have changed, from CSR (corporate social responsibility) to ESG (environmental, social and governance), but the desire to convince the world that business cares about more than the bottom line is nothing new. Even Lehman Brothers had a page on sustainability in its 2007 annual report, hailing its role as an environmentally conscious "global corporate citizen".

A decade after Lehman's collapse, only a slim majority of Americans have a positive view of capitalism (among those aged 18 to 29, socialism is winning). Will they be getting their hopes up about capitalists making the world a better place? And with no shortage of corporate scandals, from Wells Fargo's fake accounts to Facebook's intrusions into its users' privacy, can society trust finance or business to decide what is best for society?

One answer, Fink contends, is that governments are even less trusted. His 2018 letter was inspired, he says, by the breakdown of globalisation and multilateralism, and what he perceived as growing global frustration that governments are doing less for voters.

In the year before his last letter, he notes, US chief executives had spoken up for the Paris climate accord and quit White House business councils after Trump's equivocating response to white supremacist violence in Charlottesville. Since then BlackRock has faced pressure over its holdings of gun company stocks after the Parkland school shooting. Like it or not, business is already being dragged into society's thorniest debates, from immigration to LGBT rights, often by consumers and employees who find it easier to influence brands than elected officials.



A Gays Against Guns protest poster outside BlackRock's New York headquarters in 2016 © Bloomberg

Institutional investors are becoming effective environmental campaigners and the concept of the activist chief executive no longer sounds like an oxymoron. With many governments in disrepute, leaders of finance and business have — improbably — been handed an opportunity to lead on some of society's most pressing issues. Will they take it?

Colin Mayer of Oxford's Saïd Business School argues that they must, because the Friedman doctrine of concentrating on profit alone has acted as an unnatural constraint on the multiplicity of ways a company can serve all its constituencies. It is only over the past 50 years that we have witnessed "the retreat of the multi-purposed, publicly oriented corporation into a single-focused, self-interested entity," the economist writes in an influential new book, *Prosperity*. Elevating shareholders' interests above those of employees, the environment or communities may have made sense when financial capital was scarce, he says, but now finance is abundant while human, natural and social capital are in short supply.

Mayer's manifesto recasts the company's place in society, arguing alliteratively that its purpose is "producing profitable solutions to problems of people and planet." Profit, in other words, flows from the pursuit of a broader social purpose.

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As Harvard Business School's Joseph Bower and Lynn Paine have written, different businesses will define their purpose in different ways, but the model that replaces Friedman's framework must recognise that all companies "are embedded in a political and socioeconomic system whose health is vital to their sustainability".

It is an attractive vision, but it already has its doubters. According to Anand Giridharadas, a former fellow of the Aspen Institute think-tank, corporate do-gooding is nothing more than "an elite charade" that allows plutocrats to feel better about themselves while dodging any real challenge to the system that made them rich. "The Aspen Consensus, in a nutshell, is this," he wrote in a 2015 speech that provided the spark for his 2018 book *Winners Take All*. "The winners of our age must be challenged to do more good. But never, ever tell them to do less harm."

To sceptics such as Giridharadas, asking corporate philanthropists to solve society's problems is a recipe for the unfettered paternalism that took hold in America's Golden Age. Andrew Carnegie, the union-breaking steel magnate, argued in his 1889 essay "The Gospel of Wealth" that the concentrations of corporate power and wealth that characterised that earlier unequal era were natural, even welcome: what mattered more was how the wealthy distributed their surplus riches for the common good. Don't question the getting, in other words, if it is followed by giving.

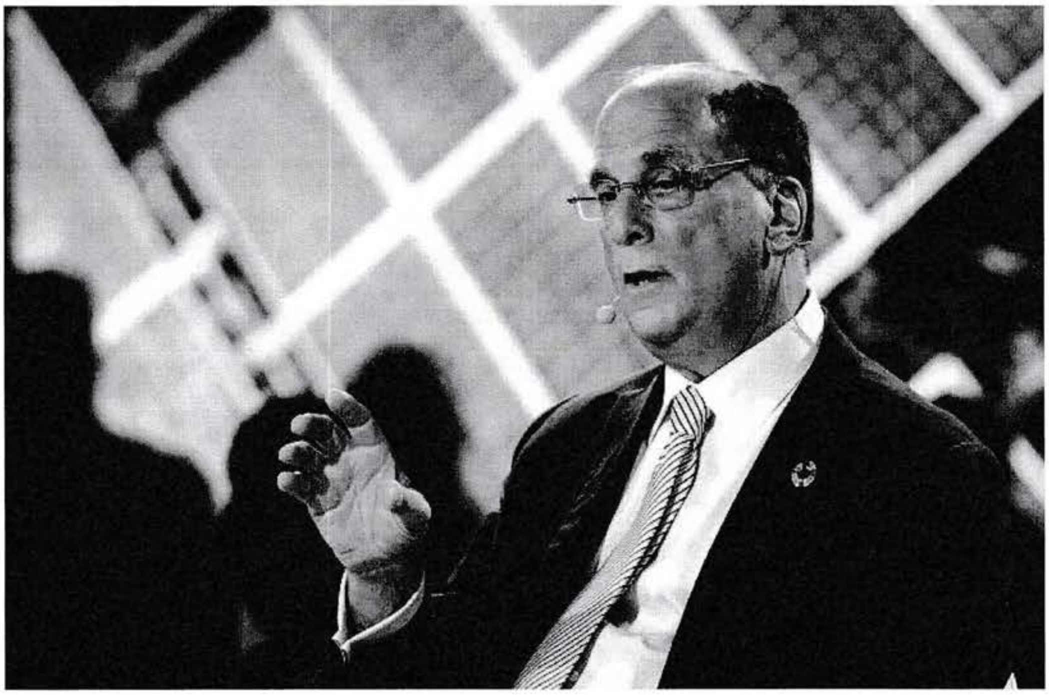
Some of those who have argued longest for business to serve a social purpose argue that it cannot do so within the current system. "The global financial crisis has woken people up in the streets and in boardrooms around the world to say we need to look at the system design flaws that produced that outcome," says Jay Coen Gilbert. "The height of lunacy is to seek different outcomes while doing the same thing over again."

Gilbert is a founder of B-Lab, which in 2007 began certifying a new type of company called a B Corporation, with a mandate to benefit all stakeholders and a commitment to submit to regular tests of its social and environmental impact. As the corporate mainstream becomes more mission-driven, larger multinationals are now showing interest, from banks to energy companies. Danone North America became a B Corp last April, joining 2,600 others including Patagonia, Gap subsidiary Athleta, and the Unilever-owned Seventh Generation and Ben & Jerry's.

The B Corp model has also inspired Elizabeth Warren, the Massachusetts senator who in August proposed an Accountable Capitalism Act that would oblige companies with revenues over $1bn to consider the interests of employees, customers and their communities alongside those of investors. With Warren this week announcing a run for the Democrats' 2020 presidential nomination, the shareholder supremacy debate could soon be thrashed out on primetime television.

Even those supporters of purposeful capitalism who would rather rebalance companies' priorities within the current system admit that hurdles stand in the path of reform. The biggest is the challenge of how to measure something as vague as purpose, which can encompass anything from treating suppliers fairly to cutting carbon emissions.

Metrics are "the soft underbelly of the ESG movement," warns Martin Whittaker, chief executive of JUST Capital, which ranks US companies on whether they are creating jobs, paying fair wages and contributing to the health of their communities and planet. (Friedman fans should note that JUST's rankings are based on a poll of the public's priorities for business that ranks shareholders dead last.)



Larry Fink, BlackRock's chief executive, who warned companies in January 2018 that they must contribute to society and deliver financial performance. Without a social purpose, he argued, companies fail to make the investments needed for long-term growth © Bloomberg

Paul Polman, chief executive of Unilever (second from right), and Singapore's deputy prime minister Tharman Shanmugaratnam (far right) take part in a panel discussion at the Confederation of Danish Industries in Copenhagen in October, part of a summit focused on sustainable growth © Reuters

Some see an opportunity in the need for better data: EY's chief executive, Mark Weinberger, predicts that the task of assessing such metrics for clients will someday be as important a business for his Big Four accounting firm as financial audits are now. But nobody has yet devised a way to measure purpose that is as simple as the bottom line of a profit and loss account. If a company misses its earnings target, investors, journalists and even algorithms know how to respond. But how should they react if it falls short of its stated purpose?

For as long as activist investors and opportunistic bidders are waiting to pounce on underperformers, no board will neglect the metric that most drives its stock. And while the purpose-before-profit movement has gathered momentum in a rising market, we do not know how it will fare in the next recession.

"Inevitably a downturn won't help," says Clare Chapman, co-chair of the UK's Purposeful Company Task Force. She notes, however, that within companies that had focused on the environment, diversity and other social responsibilities before the financial crisis, those priorities survived because "quite simply, running a business short-term is a fast way of running it into the ground."

Fink and Polman have become influential champions for the purpose-driven model, but they are on a short list of names that tend to come up in most discussions of this movement. If corporate purpose remains the preserve of a small group of western chief executives on the Davos circuit, it will fall short.

"China, India and others are absolutely not on the case at all," says Elizabeth Littlefield, a US development veteran who chairs the Global Impact Investing Network's investor forum: "It can't just be an echo chamber of CEOs who have the luxury of being concerned about these things. I worry about how we make this a truly global movement."

Even those inside the echo chamber know that some of the smaller businesses they deal with are not fully on board. One chief executive, who would not go on the record saying this, remarked drily: "Almost all of our customers are interested in what we can do to clean the environment and other stuff. You can tell it's one of their core values . . . until you get to price."

In sum, the purpose-first movement is still far from ubiquitous and lacking in reliable data, but is the pursuit of something beyond profit worse than Friedman's singular focus on shareholder returns? Encouraging companies to have a clear mission, consider their communities and steer their innovative impulses to good ends may not add up to systemic change, but it is surely better than the alternative.

Critics such as Giridharadas would rather society concentrate on restoring politics as the forum through which we address its challenges. But for as long as politicians are viewed with more suspicion than chief executives and investors, the purposeful capitalists may be our best hope.

Consumers, employees and campaigners are already learning how effective they can be in pushing companies to balance other stakeholders' concerns with their returns to shareholders. Companies, in turn, have discovered that doing so can improve their reputations, persuade investors that they have a sustainable strategy and, ultimately, benefit their bottom line.

When corporate America is paying chief executives 168 times as much as the median employee, steering the windfall from a historic tax cut to options-boosting buybacks and consolidating into ever larger groups, executives claiming to be solving society's ills can expect pushback.

The pursuit of purpose will not end the questions over how much chief executives should earn, what wages and taxes companies should pay or how much corporate power society will tolerate. Nor will investors stop judging chief executives by their share prices. But 50 years of putting shareholders first left corporations little trusted by non-shareholders and many are ready to try something different.

As companies' self-interest converges with the interests of other stakeholders, those who would improve the world have a chance to get some of the world's most powerful instruments for change onside. They should grasp the opportunity business's moral money moment has given them.

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Social purpose is not the best measure of corporate efficiency / From James Marshall, Bangkok, Thailand

Companies should act for all their stakeholders / From John Tribe, Senior Lecturer in Law, School of Law & Social Justice, University of Liverpool, UK

Shareholders have long been fooled on CEOs / From James Hazel, Stratford-upon-Avon, Warwickshire, UK