Changing the purpose of the corporation to rebalance capitalism

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Abstract  Solving the great problems of our time will require reimagining capitalism by balancing the power of the free market with capable, democratically accountable government and strong civil society. Changing the purpose of the firm has the potential to make this process of rebalancing significantly easier. Purpose-driven firms could be catalysts in the drive for systemic change by supporting transformation within their own industries, supporting cooperation in the public interest and modelling public/private partnerships, and supporting the strengthening of global democracy. Transforming the purpose of the firm will require not only changing corporate law, but also changing the metrics used to control and measure firms and the social norms that constrain and guide corporate behavior.

Keywords: sustainability, climate change, corporate governance, innovation, corporate purpose

JEL classification: K2, M1, P1, Q0

I. Introduction

Capitalism is one of the great inventions of the human race. But at the moment it is not working for the vast majority of the world’s population. Climate change is raging, many of the world’s eco-systems are on the edge of collapse, inequality continues to accelerate, and systemic racial and ethnic exclusion characterize nearly every society on the planet.

As many of the authors in this special issue suggest, the key to reforming capitalism is to rebuild the institutions that govern and constrain the economy. It is vital to revitalize our democracy (Levi, 2021), rebuild democratically accountable, capable government (Admati, 2021; Levi, 2021), strengthen civil society (Bowles and Carlin, 2021), reduce corruption (Admati, 2021), and ‘recouple’ capitalism (Kelly and Snower, 2021). But while making progress on these fronts is critically important, it will not be enough. We must also change the purpose of the firm—away from maximizing shareholder value and towards ‘solving public problems profitably and avoiding creating new problems’ (Mayer, 2018, 2019), so that the private sector can become an active partner in creating a just and sustainable society.

Consider, for example, the case of climate change. As a large and lively literature has suggested, putting in place an effective regime for pricing greenhouse emissions is
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more essential than ever (see, for example, Aldy and Stavins, 2007). But it is unlikely to be sufficient. Global warming needs to be limited to 1.5°C (2.5°F) above pre-industrial levels in order to avoid potentially dangerous climate change. This is almost certainly technologically feasible (Goodall, 2020), but it will require sustained investments at the rate of roughly 3–4 per cent of global GDP for many years, and not only the complete restructuring of the power, transportation, construction, and agricultural sectors, but also profound changes in consumer behaviour. Fully greening the US power grid, for example, will require a host of systemic investments—from control systems to power lines to storage systems—and hundreds of regulatory approvals. In the current political environment, driving this kind of transformative change will be very difficult without the active support of a private sector that is actively committed to creating social value.

Effectively addressing inequality and inequity will also be much easier when the state and civil society can partner with firms who understand their mission as being more than maximizing profits. Purpose-driven firms are much more likely to implement so-called ‘high-commitment employment systems’—that is, raising wages, treating employees with dignity and respect, and relying largely on intrinsic motivation to motivate effort (Henderson, 2020a). Moreover as Rodrik and Strancheva (2021) and Shafik (2021) suggest, solving the ‘good jobs’ problem will require building a new social contract between employees and firms, developing labour market policies that are closely linked to individual employers, and what Rodrik and Strancheva describe as a ‘process of strategic collaboration’ in combination with ‘a collaborative process of discovery’ to overcome the problem of regulatory lag and to create effective policies. Firms that are committed to solving public problems are much more likely to be willing partners in this process.

What will it take to persuade firms to adopt a pro-social purpose, and why might it make so much difference?

Across much of the world, business leaders have long believed that the purpose of the firm is to maximize shareholder value, or, in the words of Milton Friedman, that ‘the responsibility (of managers) is to conduct the business in accordance with (the desires of the firm’s owners) which generally will be to make as much money as possible’ (Friedman, 1970). This may once have been a useful framing, but it is now actively dangerous.

It is an idea that rests on three fundamental beliefs (see Burgin (2012) for an intellectual history). The first is that maximizing shareholder returns maximizes public welfare (for an early articulation of this model, see, for example, Stigler (1952)). The second is that since an individual’s ability to make decisions about the disposition of her resources and time should be one of society’s highest goals, free markets are an important foundation for individual freedom (Friedman, 1962). The third is that since managers are agents for their investors they have a duty to manage the firm as their investors would wish—which has been widely assumed to be to make as much money as possible. From this perspective, failing to maximize shareholder returns not only constitutes a betrayal of a manager’s responsibility to her investors but also threatens to reduce both prosperity and individual freedom by compromising the efficiency of the free market (Jensen and Meckling, 1976).

But maximizing shareholder value only maximizes social welfare when markets are fully competitive—when there is full information, externalities are appropriately priced, there is relatively free entry and exit, and when corporations cannot fix the rules in
their own favour. These conditions may have been approximately true in the years immediately following the Second World War, when governments nearly everywhere were popular and strong, but they no longer hold today—if they ever did.

In the 50 years since shareholder value maximization first took hold, the world has changed almost beyond recognition. Global capitalism looks less and less like the textbook model of free and fair markets on which the injunction to focus solely on profit maximization is based. Free markets only work their magic when prices reflect all available information, when there is real freedom of opportunity, and when the rules of the game support genuine competition. In today’s world, many prices are wildly out of whack, freedom of opportunity is increasingly confined to the well-connected, and firms are rewriting the rules of the game in ways that maximize their own profits while simultaneously distorting the market. If maximizing shareholder value implies fishing out the oceans, denying the reality of climate change, fighting against the policies that might enable broad-based labour market participation, and corrupting the political process, there is no reason to believe it maximizes social welfare, individual freedom, or—increasingly—meets the wishes of investors. Firms whose sole goal is profit maximization are increasingly destroying society, rather than helping to build it. It is time to rediscover the old idea that the purpose of the firm should be to support the flourishing of the society in which it is embedded.

What might this look like in practice? This is a question that is very much in flux. In August 2019 the Business Round Table—an organization composed of the CEOs of many of the largest and most powerful American corporations—released a statement redefining the purpose of the corporation as ‘to promote an economy that serves all Americans’. More than 180 CEOs committed to lead their companies for ‘the benefit of all stakeholders: customers, employees, suppliers, communities and shareholders’. Nearly every major consulting company and all the big accounting firms have practices devoted to the promotion of ‘corporate purpose’, or to the idea that firms should attempt to ‘do good’ as well as to ‘do well’.

Much of this activity is almost certainly PR, but an increasing number of firms appear to be genuinely committed to embracing the creation of social wellbeing as their primary goal. In 2010, for example, the European consumer goods giant Unilever committed itself to pursuing a ‘Sustainable Living Plan’—or ‘to help more than a million people improve their health and well-being, to halve the firm’s environmental footprint and to enhance the livelihood of thousands of people in its supply chain’. Natura, the Brazilian cosmetics company, claims that its ‘reason for being’ is ‘to create and sell products and services that promote the harmonious relationship of the individual with oneself, with others and with nature’.

These firms understand that they must succeed financially if they are to survive and to attract capital, but they view profitability as a means to an end, not as a goal in itself, and they signal the authenticity of this commitment by routinely sacrificing short-term returns in the service of achieving their (pro-social) purpose. For example, on the day that Paul Polman took over as the CEO of Unilever, he urged shareholders to put their

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1 See Unilever’s 2010 Annual Report, available at https://www.unilever.com/Images/unilever-ar10_tcm244-421849_en.pdf

2 https://www.naturabrasil.com/pages/about-us
money elsewhere if they did not ‘buy into this long-term value creation model, which is equitable, which is shared, which is sustainable’ and announced that Unilever would no longer issue either quarterly earnings guidance or reports. The share price fell roughly 6 per cent, taking nearly $2.2 billion off Unilever’s market capitalization.³

So called ‘purpose driven’ or ‘stakeholder orientated’ firms can afford to make these kinds of costly commitments for three inter-related reasons. The first is because both customers and employees are increasingly demanding that firms address the world’s problems. While there is little evidence that consumers will pay more for more sustainable products or services, in at least some cases they will switch providers when they believe they can do so without trading off either quality or price (Henderson, 2020a). Similarly, there is an increasing body of intriguing qualitative evidence suggesting that many employees—particularly young people—are increasingly willing to take lower salaries to work for a firm that they perceive embodies their values (Archor et al., 2018).

The second is because purpose-driven firms are better positioned to identify (and to act on) the commercial opportunities that our increasingly salient environmental and social challenges are creating. For example, in the early 2000s Iberdrola and Enel—both firms that made early, public commitments to ‘doing the right thing’ with regard to climate change—committed to making significant investments in renewable energy, despite the fact that at the time renewables were significantly more expensive than traditional fossil fuel fired plants, and many of their competitors were openly questioning whether climate change was caused by humans and actively lobbying against climate regulation. Ten years later, a major change in European utilities regulation in support of renewable energy cut nearly half a trillion euros from the valuations of the top 20 European utilities firms, while Iberdrola and Enel emerged as industry leaders (Henderson and Serafeim, 2020).

The third factor that can make the adoption of a pro-social-purpose social value affordable is the effect that it has on employee productivity and on organizational agility. The fact that there are large and persistent differences in productivity across ‘seemingly similar’ firms is well documented (Bartelsman and Doms, 2000; Syverson, 2011). For example, Syverson (2004) found that within 4-digit SIC (Standard Industrial Classification) industries in the US manufacturing sector, plants at the 90th percentile of the productivity distribution made almost twice as much output with the same measured inputs as the 10th percentile plant. These results are robust to a wide range of controls, including controls for the nature of competition, for the measurement of output in physical units rather than in revenue, and for problems of selection and simultaneity (Gibbons and Henderson, 2013).

One important source of these differences is persistent differences in the ability to adopt so-called ‘high performance work systems’ (Bloom and Van Reenen, 2007; Bloom et al., 2012). In general, firms with high-performance work systems invest heavily in skills development, offer significant levels of job security, promote on merit, and do everything they can to support team work, dense patterns of communication across the organization, and local problem solving.

Gibbons and Henderson (2013) argue that these kinds of practices are difficult to adopt—and hence an enduring source of advantage—because they rely on the

³ He later joked that he chose that day to make his announcement since he thought the board was unlikely to fire him on his first day.
development of high levels of trust, or on ‘relational contracts’—contracts predicated on subjective metrics that can only be enforced by the shadow of the future—that cannot simply be ‘declared’ but that must be built over time. For example Spector and McCarthy (2012) claim that for many years the (very successful) retailer Nordstrom’s employee handbook consisted of a single paragraph that read:

Welcome to Nordstrom
We’re glad to have you with our Company. Our number one goal is to provide outstanding customer service. Set both your personal and professional goals high. We have great confidence in your ability to achieve them.

Nordstrom Rules: Rule #1: Use good judgment in all situations.
There will be no additional rules.
Please feel free to ask your department manager, store manager, or division general manager any question at any time.

Gibbons and Henderson suggest that the kinds of behaviour such a statement is designed to evoke cannot be motivated by a formal contract, since by definition it is not possible to know in advance exactly what form ‘exercising good judgment’ will take. Employees must trust that managers will reward behaviours that haven’t yet been observed. This requires the development of ‘clarity’ and ‘credibility’—where clarity is a shared set of beliefs about the nature of the world, the strategy of the firm, and the likely effects of a set of plausible actions on possible outcomes, and ‘credibility’ is an informed belief that—all other things equal—the parties to the relational contract are likely to live up to their commitments, and that this implies that their adoption will require continued costly commitments over time to ‘behaving well’ (see also Adler and Heckscher (2006) and Zaheer and Bachmann (2008)). In earlier work I argue that this process is likely to be significantly easier in purpose-driven firms, both because employees are more likely to understand the firm’s strategy and because purpose-driven firms are more likely to attract pro-social individuals, and it is much easier to build cooperation when some significant number of the parties involved have a positive preference for cooperation (Henderson, 2020b).

These effects are likely to be compounded by the fact that a firm’s embrace of pro-social values often creates a shared sense of meaning and identity among employees. The belief that one’s work has meaning is one of the core drivers of intrinsic motivation and a driver of higher-quality, more-creative work (Pink, 2011). It can also create a strong sense of shared identity, another important source of intrinsic motivation (Henderson and Van den Steen, 2015). To the degree that shared purpose also supports genuine authenticity—the ability to live a life in accord with one’s deepest value—it also increases the presence of positive emotions—something that is strongly correlated with the ability to see new connections, to build new skills, to bounce back after difficult times, and to be more resistant to challenges or threats (Henderson, 2020b).

In short, there is a significant body of research consistent with the idea that a firm’s authentic commitment to pro-social goals not only makes it easier to hire and to attract customers and to identify new sustainability-related growth opportunities, but is also likely to increase the productivity and creativity of its employees. Indeed, a large literature suggests that on average there is no reason to believe that purpose-driven firms
underperform their competitors (see, for example, Eccles et al. (2014) and Edmans (2020)), and some reason to think that purpose-driven firms may actually be more profitable (see, for example, Gartenberg et al. (2019) and Ton (2014)).

II. Why purpose-driven firms might help drive systemic change

Purpose-driven firms cannot alone solve problems such as climate change or inequality since there are far too many problems that cannot be profitably addressed and that can only be solved through regulation. Building a just and sustainable economy will, as I suggested at the outset, absolutely require rebuilding our institutions. But there are at least three ways in which purpose-driven firms could be helpful.

The first is through their ability to catalyse change within individual industries. Decarbonizing the world’s transportation systems, for example, will require a host of systemic innovations and close engagement with local and national authorities. Even in the presence of strong, well-designed regulation, persuading firms to embrace this kind of sweeping change will be difficult (Henderson and Clark, 1990; Gans, 2016). Large, successful firms develop cultures, organizational processes, and incentive structures that reflect the needs of their existing business. Established firms—particularly when they are overwhelming focused on the need to generate short-term financial returns—often have great difficulty understanding the ways in which the world is changing, and struggle to act in new ways (Henderson, 2020a).

A sizeable body of research suggests that purpose-driven firms are ideally positioned to pioneer this kind of systemic innovation. As I suggested above, their commitment to a broader purpose is likely to alert them to the importance of these shifts, since purpose-driven firms are likely to have a much broader vision of their industry and are often run by leaders who possess what the psychologist Robert Kegan called a ‘self-transforming’ mind and the ability to see systems as malleable and capable of systemic transformation (Kegan, 1982).

Firms who master systemic innovation must be ‘ambidextrous’—that is, they must be able to combine the ability to juggle the need to attend to business as usual with the ability to manage the dynamic, faster-moving units that are required to incubate fundamental change. This ability requires the senior team to develop a shared understanding of the state of the world and of the firm’s strategy, to communicate this effectively to the rest of the organization, and to manage the firm through a judicious mix of subjective and objective measures that must be constantly revisited (see, for example, Tushman and O’Reilly (2016)). The characteristics that make purpose-driven firms likely to be more productive than their rivals are also likely to make this process significantly easier (Henderson, 2020b).

Purpose-driven firms are also proving to be leaders in building the cooperative public–private efforts that are also crucial to making progress. Their commitment to doing the right thing often gives them strong incentives to try to persuade their competitors to join them in addressing social problems. Unilever, for example, initially committed to buying only sustainably grown palm oil because it was keen to protect its brand and the long-term viability of its supply chain. But sustainably grown palm oil proved to
be expensive—so expensive that the firm could only afford to meet its commitment if the other large consumer goods firms agreed to make the same commitment—thus ensuring that using sustainably grown oil would be ‘pre-competitive’. Unilever was able to persuade the buyers of more than 65 per cent of the world’s globally traded palm oil to cooperate in an attempt to reduce deforestation, beginning a process of public–private engagement that continues to this day (Henderson, 2020a). As Ostrom’s research suggests, sustaining these kinds of self-regulatory efforts is difficult but entirely possible, and purpose-driven firms often have the incentive to invest in the hard work of building bridges and developing metrics that are essential if they are to succeed (Ostrom, 1990; Henderson, 2020a).

Last but not least, purpose-driven firms often have incentives to support the kinds of regulation that improve social well-being, and to advocate for the institutions that can generate them. Those firms that have made ambitious commitments to reduce greenhouse gas emissions, for example, will be significantly better off if governments can be persuaded to enact binding carbon regulation. It is surely no coincidence that many of the firms who are most visibly advocating for climate regulation are also those that are also publicly committed to pro-social purpose and that some of them are increasingly willing to speak up in defence of voting rights and the health of the democracy (Henderson, 2020c).

III. Implications for policy

If changing the purpose of the firm is so essential, how can it be done? Here I focus on three levers that might be useful: changes to accounting standards and to the metrics used to govern corporations, changes in corporate law, and—last but by no means least—changes in the normative and cultural framework within which business operates.

(i) Changing metrics

Changing the purpose of the firm requires changing the metrics used to measure and control the organization. Without material, auditable, replicable measures of the firm’s environmental and social impact it will be impossible to hold purpose-driven firms to account. If purpose-driven firms are to persuade customers to buy from them or employees to work for them because they are authentically committed to the social good, they must be able to credibly communicate that they are actually making a positive impact (or genuinely refraining from causing harm). Better measures are critical if purpose-driven firms are to change the incentives of their employees, and to measure the progress they are making towards their goals.

New metrics are also essential if the nature of the conversation between firms and investors is to shift. Business leaders often complain that the dynamics of the capital market are such that they cannot make the kinds of long-term investments that are required if they are to invest in creating social value. In October 2015, for example, when Doug McMillon, the CEO of Walmart, announced that the firm’s sales would be flat for the year and that earnings per share would fall 6–12 per cent, the value of the stock...
sank by nearly 10 per cent, taking with it roughly $20 billion in market value. McMillon had attempted to explain that the decline in earnings reflected not only a $2 billion investment in e-commerce but also a nearly $3 billion investment in paying hourly employees more—an investment that he believed would not only improve the firm’s performance by significantly increasing employee engagement, but that was also essential if Walmart was to begin addressing the issue of increasing inequality—but Wall Street was not impressed. Walmart’s stock is still majority-owned by the Walton family, who were strongly supportive of the decision, so McMillon kept his job, but many CEOs fear that in similar circumstances they would not be so fortunate. Until and unless firms can point to credible measures of assets like ‘reputation’ and ‘engagement’ and/or credible measures of ‘impact’, it will be difficult for purpose-driven firms to persuade investors to back them.

Better measures are also essential if investors are to hold firms to account for their impact on the broader world. By some measures nearly a third of publicly invested capital claims to be seeking to invest in firms that minimize their environmental impact and maximize their social contribution. Without good measures of a firm’s impact in both these areas investors will be unable to allocate their capital in the ways that they wish—and purpose-driven firms will be unable to attract the capital they need.

In the case of the very large majority of publicly traded equities that are managed by professional asset managers, good metrics will also allow asset owners to translate a concern for the long term and for social and economic performance into specific instructions for the professionals who manage their money. Many of the ultimate owners of stock—employees saving for their retirement or parents saving for their children’s education—have both much longer time horizons than their asset managers and a strong interest in ensuring that firms behave ethically and sustainably.

Developing these kinds of metrics will not be easy. There are hundreds of so-called ‘ESG’ or environmental, social, and governance metrics in use, many specialized to particular industries, and few are routinely audited or comparable across firms. But this is changing. Groups like the Sustainability Accounting Standards Board have invested heavily in developing useful standards, and a recent proposal by the IFRS (the International Financial Reporting Standards, the body that sets international reporting standards for the world) is attracting very significant attention and strong support from the world’s largest banks and accounting companies. Appropriate policy could play a powerful role in accelerating this process.

(ii) Changing the law

Many managers—particularly in the Anglo-American sphere—believe that their fiduciary duty requires them to maximize shareholder value. This is actually rarely the case. Nowhere in the world are firms legally required to maximize investor returns, and in general it is entirely legal for publicly traded firms to embrace pro-social goals.

Under Delaware law, for example, directors have fiduciary duties of care, loyalty, and good faith to both the corporation and its shareholders. This means that directors can—and should—sometimes make decisions that do not maximize shareholder value in the short term in order to pursue long-term success. US directors facing hostile takeover bids do this routinely, turning down offers that value the firm at significantly more than
its current stock price in the belief that the takeover is not in the company’s long-term interests. It is probably illegal to make a business decision that will certainly destroy long-term shareholder value, but except in a few tightly defined situations such as when they have committed to sell the firm and so called ‘Revlon duties’ have been invoked, directors are protected by the business judgement rule and can embrace a pro-social purpose if they can make a convincing case that it will increase long-term profitability (Henderson and He, 2018).

Nonetheless, in nearly every jurisdiction investors remain very much in control of the company, and their ability to replace directors at will makes many managers reluctant to commit publicly to a pro-social purpose. As I suggested above, improving the ability to measure both the presence and the impact of such a purpose would certainly help, as would changing the rules that govern activist shareholders to make their actions more transparent, increasing the holding period for long-term capital gains tax, and establishing a modest financial transaction tax (Strine, 2019). But changing corporate law could also make a significant difference.

One option is to require managers to consider the wellbeing of other stakeholders as they make decisions. For example Principle B of the new UK Corporate Governance Code states that ‘the board should establish the company’s purpose, values and strategy, and satisfy itself that these and its culture are aligned’. The British Academy Project on the Future of the Corporation suggests that directors of companies should be required to establish a company purpose, to act in a way likely to promote fulfilment of their purposes, and to have regard to the consequences of any decision on the interests of both shareholders and stakeholders (Mayer, 2019).

While these kinds of recommendations might seem relatively toothless in that they leave the investors in control of the firm, they could play an important role in reassuring managers that they cannot be penalized for considering the needs of other stakeholders, and in changing the nature of the conversation within the company and between the company and its investors. The widespread belief that a focus on the creation of social value will reduce profitability is as much an ideological or cultural artefact as it is a reasoned judgement about long-term strategy. Forcing firms to actively confront the question of whether taking a broader perspective might actually be in the long-term interest of the firm—as well as of its stakeholders—could play an important role in driving the shifts in conversation and attention that are fundamental to long-term systemic change.

Another possibility is to require firms to become ‘benefit corporations’.4 Benefit corporations are legally required to create public benefit while simultaneously seeking to give their investors decent returns. They must publish a strategy outlining just how they plan to do this, and produce an auditable report every year detailing their progress toward creating the public benefit they have promised to create. Board members are required to consider the public interest in every decision that they make.

Critically, when directors have committed to sell the firm, they can select the buyer that will create the most value for all the firm’s stakeholders, rather than the one that offers current shareholders the most cash. In a conventional firm, the knowledge that

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4 See https://benefitcorp.net/. Becoming a benefit corporation is importantly different from becoming a certified B corporation, which requires only that the firm commit to measuring itself through more than financial metrics. See https://bcorporation.net/.
there is always a risk that the directors may be forced to sell the firm to the highest bidder can make it much harder to make precisely the kind of long-term investments—in building trust, in treating one’s employees well—whose value may not be recognized in a bidding war. Moreover, the fact that conventional firms are subject to the whims of the financial markets makes them untrustworthy partners, which can in turn make it much more difficult to build the long-term, trust-based relationships that are so essential to building purpose-driven firms. Benefit corporations are thus well positioned to play a powerful role in demonstrating the ways in which purpose-driven firms can create both social and private benefit.

However, the model is heavily dependent on the firm’s ability to attract investors who share the mission of the firm, or who believe that operating this way is a reliable route to increasing profitability. In a benefit corporation all the power remains with the investors. Only they can elect the directors. Only they can sue to enforce adherence to the mission. Forcing every firm to become a benefit corporation might be a huge step forwards towards creating a universe of values-driven firms—but risks creating a world in which investors give lip service to the creation of public benefit and simply recreate the conventional firm.

Another possibility, of course, is simply to reduce the power of investors, and to vest control of the firm in employees, customers, or some form of trust or foundation. All of these forms are clearly viable: Mondragon, one of Spain’s most successful global firms, is employee owned, US customer-owned agricultural cooperatives have revenues of roughly $120 billion, and Novo Nordisk—a pharmaceutical firm whose controlling shareholder is a foundation dedicated to creating long-term social good—has been enormously successful. These are all models that are well worth exploring, and reducing the legal and regulatory hurdles that make them hard to create might support a wave of experimentation that could be immensely valuable. However it is not yet clear that they can effectively access modern capital markets at scale, potentially limiting their reach.

A potentially complementary approach to any of these moves is to change the rules that define the fiduciary duties of investment professionals. Asset managers are agents for the owners of the assets they manage, but these owners often have almost no control over the ways in which their money is invested and in many cases might plausibly wish to see their money invested in firms dedicated to the creation of social value. In response, Leo Strine, the former Chief Justice of the Delaware Supreme Court, has suggested that institutional investors be required to consider their ultimate beneficiaries’ specific investment objectives and horizons as part of their fiduciary duties, and to explain ‘how their voting policies and other stewardship practices ensure the faithful discharge of their new fiduciary duties and take into account the new information reported by large companies on employee, environmental, social and governance matters’ (Strine, 2019).

(iii) Changing norms

In the end, as Bowles and Carlin (2021) suggest, persuading firms to focus as much on the creation of social value as on the creation of financial value will require not only significant changes in accounting standards and in corporate law, but also major shifts in the normative frameworks of the business community and of the society around them.
In Germany, for example, a system dedicated to the well-being of the entire community has generated strong economic returns, large investments in environmental protection, and very low levels of inequality. German corporate law is significantly different from Anglo-American corporate law in requiring active ‘co-determination’ and, for example, the presence of employee representatives on the boards of companies over a certain size, but the nation’s commitment to stakeholder well-being is also upheld by a strong social consensus that it is the appropriate way to manage, by investors who have deep experience with its success and who are committed to its continuance, and by strong pressure from a powerful labour movement and a capable, powerful government.

In Japan, in contrast, a strong commitment to stakeholder capitalism was initially very successful but has recently been criticized for contributing to Japan’s recent weak performance. Following the Second World War, the business community explicitly embraced a model of capitalism that stressed the well-being of employees, a commitment to the long term, close engagement with suppliers, and an almost obsessive focus on the customer. These relationships were complemented by tight relationships with a few large investors who generally played no formal role in the firm’s governance. Japanese firms raised the bulk of their capital from banks, and in most firms the board of directors was staffed exclusively by company insiders and chaired by the CEO. While many firms were publicly listed, they were protected from the threat of takeover by a system of extensive cross-holdings.

This approach enabled Japanese firms to conquer the world with innovative, low-cost products of unsurpassed quality, and between 1960 and 1995 Japan’s GDP grew at an extraordinary rate. But Japan’s equity market has struggled since then, the gap between Japan’s GDP per hour worked and the G7 average has steadily increased, and by 2016 Japanese rates of productivity growth had fallen to roughly half of those in the US and Europe. Many experts blame these low rates of return on a system of corporate governance that insulates many Japanese CEOs from the investor pressure that might force them to reallocate capital to more productive uses, suggesting that the way in which stakeholder approaches are implemented and the social expectations surrounding firms matter quite as much as the details of the law.

At the global level, helping firms to find the right balance between a commitment to investors and a commitment to the well-being of the broader society will take time. It will be greatly assisted by the kinds of social and political change advocated in so many of the papers in this issue—by the revitalization of democracy, by the emergence of some kind of organized voice for employees, and by a renewed commitment to capable, democratically accountable government. But values-driven firms could be important partners in driving this agenda.

A widespread shift in the purpose of the firm could have much more than local effects—although local effects are important. Purpose-driven firms can model new ways of treating employees—raising wages, treating people with dignity and respect, and relying on intrinsic motivation, rather than threats or fear, to motivate behaviour. They can catalyse change across industries, persuading less visionary firms that solving social problems can be an important driver of economic growth. They have the motivation, the skills, and the track record to cultivate cooperation between firms, and between firms, governments, and local communities—cooperation that can solve problems no single player could tackle alone. The private sector is one of the most powerful institutions on the planet, and it has far-reaching influence on millions of lives. One recent
survey suggested that the single institution most people trusted most is the firm for which they work (Edelman, 2021). Values-driven firms can help shift cultural values, shared commitments, and deeply held values. We need broad-based institutional change and a fundamental rethinking of our normative frames. We need firms to be committed to more than simple profit maximization.

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