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Enterprise and Values series

Making Capitalism Work for Everyone

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Edited by Richard Turnbull and Tim Weinhold

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The Centre for Enterprise, Markets and Ethics

We are a think tank based in Oxford that seeks to promote an enterprise, market economy built on ethical foundations.

We undertake research on the interface of Christian theology, economics and business.

Our aim is to argue the case for an economy that generates wealth, employment, innovation and enterprise within a framework of calling, integrity, values and ethical behaviour leading to the transformation of the business enterprise and contributing to the relief of poverty.

We publish a range of material, hold events and conferences, undertake research projects and speak and teach in the areas with which we are concerned.

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For further information please contact the Director, Richard Turnbull, at:

The Centre for Enterprise, Markets and Ethics
First Floor, 31 Beaumont Street, Oxford, OX1 2NP

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List of contributors

Lord Griffiths of Fforestfach

Lord Griffiths taught at the London School of Economics, was Professor of Banking and International Finance at the City University and Dean of the City University Business School. He was a director of the Bank of England from 1983 to 1985. He served as Head of the Prime Minister's Policy Unit from 1985 to 1990 under Margaret Thatcher. He is the Chairman of the Board of the Centre for Enterprise, Markets and Ethics, Oxford.

Chris Pinney

Chris Pinney is President and CEO of the High Meadows Institute, Boston. Previously Chris was Vice President of the Alliance of Business Leadership and Director of Research and Policy at the Boston College Center for Corporate Citizenship, Boston.

Richard Turnbull

Revd Dr Richard Turnbull is the Director of the Centre for Enterprise, Markets and Ethics, Oxford. Richard was previously Principal of Wycliffe Hall, Oxford. He is a Fellow of the Royal Historical Society.

Tim Weinhold

Tim Weinhold was Director of Faith and Business at Eventide Funds, a leading Christian mutual fund, from 2013 to 2017. Tim is also an adjunct faculty member at the School of Business, Government and Economics at Seattle Pacific University, Seattle. He is also a Fellow of the Centre for Enterprise, Markets and Ethics, Oxford.

Barbara Ridpath

Barbara Ridpath is the Director of the St Paul's Institute, St Paul's Cathedral, London. Previously Barbara was the Chief Executive of the International Centre for Financial Regulation.

Introduction

Richard Turnbull and Tim Weinhold

The global economy affects the everyday lives of millions of people. Through the economic system, goods and services are exchanged, jobs created, businesses founded, taxes levied and government services funded. And lives enriched.

However, too often the system seems fixed, either in favour of big corporations, or governments or individual powerful participants. Greed and exploitation seem to replace mutuality and participation. Consequently, extreme inequalities and injustices arise, structures develop that reinforce aspects of a 'broken system' and reward is disconnected from long-term performance. As a result, increasingly large numbers of people experience alienation from the economic system whereby not all share in the fruits and benefits of economic success.

Yet this global economic capitalist system, despite all its flaws, has delivered long-term reductions in levels of poverty through jobs, enterprise and freedom. The progress has been phenomenal in terms of global absolute poverty. We cannot simply set aside the principles of economic growth and trade. Similarly, it is unrealistic to think that some sort of utopian society is possible alongside freedom, individual enterprise and personal responsibility.

The question, then, is whether the economic system can be structured in such a way that all may benefit, not necessarily equally but certainly fairly. What would be the characteristics of such a system? Aspiration, enterprise and reward should certainly be prominent, but alongside responsibility and compassion. Similarly, such a system would encompass a business structure that ensures that good work and quality long-term jobs are seen as responsibilities alongside rewarding the providers of risk capital.

We have gathered together a wide range of authors to explore this question of *Making Capitalism Work for Everyone*. Our contributors do not share exactly the same perspective on economic or other matters. We do not claim 'to know' all the answers. We are critical friends of capitalism. We seek neither utopia nor unrealistic redistributive taxation. We want to encourage wealth creation.

However, we do believe that the only effective way to ensure a prosperous economic future is a system in which all have the opportunity to succeed, all are able to participate on fair terms and all can share in just economic rewards. Similarly, we advocate a global economy in which concepts of justice and fairness shape the system. For some of us the motivations will come from a faith perspective, for others, from human values more widely.

In this first volume our contributors reflect on the principles and challenges faced by capitalism. The second volume explores practical approaches.[1]

We are deeply grateful to the Centre for Enterprise, Markets and Ethics, an Oxford-based think tank dedicated to an ethical enterprise economy for sponsoring and publishing this work.

Your two editors are delighted to have formed a close friendship as well as a professional relationship, and we commend these chapters to you.

Notes

1. All the essays plus a number of others are available in an e-book available from the Centre for Enterprise, Markets and Ethics.

Chapter 1

Instilling Values in Business[1]

Lord Griffiths of Fforestfach

I am a great admirer of Alasdair MacIntyre. He is one of the world's greatest living philosophers, invariably provocative and controversial but never without interest or depth of thought. A few years ago he gave a lecture with the arresting title 'The Irrelevance of Business Ethics'. He set out to argue that the financial crisis of 2008 was not the result of a lapse in ethics by bankers but that the very nature of dealing in financial markets was to offload risk on to a counterparty or client with no ethical consideration whatever, 'the better the trader the more morally despicable'. The result is that trying to teach ethics to traders is like reading Aristotle to a dog.

From the evidence of opinion polls the very expression 'business ethics' is an oxymoron. Since the financial crisis, banks have been fined over $300 billion, Volkswagen has admitted cheating on emission tests on potentially 11 million cars, Mitsubishi has acknowledged that it intentionally misled regulators, shareholders of blue chip companies have revolted over executive pay and a House of Commons Select Committee has investigated the sale for £1 of BHS, subsequently put into administration with a huge pensions deficit. All these suggest that business ethics is for the general public a contradiction in terms.

Why ethics matter for business

Ethical behaviour by business is important for a number of reasons.

One is that the public expect business to be ethical. They expect business to be conducted in an honest, fair and transparent manner, which serves the greater good of society and not just the interests of management and shareholders. They expect the senior managers of business firms and the entrepreneurs who set up private companies to have a moral compass that respects the dignity of those who work in the organisation and those they serve as customers. They expect that businesses will have standards that do not seek to mislead or misinform customers regarding the true price and the quality of the products and services they provide.

The fact that the public hold such views is important because through their elected representatives who pass legislation in parliaments, it is ultimately the public who grant business a licence to operate. Without such a licence, for example, limited liability companies would not exist. That licence can be changed at the will of Parliament. What has become increasingly clear is that the public will not put up with unethical business. Without ethical business, regulation will increase – just look at what's happened in banking following the financial crisis. Regulation is at best a blunt instrument in that it cannot easily be tailored to meet the needs of individual companies. Not only that but regulation is a form of taxation, and like most taxes it has a deadweight cost to society.

'The public will not put up with unethical business'

A second reason why ethics in business matters is that it underpins the legitimacy and attractiveness of a market economy. From the latter half of the eighteenth century and Adam Smith's great work on the causes of growth in *The Wealth of Nations*[2], a market economy that fosters enterprise and freedom and allows markets to work is by far the best driver of prosperity that we know, and not only that but a market economy entails a degree of economic freedom, which is a key element of political freedom. Business without ethics and values therefore undermines the appeal of a market economy and a free society.

A third reason why ethics in business matters is a personal observation. Working in a company with ethical business principles and a culture built around strong values is far more fulfilling than working in a company that turns a blind eye to ethical standards and in which the culture is based principally on success and money. I have sat on the boards of 15 companies in the private sector since working for the first 25 years of my career in the public sector. These companies were varied. Some were main boards with shares traded on the NYSE, NASDAQ or LSE; others were wholly owned subsidiary boards; some were large, others medium, some small in terms of size; two were joint ventures. The products and services covered were extensive: banking, broking, rail freight, care homes, music, cable communications, television, cleaning, killing bugs.

For me and, I suspect, for most of those who worked for the companies, the most distinguishing factor in terms of a company being 'a great place to work' was the respect shown to fellow employees, the pride the firm took in its products and services, the sense of community that existed in the organisation, management's commitment to help people develop to their full potential and the fact that it served a greater purpose than just focusing on maximising the bottom line. It is because of these qualities that such a company is trusted by its customers and the community in which it operates. It is also the reason it is able to build up a culture of trust within the organisation so that management can be trusted to make the right decisions.

Three questions business leaders must ask

If businesses are to act ethically there are three questions business leaders must ask themselves.

First, *Who are we?* Or to put it differently, *What do we stand for? What is our purpose?*

This, I believe, is the most fundamental and difficult question for any business leader to ask. To explore the purpose of a business is to go beyond profit. Without profit – which is the financial return to those who provide equity capital – a business will not survive. However, asking about purpose raises broader issues than the bottom line. Does the company take pride in the product or service it provides? Is being part of the firm a source of human flourishing? How does the company contribute to the common good by what it does?

The reason it is difficult to ask these questions is that they in turn ask each of us to look inwards and ask ourselves a far more searching set of questions, such as *Who am I? What am I doing with my life? What is the purpose of my existence?* Most of us most of the time want to park such questions and get on with the day-to-day challenges of running the business. Far better and more productive to log on and check what the markets have been doing overnight. Then respond to emails. After that, a look at today's calendar with slots filled in from early morning to late at night.

I served for 21 years on the Board of a US company, Herman Miller, which designed and manufactured office furniture. It was in the twentieth century a world leader in its field both in terms of design (it attracted great designers such as Eames, Noguchi, Nelson, Gehry, Stumpf) and environmental stewardship well before that became an important item on corporate agendas. The Chairman who invited me to join the board was Max de Pree. It was only many years later that I came across an essay written by Nicholas Wolterstorff, a distinguished Yale professor of philosophy, that I became aware of the importance of the purpose of a business. This is what he said:

'To explore the purpose of a business is to go beyond profit'

> About ten years ago now I served – quite amazingly – as a philosophical consultant to the Herman Miller Furniture Company in New Zeeland, Michigan. Max de Pree, the executive officer of the company, had invited an architect, a physician, a journalist, a furniture designer, a theologian, and me to an all-day session with him and about five of the top officers in his company. At the beginning of the day he posed ten questions that he wanted us to discuss, in whatever order we wished. He asked us not to concern ourselves with trying to say things that we thought would be useful to the company; he wanted the discussion to take whatever shape it wanted to take. I remember three of the questions. 'What is the purpose of business?' he asked. Some of his younger executives were saying that the purpose of business was to make money. He himself didn't believe that; but he wanted to talk about it. Second, he wondered whether there was 'a moral imperative', as he called it, for companies to produce products of

> good design. And third, he wanted to discuss whether it was possible to preserve what he called 'intimacy' in a large company.
>
> It became clear, in the course of the discussion, what de Pree himself regarded as the purpose of business. The purpose, as he saw it, was twofold: to produce products that serve a genuine need and are aesthetically good, and to provide meaningful work in pleasant surroundings for those employed in the company. He added that these purposes had for a long time shaped his operation of the company.
>
> Now it seems to me that these two purposes are, or can be, an expression of charity – that is, both consist to promote the welfare of the other. As a matter of fact, it became clear in the course of the discussion that it was de Pree's religious commitment – specifically, his Christian commitment – that had led him to embrace these goals. He saw his operation of the company as an exercise of charity – though he didn't use the word. His own case, at least as he presented it, was a case of 'transcendental faith' shaping economic activity.
>
> Was he prevaricating? Or deluded?[3]

Second is the question *What are our values?* Have they been set out explicitly? Are they so general as to be vacuous? Who in the firm owns the values?

It is easy to write down a set of values for a business. Indeed, nearly all large companies have similar sets of values: respect for the individual, honesty and integrity, social responsibility to the community, environmental stewardship and so on. Far more difficult is to assess their effectiveness. How do the values shape the way I work and the decisions I make? How do I behave differently because these values are set down and I am a member of that firm? What responsibilities do I now have because of these values? Do I treat colleagues differently? Do I treat clients differently?

I have found that the key to effective values in business is that they must be lived by the leadership of the company. The leadership must walk the talk. Without that the values are empty and the leaders guilty of hypocrisy –

preaching one thing but practising another. The leaders of a business cannot rely on regulation. Leadership cannot outsource the values of a business to regulators.

One test is what the leaders of a business think their values really are. Would that be shared by the average employee? Would it also be the perspective of clients and suppliers?

I was reminded of this recently in an article in *Forbes* magazine by James Heskett, professor emeritus at Harvard Business School, on the subject of servant leadership, which is a term used more in the USA than in Europe. The concept of servant leadership places great emphasis on the role of a business leader serving employees. Heskett recalls an incident at a ServiceMaster board meeting at which I was present and remember distinctly when the Chairman and CEO, William Pollard, spilled a cup of coffee prior to the board meeting.

> Instead of summoning someone to clean it up, he asked a colleague to get him a cleaning compound and a cloth, things easily found in a company that provided cleaning services. Whereupon he proceeded to get down on his hands and knees to clean the spill up himself. The remarkable thing was that board member and employees alike hardly noticed as he did it. It was as if it was expected in a company with self-proclaimed servant leadership.[4]

The third question is *What is going on in our business?*

As a non-executive director of a company whose board meets four or six times a year, one of the most frustrating challenges is obtaining sufficient information to really find out what is happening in the business. I believe it is very important that non-executives meet not only senior but middle management and even junior staff. Only once have I ever found senior management reluctant to allow non-execs to talk directly to management. Frequently the binding constraint is the time non-execs are able to devote to meeting employees. However, it is only then that they find out what is really happening in the business.

In small companies, finding out what is really going on in the business is not really a problem. In large multinationals, however, the issue is a major challenge. In the money-laundering activities carried on by certain banks the sheer size, organisational structure and large number of countries in which the bank operated have proved a major obstacle to effective control.

Practical steps to making values in business effective

A number of steps are necessary in making values effective in business.

First, it is important to set out explicitly the purpose of the business. For this a one-time mission statement is typically far too general and vague and begs the question of what the purpose of a business really is when spelt out in practical terms.

Second, it is important to set out in some detail the ethics, values and business principles of the firm. The temptation is to frame these in general terms. Management must accept that the actions of today will be judged by the standards of tomorrow, which means being ahead of the curve.

Third, on the basis of its purpose and values, the company must build a culture with implications for all employees, affecting every aspect of the business: reporting, firing, promotion, human resources, selling, buying, accounting, auditing and so on.

Fourth, senior leadership must show through 'the tone from the top' that they live the values and are committed to ensuring that the same values permeate the middle and lower echelons, the 'permafrost' of the firm.

Fifth, the leadership must be able to continually appraise the effectiveness of its values, code of ethics, business principles on conduct. They must trust, but verify. This will include keeping a close eye on disciplinary matters and terminations, with regular surveys of staff and clients. Such information is important in compensation discussions and promotion recommendations.

Sixth, in all of this, non-executive directors have a key role to play in that on behalf of the shareholders and stakeholders, they are the guardians of the purpose, values and ethics of the company.

Size, ownership, competition

The challenge of implementing values in a business can be made easier or more difficult by certain factors, namely size, ownership and the extent of competition in the markets in which the firm operates.

The size of a business matters. Implementing values in a small firm is easier than in a large firm. In a small firm it is much easier for senior management to know what is going on. A large firm needs systems of control and trust in those responsible for them. It may also be easier in a firm delivering a single product or service rather than in a conglomerate in which there are different kinds of businesses with different business cultures, something that becomes even more challenging when the company has operations in different countries.

Different forms of ownership will face different challenges. A private firm and especially a family business may find it easier to develop an effective culture than a publicly traded company. A partnership may have built in checks and balances to maintain high standards. It can be that in larger companies any concept of intimacy has disappeared.

The competitiveness of the markets in which a firm operates is a further factor to be taken into account. Competition is beneficial. It drives down costs and will lead to lower prices for consumers. It allows new firms to enter the business. It encourages innovation. However, in a highly competitive market when margins are under pressure, hiring staff is difficult and expensive; if competitors begin to use questionable methods ('tolerated practice'), ethical standards will be under pressure. This raises an important issue for public policy. What is the optimal degree of competition? Reducing barriers to entry and opening markets to foreign companies is beneficial, but is there a point at which competition becomes excessive and undermines ethical behaviour? Will the market itself be self-correcting? Should it be left to regulation? And if the market is left unregulated, at what social cost?

CONCLUSION

I believe that the subject of maintaining ethical standards in business, of creating business cultures in firms that make them 'great places to work' and of punishing wrongdoers for illegal activity, is fundamental to a market economy and a free society.

NOTES

1. This chapter formed the basis of a lecture given by Lord Griffiths of Fforestfach at an event organised jointly by the Centre for Character and Values at the Legatum Institute and Clifford Chance LLP and chaired by Christina Odone, Chair of the Centre (9 May 2016).
2. Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, London, 1776.
3. Extract from Nicholas Wolterstorff, 'Should the Work of Our Hands Have Standing in the Christian College?', in Ronald A. Wells (ed.), *Keeping Faith: Embracing the Tensions in Christian Higher Education*, Grand Rapids, MI: Eerdmans, 1996, pp. 133–51.
4. Professor James Heskett, 'Why isn't Servant Leadership more Prevalent?', *Forbes*, 5 January 2013.

Chapter 2

Re-imagining Capitalism for the 21st Century

Chris Pinney

Introduction

Few would disagree that capitalism is the most powerful economic system humanity has developed. Capitalist societies have experienced unprecedented economic and social progress, creating the highest standard of living the world has ever seen. It is the principles behind capitalism, such as individual rights, private property and free markets that generated the entrepreneurship, technological innovation and wealth that gave rise to the middle class in the seventeenth century. This in turn drove the political movements that overthrew monarchies and autocrats, leading to the development of the modern democratic state and the many freedoms its citizens now enjoy.

At the same time, it was the rise of nineteenth-century industrial capitalism and the impact on workers and income inequality that created a populist backlash against capitalism in the early twentieth century, giving rise to socialist movements and communism. As we enter the twenty-first century, it is a global capitalist economy that is once again seen as driving income inequality and disenfranchising workers in developed economies while exploiting those in emerging markets. As at the turn of the last century, we once again see a strong populist backlash against global capitalism and a growing political turmoil and uncertainty. In *How Will Capitalism End?* the economist Wolfgang Streeck notes that capitalism for the foreseeable future will hang in limbo, dead or about to die from an overdose of itself. Streeck envisages a 'society devoid of reasonably coherent and minimally stable institutions and a period of uncertainty and insecurity'.[1]

Despite these sorts of gloomy predictions, there is good reason to believe that capitalism can be re-imagined to avoid a rerun of the early twentieth century. To do so will require a fundamental rethink of the failing social contract that successfully balanced the interests of markets with the broader interests of society for the last 60 years. We now need to re-examine the responsibilities of the private, public and civil society sectors in managing a global capitalist system. We should question what each must now do to ensure capitalism continues to play its vital role as an engine for economic and social progress. Finally, we must also examine the values and principles required to ensure that markets work effectively and fairly.

This chapter offers some thoughts on these themes from three perspectives. The first considers how the technological innovations driven by capitalism reshape society and its political and social institutions. The second considers the values, principles and assumptions that gave rise to capitalism and how they can inform the future. The third explores the unravelling social contract that has governed capitalism for the last 60 years and how it can be restructured to support twenty-first-century capitalism.

The impact of capitalism on society

Over the last 500 years, capitalists in search of new ways to produce products more efficiently and profitably have been the driving force behind successive waves of technological innovations that transformed the economy from an agricultural to a mercantile one, from an industrial to a now globally integrated 'post-industrial' society. Each wave of innovation has dramatically lifted productivity, driving economic growth and increasing the returns to capital and to labour. While each advance has destroyed jobs in the previous economy, they have at the same time generated new jobs and income for workers as capitalists and their companies created new categories of products and services that raised the standard of living for all. For example, real per capita GDP in the USA grew nearly sevenfold during the twentieth century, and despite fluctuating levels of income inequality, standards of living improved for all economic groups, including the bottom 20 per cent of income earners. In 1900, fewer than one in five homes in the USA had running water, flush toilets, a vacuum cleaner or gas or electric heat. In 1950, fewer than 20 per cent of homes had air conditioning, a dishwasher or a microwave oven. Today, 80–100 per cent of American homes have these modern conveniences. As for standards of health:

> Average life expectancy in the U.S. has grown by more than 50 per cent since 1900. Infant mortality declined from 1 in 10 back then to

> 1 in 150 today. Children under 15 are at least 10 times less likely to die, as one in four did during the 19th century, with their death rate reduced by 95 per cent.[2]

As we enter the twenty-first century, capitalism is driving the next wave of technological innovation, namely machine intelligence. This new wave of technology, coupled with the impact of the globalisation of the world economy, has profound implications for our economic model and society. On the one hand, this innovation has the potential to continue to improve quality of life and dramatically reduce the need for human labour in dangerous industrial jobs or boring and repetitive tasks in service industries. On the other hand, it raises fundamental questions about the future of work and the way income is distributed in society. This leads to far-reaching implications for our economic model and the political and social institutions that govern capitalism.

According to David Autor, an MIT economist who has studied the loss of middle-class jobs to technology, 'it will be harder and harder to find things that people have a comparative advantage in versus machines', a point reinforced in a blog called *Welcome, Robot Overlords: Please Don't Fire Us?*[3] Indeed, half of the 7.5 million jobs lost during the 'Great Recession' were in industries that pay middle-class wages, which are defined as ranging from $38,000 to $68,000. Since the official end of the recession in June 2009, only about 70,000 – or 2 per cent – of the 3.5 million jobs gained have been in such mid-paying industries. At the same time, nearly 70 per cent of the restored jobs have been in low-paying industries. In the 17 European countries that use the euro as their currency, the numbers are even worse. Almost 4.3 million low-paying jobs have been gained since mid-2009, but the loss of mid-paying jobs has never stopped. Indeed, a total of 7.6 million such jobs are said to have disappeared between January 2008 and June 2013.

As more of the wealth generated by globalisation and machine intelligence goes to capital and large firms, so their influence on political systems increases. As the MIT economist Daron Acemoglu and James Robinson, a Harvard political scientist point out, although free markets tend to create widespread prosperity, they also have the potential to create concentrations of wealth and political power that are often used to suppress competition and entrench rent-seeking elites. This in turn further slows economic growth and income to labour. This skewed distribution of wealth has contributed to rising inequality, the decline of the middle class and the growth of a working poor 'underclass' whose inadequate education and low skills leave them with poor prospects for full participation in the economy as wage earners or consumers.

Some economists, including Thomas Piketty in his bestselling book *Capital in the Twenty-First Century*,[4] have argued that the period of high economic growth and moderate levels of income inequality in the developed economies during the last century are in fact an anomaly compared to historical norms. Piketty attributes the low levels of income inequality during this period to social upheavals, economic depressions and wars that shook up the social order, destroyed wealth and returns to capital and gave rise to pressures for higher taxation on both high-income earners and inherited wealth. But Piketty suggests that during the last 50 years, a period of relative stability and rising incomes in the developed economies, these pressures have moderated, contributing to a steady decline in tax rates on the wealthy. Therefore he postulates that we may now be returning to a norm in which the private return to capital exceeds the rate of national income and output. This condition, in the absence of high levels of taxation, is expected to accelerate the flow of income to those with capital and away from labour, leading to ever greater inequality and potential political unrest.

Piketty's analysis is clearly reinforced by recent data. Until a decade ago, the share of total US national income going to workers was relatively stable at around 70 per cent. The share going to capital – mainly corporate profits and returns on financial investments – made up the other 30 per cent. Slowly but steadily, however, labour's share of total national income in the USA and other OECD countries has been falling, while the share going to capital owners has gone up. During the period 2010–12, the top 1 per cent are said to have received 95 per cent of the growth in income and, according to a 2013 Credit Suisse report, now own 41 per cent of all global assets.

It is not surprising given these trends that capitalism finds itself in crisis. Once again, those who feel behind or maltreated by global capitalism are rallying behind populist and socialist movements seeking to challenge rising inequality and the power of capital over the economy and society. As in previous transitions, there is a heated debate about the values, principles and assumptions that underlie capitalism and the social contract that supports it.

What values and principles will be needed for capitalism moving forward?

Central to capitalism's future success will be the need for a set of principles that can balance the self-interest of market participants with the broader interests of society. As we consider the road ahead, it will be useful to reflect on the values that have driven capitalism's success in the past and how they can be drawn on to shape the path forward.

The foundations of capitalism were laid at a time when Catholicism still predominated and daily work itself was considered profane and mundane. It was the early Protestants Martin Luther (1483–1546) and John Calvin (1509–64) whose writings first established the perspective that daily work and self-improvement was a legitimate way to be in service of God's will and therefore encouraged. It was Calvin's writings around asceticism – frugality, rational planning and delayed gratification in service of God – that formed the backbone for the Protestant work ethic that in turn provided a strong underpinning for an emerging capitalist society.

'It is not surprising given these trends that capitalism finds itself in crisis'

Building from this foundation on the value of work, John Locke (1632–1704) championed free will and the right of individuals to own property, two principles that remain cornerstones of capitalist society today. His philosophy was founded on a belief in property rights, which are earned through work and can be transferred to other people only at the will of the owner. He believed that shareholders should receive profits because they have risked their property. Therefore it is the responsibility of the company's workers to help the enterprise generate profits. Locke's work on property rights and free enterprise is often seen as setting the groundwork and legal basis for the modern corporation.

Adam Smith (1723–90), following on Locke, was the champion of two additional principles that are still core to capitalism today. These are the principles that the best economic system for society is one that recognises individual self-interest, and that the means of production are best in private hands rather than the state's. In his renowned *Inquiry into the Nature and Causes of the Wealth of Nations* (1776), Smith stated that society is best served when each person is allowed to pursue his own best interests and that the 'invisible hand', or the competition between individuals in the marketplace, would ensure benefit to all. Importantly, however, Smith viewed this competition played out within the confines of government regulation. He reasoned this would ensure that the self-interested behaviour of the individual would serve the common social good.

Also critical to both Locke and Smith's reasoning was the assumption that the participants in the market were themselves moral beings who, acting in the spirit of the Protestant work ethic, adhered to the golden rule (see Tim Weinhold's chapter below) and acted in the interests of themselves and their fellow man. This was further elaborated by Immanuel Kant (1724–1804). Under his 'categorical imperative', he held that people should act according to the maxims they would be willing to see become universal norms. People would adhere to the rules and keep promises, such as contracts, and follow the rules out of enlightened self-interest and therefore would never treat others simply as a means to an end.

Max Weber (1864–1920), in *The Spirit of Capitalism*, noted that the countries that adhered to the values espoused by Protestant theology had the highest rate of business and economic growth. Weber saw the emerging bureaucratic organisation of the industrial age with its high degree of specialisation of activities as the organisational form most capable of achieving commercial success and meeting the needs of a modern economy. He argued that this form of organisation was the most efficient and was technically superior to all other forms of administration. To him it was the most effective way of maximising efficiency and eliminating favouritism. The rise of the large, highly specialised and compartmentalised bureaucratic organisation, however, was to have a profound impact on society, and increasingly disconnected individuals from a view of work and capitalism being in the service of a higher purpose.

Weber later in his career became highly concerned about this. He noted that:

> each man becomes a little cog in the machine and, aware of this, his one preoccupation is whether he can become a bigger cog. ... The problem which besets us now is not how can this evolution be changed? That is impossible. The question is what will come of it.[5]

As capitalism developed in the twentieth century, Weber's fears around the impact of the bureaucratic organisation were soon realised. While the power of large firms and the state grew in the industrial age, the influence of faith and the Protestant ethic diminished dramatically and was replaced by in an increasingly secular society focused on individualism, materialism and consumption. The values of respect for others and being of service to a higher social purpose that were an essential foundation for capitalism's early success rapidly eroded. Business owners became narrowly focused on maximising profits in highly competitive markets. Workers became a commodity in fragmented specialised workplaces devoted to efficiency. The alienation and disregard for rights and needs of workers under this form of organisation gave rise to trade unions and in turn became the fodder for socialist movements that called for state control over the economy. This culminated in the communist revolution in Russia and the subsequent spread of communism through Eastern Europe and later China. In the Western developed capitalist economies that survived this tumultuous era, we saw the rise of the democratic welfare state with a popular mandate to ensure measures were in place to regulate the marketplace and that workers were fairly treated, including the right to form labour unions.

The rise of the social welfare state and the trade union movement brought balance back to the relationship between the interests of capital and society. It ensured that the benefits of a capitalist-driven economic growth were shared broadly with society. At the same time, this clear division of responsibility for social well-being between the public and private sectors allowed the private sector to continue focusing ever more narrowly on profits and wealth generation for their shareholders, leaving all responsibility for regulation of markets and care for society to government. This was most succinctly articulated in the late twentieth century by the economist Milton Friedman, who famously said:

> there is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud.[6]

We now live in a global economy in which the ability of sovereign states to set the 'rules of the game' and sustain the social welfare of their citizens is in rapid decline. Built for the industrial age, the large bureaucratic institutions of most governments have little capacity to keep up with the pace of change and the needs of their citizens. As governments prove increasingly unable to serve the public interest, we see public confidence in them and their leaders falling to unprecedented lows. At the same time, companies and markets have flourished. Stock market valuations continually reach new highs. Large businesses now often have unprecedented power and influence on our political system and society. Indeed, if they were compared to the size of national economies, they would account for over half of the top 150 such entities.

It is not surprising in this environment that society is now demanding that capitalists and their companies take much greater direct responsibility for their impact and role in society. This lies not only in taking more responsibility for their environmental and social impacts but also in playing an active leadership role in helping address social challenges, from global warming to world poverty. As noted by Richard Edelman, the author behind the annual Edelman Trust Barometer, heads of large global firms must now understand that they are part of global governance and must see themselves as statesmen as well as business leaders.

This is a new paradigm for companies and their leaders. Corporate leaders must now consider the role and purpose of their firms in society in ways that go well beyond the Friedman doctrine. It requires them to think holistically about all the stakeholders their firm affects and manage their relationship with them. Operating legally is now simply one component of earning the licence to operate; the rest must be earned from the stakeholders they impact, including their workforce and customers.

At a personal level, this shift requires the leaders of large firms to rethink their role as leaders not simply of businesses but of organisations with a profound impact on society. Their challenge internally is to drive and align incentive systems around a purpose-driven culture that is about more than financial performance and the next bonus cheque.

There are signs that this reflection by business leaders on capitalism's purpose and their role as leaders is beginning to happen. In the USA there are forums such as Conscious Capitalism that focus corporate members from mid- and small-sized firms around an agenda of higher purpose, stakeholder engagement and conscious leadership and culture. Catering to a similar audience, the B Corporation movement provides a framework for certification for businesses with explicit social-purpose statements in their mission.

At the large enterprise level there are global initiatives focused on business leadership on a wide variety of systemic issues. One example is the B Team, a not-for-profit initiative formed by a global group of leaders to catalyse a better way of doing business for the well-being of people and the planet. This organisation is led by executives from Global 500 firms including Richard Branson and Paul Polman. Similarly, the World Business Council on Sustainable Development (WBCSD) is a global, CEO-led organisation of over 200 businesses and partners working to accelerate the transition to a sustainable world. This council has played a major role in mobilising business behind COP21 and other initiatives to address climate change. In 2016 the World Economic Forum, with the support of business leaders, launched the

Global Commission on Business and Sustainable Development to decode the newly launched UN Sustainable Development Goals (SDGs) and show why it makes sense for business to engage in sustainable development at a far more strategic level.

Turning to finance, the Focusing Capital on the Long Term initiative led by McKinsey and major financial and corporate leaders is committed to developing practical approaches that encourage long-term behaviours in business and investment decision-making. At the national and local level, we are also seeing growing engagement by business leaders. A good example is Business in the Community, a UK charity with more than 800 corporate members and 30 years' experience tackling a wide range of issues that are essential to creating a fairer society and a more sustainable future. These are but a few examples of business-led initiatives working to help CEOs and their companies understand their changing role in society and expand their positive impact.

'Leaders must now consider the role and purpose of their firms in society'

Another important driver pushing CEOs and their companies to consider the broader social impact and purpose of their firms is the competition for talent and the expectation of customers. There is a growing realisation by corporate leaders that having a clear sense of social purpose is increasingly important to attract and retain motivated employees from the millennial generation. A recent Babson College study found that companies with a strong sustainability commitment see increases in employees' productivity by as much as 13 per cent, reductions in turnover by as much as 50 per cent, and workers willing to take a pay cut of up to 5 per cent to work there.[7] The corporate purpose conversation is complemented by the spirituality and mindfulness in the workplace movements. A study by a large multinational firm in 2013 showed that employees working in environments that support their right to be open about their religious beliefs feel safer, have better working relationships with colleagues and are more likely to be engaged in their work.[8]

Turning to consumer expectations, a 2015 Nielsen study showed that 66 per cent of global respondents said they were willing to pay more for sustainable goods, up from 55 per cent in 2014 (and 50 per cent in 2013). At the same time, there is a small but rapidly growing movement by investors in putting their money behind their beliefs. According to the US SIF Foundation's 2016 report *Sustainable and Responsible Investing Trends in the United States*, as of year-end 2015, more than one out of every five dollars under professional management in the USA – $8.72 trillion or more – was invested in socially responsible and sustainable investment funds.

These kinds of marketplace drivers, coupled with broader societal expectation for business leadership in society, provide a useful platform for considering how to restore the values of enlightened self-interest and reciprocity with society that are essential to restoring faith in capitalism in the twenty-first century.

What kind of social contract will be needed for capitalism in the twenty-first century?

Central to the success of capitalism to date has been a social contract that relied on the ability of governments to ensure that the competitive and profit-driven ambitions of the marketplace played out within the confines of government regulation. This, as Adam Smith reasoned, would ensure that the self-interested behaviour of the individual would serve the common social good.

During most of the latter part of the twentieth century this arrangement worked well. Governments regulated markets, placed constraints on the movement of capital, set labour standards and the right of workers to organise unions, and imposed progressive taxation regimes to redistribute wealth. Labour unions operating within protected labour markets were in turn able to negotiate effectively for their share of income from the profits generated by capitalism. This ensured that the wealth generated by capitalism raised all boats and drove an increasingly consumer-based economy.

As we entered the twenty-first century, this social contract was fast unravelling in the developed nations due to an increasingly globally integrated economy driven by rapid advances in technology. Global economic integration began in the 1970s as new shipping and communications technologies gave the private sector unprecedented access to a global labour market and supply chain. Global labour market arbitrage enabled capital to escape the constraints of the high-cost developed-economy labour markets, reducing capital's costs and increasing its profitability while diminishing the power of unions. For the first time in a century the developed economies saw financial gains from rising productivity no longer shared with their workforce. At the same time, the economic forces of globalisation created political pressure on governments to reduce tariffs and lower taxes on corporations and the wealthy to compete for capital investment and jobs in a global marketplace.

The net effect of globalisation and technological innovation over the last 50 years has been a dramatic change in the balance of power between capital, government and labour in favour of capital. While the power of government and labour has declined in relative terms, the power of civil society has increased dramatically. Today there are a host of activist NGOs, from Greenpeace to Human Rights Watch, that are now at the forefront of holding capitalism and the private sector accountable to the public interest. At the same time, it is organisations such as the Environmental Defense Fund and the Fair Factory Coalition that are working with companies to help them find practical ways to discharge their new responsibilities as corporate citizens.

Moving forward, we can expect a continuous decrease in the capability of governments to set viable rules for global capitalism and in providing services to citizens. Falling revenues, an ageing workforce and mounting entitlement spending will leave little room for governments to lead the innovations now needed. This will leave increasing responsibility for setting the rules to protect the public interest and for delivering public goods to the private sector and civil society. Successful twenty-first-century capitalism will require a much more collaborative and adaptive social contract where responsibility and accountability for setting the rules and ensuring provision of public goods and services are distributed across the public, private and civil society sectors. Central to this transition will be the need for governments to see their role not as the sole mandator of the ‘rules’ and primary deliverer of social services but rather as enabler and collaborator with the private and civil society sectors to ensure that rules are in place and services delivered.

The first decades of the twenty-first century have shown the beginnings of a move to this new social contract. Every major global firm is now issuing a corporate responsibility report of some kind and has dedicated staff working on corporate sustainability and social responsibility. Over the last 20 years, ‘rule setting’ for these firms has moved well beyond compliance with the law. It now includes embracing a wide variety of ‘soft law’ or voluntary codes and standards that have been actively negotiated with NGOs and other stakeholders, including governments. These range from standards on labour practices and human rights to consumer packaging to environmental practices. Governments have begun to appreciate that industry-level voluntary initiatives such as the Responsible Care programme of the American Chemistry Council, with some government oversight and monitoring, can make an important contribution to protecting the public interest. At the same time, governments are starting to understand that enabling adaptive problem-solving by the participants in a dispute can often be more effective than, or a useful supplement to, formal rules and regulations. The UN ‘Protect, Respect and Remedy’ Framework for Business and Human Rights, for example, sets out a set of principles for valuing human rights and a framework for dialogue designed to enable multisector solutions to human-rights challenges. The framework relies on voluntary corporate leadership recognising that respecting rights is not currently an obligation that international law generally imposes directly on companies. This kind of framework is a good example of adaptive problem-solving and multisector burden-sharing of the public interest that will be required as we go forward.

We will also need to see much more robust public–private partnerships to address systemic social and environmental challenges. A good example of emerging models for this can be seen in the active involvement of global firms in developing the COP21 framework to control global warming. The final COP21 agreement includes commitments from more than 5,000 companies that together represent over $38 trillion in revenue. Also in Paris, the Science Based Targets initiative announced that 114 companies – including Ikea, Coca-Cola, Walmart, Kellogg and Dell – voluntarily committed to set emissions reduction targets in line with what scientists say is necessary to keep global warming below the threshold of 2 °C.

From reducing poverty through the UN Sustainable Development Goals to improving education, there are now thousands of initiatives at the local and international levels in which business leaders are active participants trying to solve systemic social challenges with NGOs and governments. Scaling up these forms of collaborative governance and service delivery initiatives on a global scale is essential to build a twenty-first-century social contract. It is a contract in which the private sector must now take much greater direct responsibility for managing its impacts on society and partner with the public sector and government to address broader challenges. It is only through this kind of active sharing in responsibility for society by the private sector that we ensure capitalism can remain a key driver for economic and social progress.

Conclusion

The challenges facing capitalism today are many but there is good reason to believe that by drawing on the values that guided the founders of capitalism and by re-imagining the social contract, these challenges can be overcome. None of this will be easy or simple to achieve. It will require business leaders who understand that the business of business can no longer simply be maximising returns to shareholders. It will require government leaders who are willing to move beyond the twentieth-century command-and-control mindset of their industrial-age bureaucracies. It will require civil society leaders who are more than critics but are solutions-orientated.

‘Business can no longer simply be maximising returns to shareholders’

As some of the most powerful actors in society, private-sector leadership will be particularly critical. It is also the private sector that has the most at stake in the current crisis in capitalism. It is only through their active participation and leadership that we can expect to achieve the kind of robust partnerships with government and civil society needed to address the complex challenges ahead. As we have seen, this kind of leadership is possible and the seeds of this transformation in the role of business in society are emerging. The challenge now is to make sure they develop fully into a new social contract that can ensure capitalism can continue to play its vital role in driving economic and social progress in the twenty-first century.

Notes

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Chapter 3

Recovering Moral Purpose in Capitalism

Richard Turnbull

Introduction

Capitalism is a complex word, even inadequate. Marxism uses the term in contrast to 'labour' (with the assumption that the accumulation of capital can only be at the expense of labour, a zero-sum game). Economic theory holds capital to be one of the 'factors of production', land, capital, labour and entrepreneurship, which at least allows for economic growth. Capitalism, at least in the public mind, may be linked with the opportunities, personal responsibility and individual freedom that lead to wealth creation, or with greed, lack of opportunity and inequalities that may lead to poverty – sometimes even in the same survey.[1] The Ipsos Mori Veracity Index 2016 lists 'bankers' and 'business leaders' in 19th and 20th places out of 24 professions in terms of being 'trusted to tell the truth'.[2]

There are many dilemmas. The globalisation of world trade has extended the benefits of growth, not least reductions in global poverty, but not only is the growth shared unevenly, the exclusion of many from the benefits leads to alienation. Corporate structures have tended to reinforce rather than resolve the problem. Oligopolistic markets that lack real competition are not really capitalism at all. Neither are public bailouts for failed businesses – even banks; more like socialism for the already wealthy. Corporate values and ethics as expressed in a firm's statement of purpose, mission or values have not prevented scandal.

So for some, the recovery of moral purpose in capitalism is an oxymoron. Nevertheless, the fact remains that it is the capitalist economic system that, for all its failings, delivers goods and services, well-being of individuals and communities, provides employment and opportunity and encourages enterprise and entrepreneurship. The recovery of moral purpose for capitalism, rather than being a contradiction, is the essential prerequisite for its effectiveness.

Therefore perhaps capitalism is the wrong word to describe an enterprise, market-based economy built on values of purpose, service and integrity.

In other words, an economy with values shaped historically by the Judaeo-Christian ethic, encompassing growth, reward, incentive and opportunity, but also fairness, responsibility and compassion as integral elements. Yet capitalism is here to stay. Adjectives such as inclusive, conscious, restorative, relational have all failed to capture the imagination. What capitalism needs is not a new definition but the restoration of moral purpose in markets, in business purpose, conduct and structure and, indeed, in the character of market participants.

Contours of capitalism

However, we should begin by setting out the contours of capitalism or enterprise. The debate too often begins in the wrong place – a rogue trader in a bank, a corporate scandal or issues of executive pay. From the problems, solutions are debated. The issues may indeed be very important, but if there is to be a holistic approach to creating an enterprise economy, then it is essential to begin with a vision for the market economy itself.

1. The merits of capitalism

At the heart of the moral case for enterprise and capitalism is, first, *the necessity of wealth creation for the economic and moral well-being of society*. The most effective mechanism for achieving the economic growth necessary for the common good is the market economy. This is the means for the provision of goods and services, the management of savings and investment, the encouragement of the propensity to save, the provision of employment and a tax base. The market economy brings inestimable benefits to society. As the late Michael Novak (1933–2017) notes:

> Of all the systems of political economy which have shaped our history, none has so revolutionized ordinary expectations of human life – lengthened the life span, made the elimination of poverty and famine thinkable, enlarged the range of human choice – as democratic capitalism.[3]

This, he argues, means ‘a predominantly market economy; a polity respectful of the rights of the individual to life, liberty and the pursuit of happiness; and a system of cultural institutions moved by ideals of liberty and justice for all’.[4] The evidence for the positive impact of the market on poverty reduction is insurmountable. Extreme poverty has fallen.[5]

A second crucial element to capitalism is *freedom to trade and undertake economic activity*. The market brings buyer and seller together, who trade, to mutual advantage, at the agreed price. William Bernstein tells the extraordinary story and history of trade and the overwhelming mutual benefit humanity has gained from the principle of trade: ‘World trade has yielded not only a bounty of material goods, but also of intellectual and cultural capital.’[6]

Both these points, which are all too frequently lost in debate, are reinforced by Milton Friedman’s observation that he knew of ‘no example in time or place of a society that has been marked by a large measure of political freedom, and that has not also used something comparable to a free market to organise the bulk of economic activity’.[7]

Economic growth, of course, is a contested area. For some, ‘only *relative growth* is possible: the global economy is playing a zero-sum game, with an ever-shrinking pot to be divided among the winners.’[8] However, without the wealth creation generated by the market, which leads to economic growth, it is impossible to deal effectively with issues of poverty and social welfare; to suggest otherwise is illusory.[9] Indeed, ‘higher per capita income is strongly correlated with some undeniably important factors, such as longer life expectancy, lower incidence of disease, higher literacy and a healthier environment.’[10]

Third, *the propensity to save*. The importance of savings – deposits, investment funds, life and pension funds – is often overlooked. The efficient pooling and investment of this capital in high-quality, innovative companies, technological advance and product development is an essential driver of growth and employment in an enterprise economy.

2. The failings of capitalism

The market is an efficient mechanism but it is not perfect. There are problems of monopoly, oligopoly, price fixing and the fact that the market is populated by individuals who are themselves not perfect but flawed. In the same way that the benefits of the market cannot be ignored, neither can its imperfections. Similarly, economic growth may accrue unevenly. Thus the market may lead to inequalities. Equality is not a goal per se – but extreme inequalities reinforce the loss of opportunity in an economy, significantly dampen aspiration and may result in lack of access to justice or the other basic institutions of civil society.

The first problem lies then in *the failure of competitive markets*. So, for example, in both banking and energy sectors in the UK, the market is dominated by a small number of large players. The consequence of this is that price competition is reduced, consumer choice may be limited and there are significant barriers to entry and the potential for restrictive practices. Reduced choice and high prices disproportionately affect the poor. In the early 1800s there were some 800 country banks, outside London. With the advent of joint-stock companies there were, by 1866, some 154 joint-stock banks that were members of the clearing house system; now there are just five.[11]

‘The market is an efficient mechanism but it is not perfect’

The second problem is the painful consequences of *reallocating capital*. The impact of the movement of capital from a dying or declining industry into new areas of growth has significant and negative structural impact. This may be true in terms of unemployment, the knock-on effect on consumer spending, issues of poverty and structural decline of communities. The market may indeed bring about long-term recovery but the impact of the decline and its effects cannot be denied. For example, in 1971 there were, in the UK, 320,000 people employed in the steel industry. By 2015 this had fallen to 21,000 (with a further 10,000 in steel processing). From 1975 to 2015, employment in the steel industry in Wales fell from over 60,000 to

8,500.[12] The brunt of this impact has fallen on particular communities, such as, for example, Port Talbot in South Wales.[13]

The third issue is the *exploitation of power* often seen in examples of corporate and personal greed. This perception of corporate greed is further reinforced by apparent rewards for failure, excessive remuneration and failings in corporate governance. All of these things underline the sense of 'crony capitalism', the accumulation of capital by the few, and greed.[14]

The point is that a combination of capital accumulation, globalisation of production, structural decline in industries and failings of corporate governance, combined with greed and malpractice, produces effects that cannot be ignored.

3. Capitalism and faith

The market economy has always attracted people of faith. The reasons are, of course, varied. Sociologists will point to the 'Protestant work ethic' and the formation of what Max Weber referred to as 'the spirit of capitalism'.[15] In other words, Protestants worked hard for the Lord in the world, their faith of individual discipline shaping a work ethic. For others, such as the Quakers, persecution and exclusion from the universities and from public office meant that many turned not only to business per se but also to technological research and development. Quaker involvement in manufacturing and banking went considerably beyond their numerical influence. It is quite extraordinary how many of our companies – Cadbury, Barclays, Huntley & Palmer, Clarks – had Quaker origins. The Quakers produced 'advices on trade' over many decades, warning against everything from overtrading to indebtedness and advocating the priority of good accounting. They made provision for the welfare of their employees – from sick pay to pensions; from savings banks to model housing.[16]

However, these explanations are only partial. Two other factors have formed and shaped how people of faith have influenced business. First, the development of culture. People of faith have often formed networks of families, contacts, even schools and so on. These factors led to a culture of trust and integrity in business dealings. Trade networks, credit finance, apprenticeships all developed through these culturally shaped groupings. In addition to that, most religiously minded people had clearly developed moral codes – for the Christian most usually the Bible – and as a consequence, habits of moral behaviour (honesty) also translated into business practice: fair pricing, resistance to bribes, weights and measures and indeed concern for employees and wider society.

Faith provided, for some though not all, a framework of culture and conduct. Both of those aspects of a moral, purposeful, inclusive business ethic are today often sadly lacking.

Perspectives on business

1. The changing nature of business purpose

In 1987 one of the leading chemical conglomerates at the time, ICI, described its purpose as follows:

> ICI aims to be the world's leading chemical company serving customers internationally through the innovative and responsible application of chemistry and related science. Through the achievement of our aim we will enhance the wealth and well-being of shareholders, employees, customers, and communities which we serve and in which we operate.

In 1994 the company objective had changed to:

> Our objective is to maximise value for our shareholders by focusing on businesses where we have market leadership, a technological edge, and a world competitive cost base.[17]

So what changed? What changed so that ICI no longer aimed to be 'the world's leading chemical company'? What changed such that ICI's application of science was no longer to be 'the innovative and responsible application of chemistry and related science' but only that in which they had 'a technological edge'? What happened to the 'employees, customers, and communities which we serve', to be replaced by 'to maximise value for our shareholders'?

The case of ICI is illustrative of the way business has become separated from ethics, values and a truly holistic purpose that serves the economy and society well.[18]

'Profit is essentially a by-product of purpose'

The problem lies in the way 'shareholder value maximisation' has become the single measure of business return. Continued adherence to this mantra imperils the future of the enterprise economy.

Profit – the surplus of revenues over costs, the value added to goods in the process of manufacture and sale – is a deeply moral concept. Profit is essential to the proper, effective and long-term functioning of a business. However, profit is essentially a by-product of purpose.

The objective of profit does not stand alone but is set in the context of a business's wider purposes. It is one that brings value to our ever globalised, ever competitive marketplace, in a manner that continually strives for a goal that is greater than itself. Profit becomes a by-product of this purpose-driven business model.[19]

Shareholder *value* maximisation is one of several factors that encourage short-term decision-making over long-term *values*. Others would include the tenure of CEOs, the expectations of quarterly reporting and executive remuneration based on short-term performance. Current shareholders benefit at the expense of future shareholders. The conclusion might be that all that matters is the current share price and hence company valuation. Not so.

2. Business for social good

Bill Drayton, founder and chairman of Ashoka: Innovators for the Public, and named in 2005 as one of the 25 best leaders in the USA by *US News and World Report*, observes: 'For three centuries the social and business halves of society drifted apart. So far apart that they developed different languages, styles, legal structures, and mutually negative stereotypes of one another.'[20] This separation goes to the heart of why business has become compartmentalised from the communities and societies whose fundamental consent and licence is essential for enterprise to operate effectively. The social contract is breaking down.

This separation is not one that can be simply bridged by corporate social responsibility, which is more a symptom of the divide than a solution.

Historically the business world has been more connected to communities and society in both direct and indirect ways. In the nineteenth century many factory owners developed 'model villages'.[21] The idea that industrialists, entrepreneurs and business owners might build such model villages is, to many, surprising if not somewhat baffling. These villages remain today as monuments to a bygone age. However, their development reminds us that in the period of the great Quaker firms, business magnates had a real vision for the relationship of business, family, workforce, locality and wider society.

The model villages were an expression of this integrated vision. In Bournville the houses had gardens; there was planned open space, a village green, cricket ground; and provision was made for schools, worship, shops, adult education facilities, libraries, schools, baths and so on. Both Cadbury and Rowntree decided against 'out and out sale of housing at cost price'[22] or anything that had the 'stamp of charity',[23] preferring long leases with mortgages and deposits on a sliding scale.

There were wider housing examples in London. The Artizans', Labourers' and General Dwellings Company, a for-profit joint stock company whose President was the Christian social reformer Lord Shaftesbury, built 6,400 residences for working people by 1900, accommodating 42,000 people. Other examples included the Four Per Cent Industrial Dwellings Company – the clue being in the name – and the Metropolitan Association for Improving the Dwellings of the Industrious Classes, which adopted business principles for social purposes. Business principles and capital return for social good.

The nineteenth century also saw the beginnings of micro-finance and local banking. The Emily Loan Funds were established in memory of Lord Shaftesbury's wife, who died in 1872. They were aimed especially at flower sellers who could not operate in winter. The Fund would loan an amount to enable these women to purchase stocks of goods suitable for sale in winter or else the hire of a potato oven. Other similar 'finance societies' funded the purchase of barrows or donkeys with low-cost loans. We also see banking at work among the poor, pertinent today in our debates about credit unions and so on. Penny Banks and Provident Societies were effectively savings banks, taking small deposits on a weekly basis.

Today this application of business skills to social problems is called 'social entrepreneurship' and 'social impact investing'. The Organisation for Economic Co-operation and Development (OECD) defines social impact investment as investment made 'with the intention of generating a measurable, beneficial social and environmental impact alongside a financial return'.[24] There are other ways of approaching the issue of definition but the essence is that social impact investing involves both *financial* returns and *measurable social impact*.

Social enterprises have become one of the new modes of business organisation for social purposes. The most effective social enterprises use a variety of means of capital, including venture capital and private equity. In addition, there will be robust governance structures, highly skilled individuals, diverse partners and a clarity of social vision. In this way it is possible to harness significant funds to achieve social purposes through the application of business skill and commercial objectives.

Three challenges

How then are we to respond to these changing features of capitalism and restore moral purpose to the heart of an enterprise economy?

1. The challenge of purpose

Purpose needs to be restored to business. This restoration of purpose cannot be reduced to either legislative or corporate social responsibility. However, as a starting point, the repeal of section 172 of the Companies Act 2006 would signal intent. Section 172 requires directors to act for the success of the company for the benefit of members (effectively shareholder value maximisation), while having regard for employees, customers, suppliers and environmental impact. The effect of the section is to establish a hierarchy of priorities. As Professor Andrew Keay has said, the bottom line is: 'Did the action promote the success of the company for the benefit of the members?'[25]

However, purpose cannot simply be legislated for. Purpose and values can only be implemented in a culture. Both the history and academic study tells us, as Professor Mark Casson has argued, that 'the quality of entrepreneurship depends on the quality of business culture.'[26] So one further step is to emphasise that business success cannot be measured by a single numerical value. A second step is to think about how culture is determined. There may, in this regard, be considerable differences between the culture of a small- or medium-sized enterprise (SMEs) and that of a large corporate entity. A small, family-run company is likely to have a very strong culture, which may be benevolent or otherwise; a large corporate may have more defined processes and perhaps a very open culture, but face significant pressures on culture from middle management in particular.

A business culture can be defined as the attitudes, expectations and processes that shape the behaviour of a company and its employees in the conduct of business. Culture therefore includes both formal and informal aspects, personal characteristics and example, as well as good-quality processes. The key challenge is how to implement these expectations throughout a company.

The complexity is this: to argue that, for example, a culture should be transparent is easy to write but less so to implement. However, there are some questions that might help in forming and shaping an appropriate corporate culture:

- Does the company have clearly articulated purposes, aims and values that go beyond shareholder value maximisation?
- Is there a named person in the company responsible for purpose and aims and also the implementation of corporate values?
- What are the stated circumstances in which the company would turn down otherwise profitable business?
- Are controversial policy matters (e.g. remuneration) the subject of a clearly stated policy and process?

2. The challenge of structure

The idea of the joint-stock company – that is, a company with external shareholders who share fully in the profits but are limited in their losses – has been a vehicle for raising capital for investment for over 150 years. While the structure has many advantages, its ambiguity is shown by the simple fact that prior to 1855 (the introduction of the Limited Liability Act), the establishment of a joint-stock company required an Act of Parliament. Even *The Economis*t recognised the complexity: in 1856 the magazine regarded limited liability as overrated; by 1929 as indispensable.[27]

The answers to the problems of capitalism do not in themselves depend on corporate structure. However, structure can provide a framework from which other matters flow. Indeed, society is increasingly recognising the importance of corporate governance.

There are two aspects to consider. The first is formal structure. There are those, such as the B Corporation movement, who advocate formal changes to corporate structure, such as through the Memorandum and Articles of Association and an accreditation process. Professor Colin Mayer advocates a 'trust company' with a 'board of trustees' responsible for the stewardship of corporate values and voting rights dependent on the length of time equity shares are held.[28] More detailed reflection on the relative merits of such approaches is beyond the scope of this chapter. However, in essence the more company law allows for a wider and greater variety of structures, the greater the opportunities for exploring new ways of inculcating purpose and values within a corporate structure.

The second aspect is new approaches within the current structures. The idea of the non-executive director is a powerful one in terms of checks and balances within the system. The problem is that many non-executives fail to maintain the vigorous independence the role requires. Similarly, for some the non-executive role becomes a career in itself. Thus the professions and the professional bodies should be encouraged to widen the pool of potential non-executive directors through identification, mentoring and training. Similarly, some consideration should be given to restricting the number of non-executive roles that may be held by one individual simultaneously, so that full attention can be given to the discharge of the responsibilities.

There is also the question of the handling of certain 'hot potato' topics. Executive remuneration is probably the most significant of these but there may also be supply-chain, environmental or employee-related issues. In essence these are reputational matters. A healthy capitalism does not mean that executives should not be well remunerated or that credit should not be taken from suppliers. However, companies with good ethics and values will want to ensure that pay reflects merit and long-term performance; that smaller suppliers are not exploited in respect of payment terms; that the contractual arrangements of employees are not abnormal, unreasonable or exploitative; and that firms take seriously their environmental impacts. In essence, clear and transparent policies are the key here, although some would argue, for example, that a company's annual remuneration report (if applicable) should be formally voted on by shareholders or the ratio of pay within the company published. These suggestions may indeed warrant adoption, but a more radical approach would be for an annual report from the independent non-executive directors covering all the key areas of risk or contention, such a report requiring to be approved at the AGM, published on the website and circulated to all employees, key customers and suppliers.

3. The challenge of character

We are, in our current age of diversity and tolerance, very wary of enjoining moral codes on others. Ultimately the question is one of character. No amount of legislation, structural organisation or regulation can force good behaviour. However, society needs, for the good of business, the economy and civil society to draw a distinction between the *moral* and *moralising*. The former is a state of mind, an attitude of heart, a recognition of responsibility and an appreciation of the impact of values on behaviour. The latter is more of the nature of 'injunctions' concerning particular behaviours. The consequences of a failure to appreciate the central importance of moral character was clearly espoused by a quote, which although unsourced, is famously attributed to Theodore Roosevelt: 'To educate a person in the mind but not in morals is to educate a menace to society.'

'No amount of legislation can force good behaviour'

Among the consequences of moral character are a responsible attitude to wealth and also to society. The steely discipline that shapes an entrepreneur – the patient wait for return – is likely to enhance a view of wealth that recognises that such wealth was hard earned, is transient and carries responsibility. Equally, the apparent rugged individualism of the entrepreneur usually belies the reality of a team and a culture. Values shaped in such a setting are more likely to recognise a wider responsibility to civil society – or as was illustrated in the original corporate objectives of ICI: 'to serve ... the communities in which we are set'. Just like Cadbury at Bournville.

Conclusions

The future of capitalism, its nature, shape and organisational features, is essential to a healthy society and indeed an inclusive economy. Capitalism carries innumerable advantages for everyone. However, all is not well. This is partly due to structural problems within the market economy but much more so because capitalism as practised today has, regrettably, rather lost its way. A breadth of purpose, responsibility towards wealth, recognition of the impact on our communities and civil society, and above all the restoration of moral character and discipline, would go a long way towards repairing the tear. We need not call this 'moral capitalism' or 'inclusive capitalism'; better just 'capitalism'. Yet the word is problematic. An 'enterprise economy' sounds so much better.

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Chapter 4

Capitalism's Great Divide: The Two Sides of Self-Interest

Tim Weinhold

Adam Smith probably tops history's list of influential teachers with the most followers who largely misunderstood their teacher's message. As we all know, Smith is widely viewed as the father of capitalism, based on his 1776 book, *The Wealth of Nations*. Smith and his book remain hugely influential to this day.

His principal thesis was that individuals – and enterprises and countries – should focus their productive activities on that which they do best, and then, via a free market, trade their specialised outputs for the goods and services produced by others. He argued that this combination of specialised production, with supply-and-demand-based free-market trading, most efficiently allocates productive resources and, as a result, maximises overall wealth creation. As well, it (generally) maximises utility for all participants; that is, everyone is better off.

Smith's core contention, therefore, is that the market's 'invisible hand' transforms self-interested production and trading behaviours into outcomes of maximum economic and social benefit. This has provided the foundational rationale for business and free markets – in other words for capitalism itself – ever since. Much of this is summed up in the book's most famous sentence: 'It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their own self-interest.'

A malignant misunderstanding

Arguably no other single sentence has ever been so thoroughly misunderstood, by so many people, to such disastrous effect. In fact this misunderstanding goes to the heart of why so many are now so critical of contemporary capitalism. More specifically, it explains why the rewards of late-twentieth and twenty-first-century capitalism have flowed increasingly to the wealthy, while the fortunes of much of the (Western) middle class, working class and poor have deteriorated.

The misunderstanding arises from a failure to recognise that, morally and practically, there are two very different kinds of self-interested behaviour. One occurs when an individual – or enterprise – acts for their own benefit *at the expense of* someone else. We generally describe such behaviour as selfish *and* predatory. Fortunately, there is a quite different sort of self-interested behaviour – where someone achieves a favourable outcome for themselves and for the other individual(s) affected by their action.

Though both behaviours are self-interested, their effects are poles apart. The first unilaterally imposes costs on someone else, making them worse off; that is, they are harmed. The second, by contrast, benefits not only the one taking action but the other party as well.

It is not surprising, then, that from our toddler years on we experience being on the receiving end of these two behaviours very differently. Reflect back, for example, on your own toddlerhood. Suppose you had been playing with a favourite toy and your older sibling came by and snatched it away saying, 'I want to play with this now!' Not very hard to recall how you felt, right? A terrible injustice has been perpetrated! Call in the authorities (Mom or Dad)! Such a grave wrong, such a violation of all that is just and proper, must be put right – NOW!

Suppose, though, that your sibling had said, 'I'd like to play with your toy now, so how about if I let you play with my super-duper new toy?' Provided that the new toy in question really was super-duper, you probably would have been quite happy to accede. In both cases, the result for your sibling was the same – they got to play with the toy they wanted. But the respective outcomes for you are quite distinct: in one scenario you were disadvantaged (harmed); in the other you were made better off (helped).

If even a toddler instinctively understands the watershed difference between these two versions of self-interest, why, we might ask, has it proved so difficult for adults – specifically economists, business people, business academics, political commentators and the like – similarly to understand that difference when it comes to the way business, and capitalism, are meant to work?

Devotees in the dark

Yet a great many of Adam Smith's devotees find themselves unable to grasp that distinction. Over and over they evidence a belief that, effectively, Smith's most famous sentence reads, 'It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their selfishness.' They believe that Smith was claiming for free markets and capitalism something quite extraordinary: that they magically transmute the lead of selfishness and exploitation into the gold of maximised benefit for individuals and society. This is nonsense and delusion.

And yet we find the Harvard economist Edward L. Glaeser declaring in *The New York Times*:

> Two hundred and thirty years ago, Adam Smith made the case for selfishness when he wrote that 'it is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own self-interest.'[1]

Or we read comments like this one, attributed to one of the two most influential economists of the twentieth century, John Maynard Keynes: 'Capitalism is the extraordinary belief that the nastiest of men for the nastiest of motives will somehow work for the benefit of all.'[2] Keynes may simply have been paraphrasing an earlier quotation from a close colleague, E. A. G. Robinson, who wrote in his book *Monopoly*: 'The great merit of the capitalist system, it has been said, is that it succeeds in using the nastiest motives of nasty people for the ultimate benefit of society.'[3]

Of course, no one has done more to associate capitalism with selfishness – and its close corollary, greed – than Ayn Rand. Then again, in her full-on defence of selfishness and greed, maybe she meant something different from what we imagine. Rand acknowledged, for instance, in the introduction to her book *The Virtue of Selfishness*, that she was using the term 'selfishness' to mean, more precisely, 'concern with one's own interests'.[4] Hmmm.

Along similar lines, consider this defence of greed from the other most influential economist of the twentieth century, Milton Friedman:

> Well first of all, tell me: Is there some society you know that doesn't run on greed? You think Russia doesn't run on greed? You think China doesn't run on greed? What is greed? Of course, none of us are greedy, it's only the other fellow who's greedy. The world runs on individuals pursuing their separate interests ... there is no alternative way so far discovered of improving the lot of the ordinary people that can hold a candle to the productive activities that are unleashed by the free-enterprise system.[5]

If smart, prominent commentators like these are going to treat 'selfishness' and 'greed' as synonyms for 'self-interest', no wonder so many devotees imagine Adam Smith claimed the market's beneficent hand turns selfishness and greed into social and economic blessing. This has done great harm. In particular it has caused a great many business people to believe that selfish, exploitative behaviour, though toxic in every other arena of life, is somehow magically beneficial when practised in business.

Impact, not motivation

But failing to distinguish the words 'selfishness' and 'greed' from 'self-interest', as sloppy and unhelpful as that may be, is not our real problem. Rather, the words themselves focus our attention in the wrong direction – towards the character and motivation of the actor. As a result, they keep us from recognising what truly differentiates good from bad and moral from immoral behaviour.

Let's revisit for a moment our hypothetical scenario from your toddlerhood. When your sibling wanted your toy, your response had nothing to do with his or her motivations or character. If your sibling's behaviour injured you – made you worse off – then you knew you had been mistreated and a wrong perpetrated. Period. If, instead, their action left you better off, you were happy to approve their behaviour – whether or not they were motivated by self-interest, selfishness or greed.

You knew your sibling's conduct was wrong, or not, *entirely based on the effect it imposed on you*. Which means that, even as a toddler, you were thinking clearly as to what actually differentiates behaviours that are good from bad, right from wrong, moral from immoral; and that you were already thinking clearly about how we should assess good versus bad business conduct, and the difference between moral versus immoral versions of capitalism.

The golden rule

Of course, there's more here than the justice instincts of toddlers. Throughout human history – across religions, across civilisations, even now in our post-religious Western secularism – one principle has always provided the bedrock foundation for human morality: the golden rule – 'Treat others as you yourself wish to be treated'; or in its alternative rendering – 'Love your neighbour as yourself.' Notably, this cornerstone moral principle zeroes in on our actions – how we actually treat others – not our motivations.

Just as notably, the golden rule envisages a behavioural landscape comprised of not two but three impact categories – two of which meet the golden rule test. One such behaviour/outcome occurs when an individual – or enterprise – chooses to do good for someone else to their own detriment. We typically refer to such behaviour as altruism or selflessness. More precisely, though, we can label this 'lose–win' behaviour. The one taking action is disadvantaged for the sake of benefiting another.

Most of us have a tenuous relationship with selflessness. We acknowledge its moral attractiveness yet practise it infrequently. There are exceptions, of course. Many parents exhibit a great deal of lose–win behaviour towards their children. Good soldiers in combat may do so as well. And good spouses. Nevertheless, selflessness seems more the province of saints like Mother Teresa than us ordinary mortals. Across the landscape of human behaviour it is decidedly more the exception than the rule.

Fortunately there is another behaviour/outcome that also fulfils the golden rule. Win–win behaviour, as noted earlier, occurs when someone's conduct brings about a beneficial outcome for themselves *and* for the other individual(s) affected by their action. Such behaviour is almost always motivated by self-interest. Yet it entirely meets the 'Love your neighbour as yourself' moral test.

Selflessness, therefore, is not the only way to keep the golden rule. Self-interested actions also meet the test for good and moral behaviour — *provided they don't come at the expense of others*. It's only when self-interest crosses over from win–win behaviour into win–lose territory that it violates the golden rule and becomes what most of us call selfishness (Ayn Rand and certain economists notwithstanding). A simple summary diagram should prove helpful (see Figure 1).

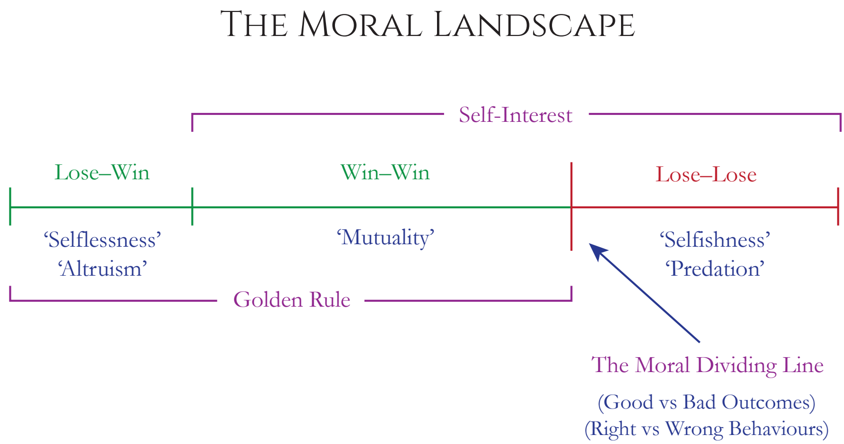

Figure 1: The moral landscape

A great deal of what passes for moral commentary, at least as it relates to business and economics, assumes the important moral watershed is between selflessness and selfishness (or self-interest) – as if the foundational injunction is to 'Love others *rather (or more) than* yourself.' This both misunderstands the golden rule and misses the moral divide of real consequence.[6]

In fact the line of first-order significance is that between win–win mutuality and win–lose selfishness. It is here that we find the precise divide between what is moral and immoral, the exact boundary between right and wrong. It is also the difference between good and bad outcomes or, more broadly, between blessing and blight. More prosaically it is the difference between the merchant who makes money by providing a beneficial product and the mugger who takes money at knifepoint – or the loan shark (or payday loan company) who does so via extortionate interest. One practises a morally commendable self-interest, while the others' behaviour is morally reprehensible.

Smith's moral understanding of self-interest

As a moral philosopher, Adam Smith understood this distinction clearly, even if many of his followers do not. In his book *The Big Three in Economics: Adam Smith, Karl Marx, and John Maynard Keynes*, the prolific economics author Mark Skousen describes Smith's fundamentally moral understanding of self-interest:

> Smith recognized that people are motivated by self-interest. It is natural to look out for one's self and one's family above all interests, and to reject this would be to deny human nature. Yet at the same time, Smith did not condone greed or selfishness. For Adam Smith, greed and selfishness are vices.[7]

Skousen elaborates Smith's morally circumscribed view of self-interest in a piece for the Foundation for Economic Education:

> [Smith] wrote eloquently of the public benefits of pursuing one's private self-interest, but he was no apologist for unbridled greed. *Smith disapproved of private gain if it meant defrauding or deceiving someone in business*. To quote Smith: 'But man has almost constant occasion for the help of his brethren ... He will be more likely to prevail if he can interest their self-love in his favour ... Give me that which I want, and you shall have this which you want, is the meaning of every such offer.' In other words, *all legitimate exchanges must benefit both the buyer and the seller, not one at the expense of the other*.
>
> Smith's model of natural liberty reflects this essential attribute: 'Every man, *as long as he does not violate the laws of justice*, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men.'[8]

All of which makes especially compelling Smith's pithy, emphatic statement of what we might call the 'foundational justice dictate' in his earlier (1759) masterwork, *The Theory of Moral Sentiments*: 'There can be no proper motive for hurting our neighbour.'[9] It would be hard to misinterpret that.

The bottom line is this: Adam Smith, the father and foremost apologist for self-interested capitalism, nevertheless saw a bold bright line between actions that benefit both us and our neighbour versus those that help us but harm our neighbour. He recognised that a self-interested win–win mutuality was essential to business success and the creation of wealth, yet never countenanced win–lose selfishness and predation. He knew that taking advantage of others for one's own benefit is both deplorable and dangerous. Smith understood clearly (along with virtually every other moral thinker throughout history) that such predatory behaviour undermines the very foundation of human society – and deserves to be roundly condemned by all.

Why this matters

This is consequential for three key reasons:

- Many CEOs countenance win–lose plunder and predation in their business models out of the mistaken belief that the father of capitalism claimed markets transform business selfishness into social well-being. Adam Smith did no such thing. Smith offers business leaders no magical-thinking smokescreen for practices that harm or exploit their stakeholders.
- The distinction between helpful versus harmful versions of self-interest points us insightfully towards what has gone wrong in our contemporary – late-twentieth and twenty-first-century American public company – expression of capitalism. We will turn to this subject in a moment.
- Even more importantly, it points us towards a reformed – really a restored – version of capitalism that does, indeed, 'work for everyone'. Notably, it does so without asking business people to become particularly high-minded or altruistic. This reformed capitalism requires no abandonment of self-interest for the sake of 'the greater good', nor a forswearing of profit. It simply acknowledges that there are necessary limits to both. We will take up this subject in due course.

The turn towards selfishness

During the middle portion of the twentieth century, American business was the envy of the world. American corporations were the pre-eminent global leaders in virtually every industry. And the prevailing view among CEOs and business academics was that the purpose of a corporation was to create value for several different constituencies, more or less in this rank order: customers, employees, host communities, society and shareholders. In practice this meant companies generally aimed at win–win outcomes vis-à-vis their various stakeholders.

But starting in the 1970s, American business embraced an entirely different conception, a view that the pre-eminent purpose of a corporation is to maximise the wealth of its owners.[10] This view, labelled 'shareholder value maximisation' (SVM), has been the prevailing consensus ever since.

This watershed reconception of business purpose was first advanced by Milton Friedman in his famous 1970 opinion piece in *The New York Times Magazine* entitled, 'The Social Responsibility of Business is to Increase its Profits'.[11] Then in 1976 two business academics, Michael Jensen and William Meckling, published 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure'.[12] This hugely influential article argued for giving CEOs substantial grants of stock, or stock options, to better ensure their energies were pointedly focused on behalf of shareholders.

But it was in the 1980s when business people themselves embraced in a big way this new understanding of corporate purpose. They were especially influenced by Jack Welch's 1981 speech, 'Growing Fast in a Slow Economy', in which he made clear that, henceforth, General Electric's primary objective would be to return maximum value to shareholders.[13] This conception of corporate purpose has reigned supreme in America ever since. (It got considerable, but less, traction in other English-speaking countries, and relatively little in Europe.)

In practice, SVM has translated into a rigorous focus on maximising short-term profits. But maximising one outcome necessarily means sacrificing others. So when profits conflict with creating value for customers (or with the good of employees, suppliers, host communities or even society as a whole), SVM dictates that profits prevail.

In fact this understates the distorting effect of SVM. Once corporate purpose is defined in terms of immediate maximised wealth for shareholders, the priority job of senior management becomes channelling every dollar possible *away from* employees, suppliers, communities, society, even away from research and development for future growth – all for the sake of a fattened bottom line this quarter or next. SVM represents, therefore, a giant turn towards selfishness, towards advantaging business owners – senior management owners in particular – *at the expense* of everyone else.[14] Consequently a great many businesses have moved squarely into the win–lose, plunder and predation end of the moral landscape.

The effects have been severe. Rather than a last resort, layoffs are now a go-to choice to boost near-term profits. Pension plans have all but disappeared. For many retail workers, so too have predictable hours and incomes. More and more health care cost has been pushed from employers to employees. At a more foundational level, the 'gig economy' threatens to undo the entire landscape of worker protections, blithely turning employees into contractors with virtually no rights or security. And maybe most significantly, the share of economic output flowing to profits (shareholders) is at an all-time high, while the proportion flowing to workers has never been smaller (see Figure 2).[15]

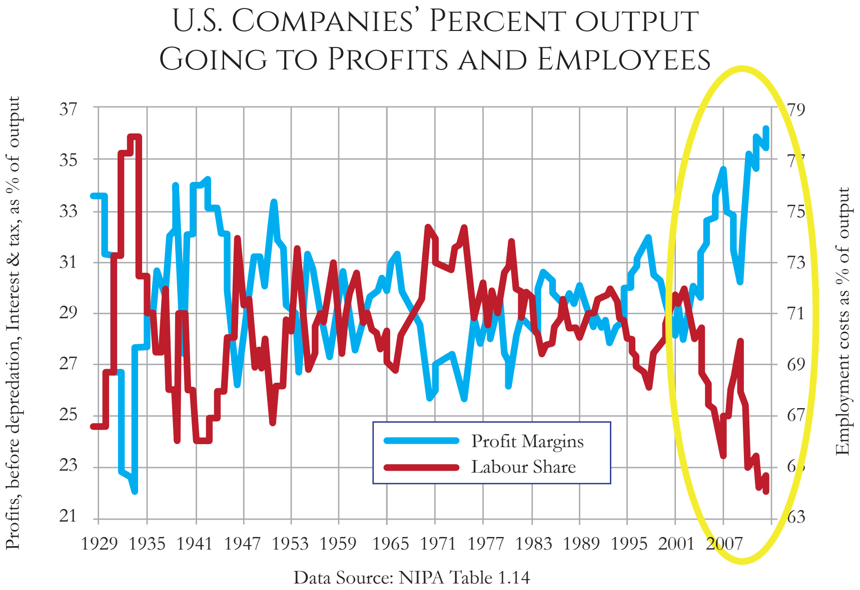

Figure 2: US companies' per cent output going to profits and employees

Of course, corporate win–lose predations are hardly restricted to employees. Anti-customer corporate scandals – GM's ignition switch, VW's emissions cheating, Wells Fargo's bogus accounts, Wall Street's seemingly endless stream of malfeasance – have become commonplace. So has corporate tax avoidance, including through domicile inversions and aggressive use of tax havens.

And what about unilaterally pushing business costs onto taxpayers? As a rather notable instance, American taxpayers spend in the vicinity of $8 billion a year providing poverty assistance benefits to Walmart workers[16] – despite the company topping the 2016 Fortune Global 500 with revenues of $482 billion. And, of course, there's this egregious example of misbehaviour: less than a decade ago the greed and recklessness of our largest financial institutions came within a hairsbreadth of taking the entire global economy over the cliff.

'No wonder the ranks of capitalism's critics continue to swell, as does the vehemence of their critiques'

No wonder the ranks of capitalism's critics continue to swell, as does the vehemence of their critiques. No wonder more young people now say they prefer socialism to capitalism (43 per cent to 32 per cent).[17] No wonder the communications group Edelman reported recently that the credibility of corporate CEOs has fallen 'off a cliff', dropping 12 points in just the past year.[18]

A better way

There is a better way. Business, practised wisely and well, is an extraordinarily powerful means for human betterment. Business fulfils this high calling by creating value for its stakeholders in two particular and important ways. First and foremost, business solves human problems. In fact it solves an especially large and important set of human problems: the material challenges of human existence.

Virtually every product and service offered by business is meant to meet a material human need.[19] In some cases business products may represent novel and dramatic new solutions to those needs (breakthroughs), as happened with the invention of automobiles, personal computers and mobile phones. In other cases the solutions may be more modest: a less expensive option for air travel, a more comfortable mattress or a non-polluting laundry detergent.

All of which makes business, quite literally, a solutions machine targeted at humankind's material welfare.

But business creates an entirely different type of value as well. When a business sells its products for more than their cost of production, it creates profit – and thereby enlarges human wealth. Provided this wealth is broadly deployed rather than narrowly hoarded, business both solves human problems and creates the economic provision that makes those solutions affordable and accessible.

'Business solves human problems'

Both forms of value creation are extraordinarily important. As Eric Beinhocker and Nick Hanauer note in their compelling article, 'Capitalism Redefined': 'Ultimately, the measure of a society's wealth is the range of human problems that it has found a way to solve and how available it has made those solutions to its citizens.'[20] It is no overstatement, therefore, to say that business provides the material foundation for human flourishing.

Or, more precisely, business *is capable of* providing the material foundation for human flourishing. It delivers these great benefits when, and to the degree that, it engages in win–win behaviour. Period. But win–lose behaviour is an entirely different matter. When business selfishly and narrow-mindedly pursues profits *at the expense* of stakeholders, then it becomes something altogether disparate. Rather than a means of value creation, it becomes a mechanism for value extraction – in other words, for plunder and stealing. That version of business – based on the intrinsically selfish ideology of shareholder value maximisation – rightly deserves the ire and condemnation increasingly directed against it.

The Business 360 Framework[21] provides a helpful analytical tool by which to understand and apply all this in practice, as shown in Figure 3. The top-left part of this figure identifies the crucial difference between win–win behaviour that creates value for stakeholders, versus win–lose behaviour that extracts value, and provides a +100 to -100 reference scale. The top-right part lays the basis for applying this create-versus-extract value assessment to each of a company's primary stakeholders. The bottom-left and bottom-right parts show, in turn, two sample 360 Impact Maps that might result from such an analysis. We might label these particular assessments 'Business for blessing' (bottom-left) and 'Profits by plunder' (bottom-right). More simply, let's just call them examples of good business versus bad business.

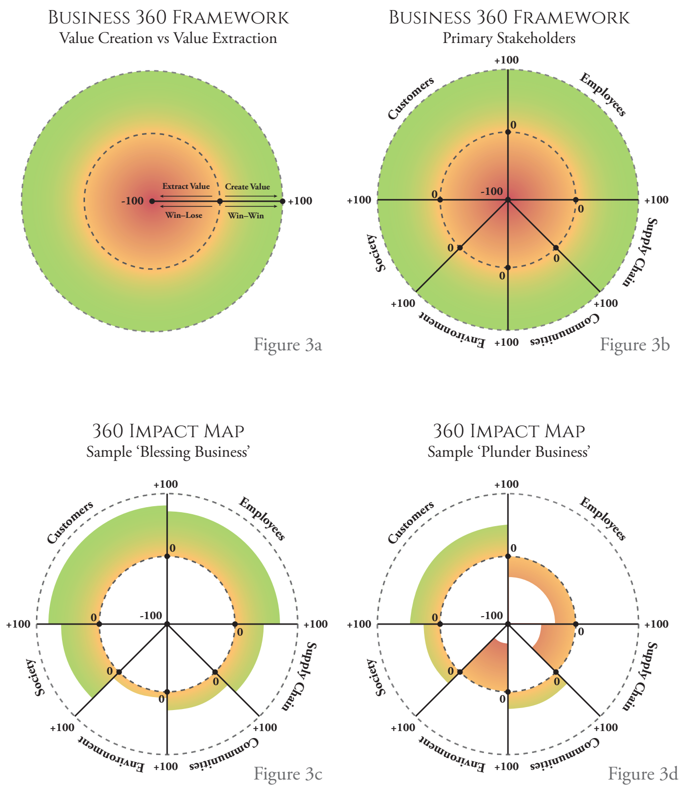

Figure 3: Business 360 Framework

The wisdom of win–win

Is good business too much to ask? Hardly. First off, it's the way business was characteristically practised until recently, including during its (American) mid-twentieth-century heyday. Second, it asks business to forsake neither self-interest nor the pursuit of profit. It simply requires that business not pursue self-interest and profit in ways that harm others. How is that unreasonable? (And what argument would business make as to why it *should* be allowed to inflict harm on others?)

More importantly, win–win behaviour is in the best interest of business. Treating others the way we want to be treated is the only behaviour that really works. It's the behaviour that creates trust and fosters relationship. These are the essential building blocks of *sustainable* business success – trust and relationship with customers, with employees, with suppliers and so on. In fact without trust and relationship, business grinds to a halt.

It's not surprising, then, that the empirical evidence for golden-rule behaviour in business is compelling. In *The Ultimate Question*, first published in 2006, Fred Reichheld introduced the powerful new business metric Net Promoter Score (NPS). Superficially, NPS measures how well or poorly a company satisfies its customers. But according to Reichheld, what NPS really measures is golden-rule behaviour. In turn, Reichheld marshals compelling data demonstrating that companies with superior NPS scores have substantially higher rates of profitability and growth than their competitors.

Similarly, in her 2013 book *The Good Jobs Strategy*, Zeynep Ton, one of the foremost retail operations experts, makes a powerful empirical case that – even in the extremely price-sensitive arena of low-cost retail – the most successful companies are the ones that pay and treat their workers well. Specifically, she found that these 'good jobs' companies were anywhere from 50 to 300 per cent better than their competitors at bottom-line performance metrics such as inventory turns, sales per employee and sales per square foot.

Let's complement this with some anecdotal evidence:

> Isadore Sharp, founder and chairman of the Four Seasons hotel group: 'Our success all boils down to following the golden rule.'

> Colleen Barrett, retired president of Southwest Airlines: 'Practising the golden rule is integral to everything we do.'
>
> Andy Taylor, CEO of Enterprise: 'golden rule behaviour is the basis for loyalty. And loyalty is the key to profitable growth.'[22]
>
> John Bogle, founder and former CEO, Vanguard Group: 'You [only need] one rule ... "Do unto others as you would have them do unto you."'[23]

The 'golden rule' is called that for a reason. Throughout human history it has been the gold standard for good behaviour. *And for prudent behaviour*. Profiting at the expense of others may work in the short term but not in the long. The merchant who delivers good value can expect to operate indefinitely; not so the knife-wielding mugger. Or as Jim Collins says in his seminal book *Built to Last*: 'You can cheat your way to seeming greatness for five or ten years, but not for fifty or one hundred years.'[24]

It's high time, therefore, for American public company CEOs to give up their profits-by-plunder myopia; high time to forsake win–lose value extraction and recommit to win–win value creation for all stakeholders. It's how capitalism was always meant to work – for *everyone*.

Notes

1. Edward L. Glaeser, 'Can Business Do Well and Do Good?', *The New York Times*, 6 January 2009; emphasis added.
2. From Quote Investigator: Exploring the Origins of Quotations, http://quoteinvestigator.com/2011/02/23/capitalism-motives.
3. From Quote Investigator: Exploring the Origins of Quotations, http://quoteinvestigator.com/2011/02/23/capitalism-motives.
4. https://en.wikipedia.org/wiki/The_Virtue_of_Selfishness.

5. Transcript of Milton Friedman interview quoted in 'Donald Trump Says Greed Is Good', by Aaron Sandler, *The Daily Wire* website.

6. Which is not to say the divide between selflessness and self-interest is unimportant. It has considerable significance related to one's character growth and spiritual development. But as regards *outcomes*, and the difference between right and wrong, moral and immoral, the dividing line of real consequence is between win–win mutuality and win–lose selfishness and predation.

7. Mark Skousen, *The Big Three in Economics: Adam Smith, Karl Marx, and John Maynard Keynes*, Armonk, NY and London: M. E. Sharpe, 2007, p. 29.

8. Mark Skousen, 'Is Greed Good?', Foundation for Economic Education, 1 May 2001; emphases in first paragraph added; emphasis in second paragraph original.

9. Adam Smith, *The Theory of Moral Sentiments*, II.ii.2.

10. In her excellent book *The Shareholder Value Myth*, the respected Cornell Law School professor Lynn Stout makes a convincing case that neither shareholders nor anyone else are the *legal* owners of corporations. That said, whatever their precise legal status, in the shareholder-centric version of business embraced in the USA since the 1980s, shareholders are clearly the effective and beneficial owners of public corporations – Lynn Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public*, San Francisco, CA: Berrett-Koehler, 2012.

11. Reprinted in Walther Ch. Zimmerli, Markus Holzinger and Klaus Richter (eds), *Corporate Ethics and Corporate Governance*, Heidelberg: Springer, 2010, pp. 173–8.

12. Michael C. Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure', *Journal of Financial Economics* 3:4, 1976, pp. 305–60.

13. John F. Welch, 'Growing Fast in a Slow Economy', speech to financial community representatives, Hotel Pierre, New York, 8 December 1981.

14. In fact it disadvantages long-term shareholders as well. A major study from the Harvard Business School, 'Competitiveness at a Crossroads', February 2013, comes to the blunt assessment that American business is losing the ability to compete in the global marketplace. Much of this is driven by companies'

squeezing research and development budgets to maximise short-term profits and fund dividend payments and stock buybacks.

15. This chart comes from Andrew Smithers, economist and founder of Smithers & Co. Until recently he also wrote a recurring column for the *Financial Times*. The chart can be found at www.pbs.org/newshour/making-sense/merle-hazard. To be clear, SVM has not been the *only* driver of the disproportionate flow of business rewards towards owners and away from workers during the last few decades. Globalisation and automation have also had significant effect. Without the embrace of SVM, however, business would have looked for ways to mitigate the anti-worker effects of these other factors. Instead, SVM justified a wholesale embrace of any measures that fattened profits at the expense of workers and/or other stakeholders.

16. 'The Low-Wage Drag on Our Economy: Wal-Mart's Low Wages and their Effect on Taxpayers and Economic Growth', a report from the Democratic Staff of the US House Committee on Education and the Workforce, May 2013.

17. Catherine Rampell, 'Millennials Have a Higher Opinion of Socialism than of Capitalism', *The Washington Post*, 5 February 2016.

18. *2017 Edelman Trust Barometer: Global Annual Survey*, 15 January 2017, www.edelman.com/trust2017.

19. That said, it should be acknowledged that some businesses meet 'needs' that many may judge to be illegitimate – such as pornography or gambling.

20. Nick Hanauer and Eric Beinhocker, 'Capitalism Redefined', *Evonomics*, 30 September 2015 – http://evonomics.com/redefining-capitalism-eric-beinhocker-nick-hanauer; originally published in Democracy: A Journal of Ideas, 31, Winter 2014 – http://democracyjournal.org/magazine/31/capitalism-redefined/?page=all.

21. Developed by Eventide Asset Management, LLC as a guiding framework for 'better investing for a better world'.

22. All three quotations are from Fred Reichheld with Rob Markey, *The Ultimate Question 2.0: How Net Promoter Companies Thrive in a Customer-Driven World*, Boston, MA: Harvard Business School Publishing, 2011.

23. John C. Bogle, 'What I've Learned in a Half Century in Business – Twelve Rules For Building A Great Work Force', 23 April 2003, www.vanguard.com/bogle_site/sp20030423.html.

24. James C. Collins and Jerry I. Portas, *Built to Last: Successful Habits of Visionary Companies*, New York: HarperBusiness, 1994, p. xi.

Chapter 5

The Paradox of Globalisation

Barbara Ridpath

Introduction

Globalisation has gone from praised to pilloried. Throughout most of the post-war era, international trade has been seen largely as a 'good'. The advantage to both parties of trading was based largely on Adam Smith's description of comparative advantage in the pin factory. In his example, specialisation enables an economy to be more productive. However, today the lifting of millions from poverty around the world is often measured against the expense of job losses to workers closer to home, a reduction in the bargaining power of labour and an unhealthy interdependence among countries. Externalities such as pollution have been shifted to countries least able either to protest or rectify them.

At the heart of the anti-globalisation movement lies an argument against the inappropriate distribution of the fruits of globalisation, rather than one against its benefits. Nonetheless, this subject will remain a political minefield for years to come. This chapter argues that the benefits of trading, operating and investing cross-border exceed the harm, and that advances in technology make it easier for smaller firms and individuals to take advantage of their benefits. It will explore what is at the heart of the anti-globalisation issue and how to limit the nefarious effects. It will acknowledge the need to consider issues beyond pure economic efficiency, including quality of life and the common good. The intention is to give the reader the analytic tools to arrive at his or her own position on the subject, in order to improve debate and decision-making.

Background

From the age of exploration, we traded commodities and raw materials for finished goods. Then we began to move production closer to the source of the raw materials. After that, manufacturing moved to where the lowest production costs could be found. In the recent past, computing and communication improvements have enabled firms from Apple to Airbus to source materials, produce components and provide assembly in multiple locations. 'Country of origin' has become rather more difficult to define as a result. In the near future we may be able to 3D-print objects wherever we choose, completely delocalising design from manufacture. Already services can be outsourced through the internet from labour thousands of miles away, providing anything from secretarial services to engineering design. Looking further ahead, jobs taken by artificial intelligence may make moot the whole issue of delocalisation of labour.

We have come a very long way from when trade and globalisation initially benefited those most able to take advantage of economies of scale; those who could build car plants, steel plants and aluminium smelters where labour, energy or transport was cheapest. Now, in what is being called the fourth industrial revolution, thanks to the internet, almost any work can be 'outsourced' to the cheapest supplier anywhere in the globe; almost any small firm or individual can participate as a buyer or seller. Preparation and presentations for an investment banking client meeting, first drafts of company audits, website designs and copy-editing have all been delocalised. Courses can be taught and taken online. As a result, an analyst in Chicago might lose his or her job to a firm in Mumbai, but it also enables a parent in Falmouth to work from home in order to spend more time with small children. Those affected today are no longer just unskilled staff but white-collar professionals at all levels.

Why blame globalisation?

The world as a whole is richer for trade. One billion fewer people live on less than \$1.90 a day than in the early 1980s.[1] Hundreds of millions of people have been pulled from poverty. The percentage of the world's population whose basic human needs – food, water and shelter – are now being met continues to rise. In wealthy countries the costs of basic items of clothing, food and electronics continue to decline as a result of global production possibilities.

Trade and exchange are not at the heart of the issue. Rather, the perception that globalisation is to blame is the result of three clear factors. The first is power; specifically, unequal bargaining power. The second is differential labour, tax and regulatory conditions in different markets. The third set of issues includes education, training and culture.

The unequal bargaining power of some economic actors tilts the playing field to their advantage. The ability to shift, or even to threaten to shift jobs from one place to another limits the bargaining power of local labour. Historically, this was easier for big companies to do than small companies. Over time, this restricted union negotiating power in much of the northern hemisphere. These days, when almost anything can be outsourced, even the smallest companies can source work where it can be done most efficiently, whether 'efficient' is defined by costs, quality or a combination of the two.

Successfully manoeuvring in global markets has exacerbated income and particularly wealth differentials between the best off and the worst off. Stagnating real incomes have given many people the impression they are effectively falling behind. It has also concentrated the power that comes with wealth. Commanding large labour forces and highly profitable corporations affects influence with governments and policymakers who pass legislation and write regulations that determine tax rates, tariffs, regulations and employment law. Differences in these factors can have dramatic bottom-line effects on corporate costs and profits. Some jurisdictions intentionally draft legislation as a means of attracting overseas investment. This can become a race to the bottom among countries that compete to provide the most hospitable investment environment. Their intention is to create employment, generate tax revenue and increase economic growth. However, companies and their advisors have become extremely adept at finding the most attractive locations in which to base production, patents and legal entities to maximise the benefits of favourable tax and regulation, sometimes with little value-added in the jurisdiction.

Abilities to tilt the regulatory playing field or reap the tax benefits of jurisdiction-shopping can have significant implications not only for protecting profits but also for protecting market share and ensuring competitors stay small. Smaller organisations often do not have the influence or the scale to take advantage of global comparisons on such a wide range of issues. While advisors who have cut their teeth on large corporations are well placed to advise smaller companies how to take all the advantages they can, these producers are less able to influence policy unless they work through trade organisations.

Differential levels of economic development and lower costs of living and labour were once the biggest differentiators for a company searching to minimise costs. They remain important, but as the benefits of globalisation spread, these differentials tend to decrease, as evidenced by the erosion of competitiveness as wages rise in China. Over time, incremental differences tend to have more to do with the policy, tax and regulatory environment discussed above, and the pool of appropriately skilled talent available.

As production of goods and services requires ever more technical skills, the softer issues such as skill levels, education and training become more important. Successful countries have raised skill levels among their citizens to protect against the risk of joblessness due to globalisation. Some nations use strong industrial policies that attract the companies of tomorrow or offer government-sponsored innovation grants,[2] or strong research universities that help spur innovation and talent. All of these techniques encourage clusters of highly skilled workers that attract investment. Another strategy is to focus on service jobs that used to be more difficult to delocalise. Over time, both outsourcing and automation mean such tactics may provide only temporary respite. Few governments or countries have actively and successfully addressed necessary workforce education and retraining to prepare for future workforce needs, perhaps presuming that the market would force the adjustment. This has inadvertently created much of the current backlash against globalisation.

The hardest and most sensitive issue to address is often the 'willingness to work hard' argument. The incentives to work hard for those without social safety nets, or those of the first generation with the possibility of escaping poverty, can contrast markedly with those for workers from wealthy countries unaccustomed to facing competition for their skills from elsewhere. However, economic prosperity is only one element in overall prosperity. A concept of prosperity that includes community, health, leisure, culture, meaningful work and a sustainable environment would go some way to balance current emphasis on consumption and economic growth. Both France and Bhutan have tried to measure gross national happiness. For the moment, however, there is little that encourages businesses to consider the implications of their actions beyond the financial outcome.

Who pays, who benefits?

It is clear that not everyone wins from this game of globalisation. Finding oneself in a global marketplace without strong skills or bargaining power is a disheartening and destabilising position for many workers, and indeed many companies. And it is not just the displaced steel worker in the American Rust Belt. The textile worker in Asia working unacceptable hours in dangerous conditions may be materially better off, but may risk his or her life to be so.

> **'Not everyone wins from this game of globalisation'**

Are these forces genuinely beyond our control? Is it possible for employees, consumers and small companies to improve their bargaining position? These questions can be addressed at two levels. At the 'macro' level there are issues that can only be resolved across boundaries by coalitions of the interested and willing. These are issues such as tax policy coordination, labour bargaining and raising conditions among the lowest paid. Issues at the 'micro' level are those for which individuals can take responsibility as investors, entrepreneurs, employers, employees or consumers.

At the macro level: International action on tax and labour conditions needs to be coordinated. The International Labour Organization (ILO) was formed in 1919 specifically to bring together governments, employers and workers, to set labour standards, develop policies and devise programmes promoting decent work for all women and men. While these are noble standards, workers' rights have been largely eroded by diminishing labour-union membership; the move to using contract or freelance workers (sometimes called the 'gig' economy); the technological ability to outsource around the world through the internet. New means must be found to seek any kind of level playing field. Reinvigorating the ILO to stop a race to the bottom in regulation on health and safety and work protections would be a start. Creation and protection of social safety networks around the world would diminish a race to the bottom on pay and working conditions. In each case it is important that such changes do not so diminish competitiveness that whole populations are re-impoverished. Corporations do not necessarily see this as something that is in their interest, so it is important to find coalitions of politicians, policymakers and non-governmental organisations that can speak for those with insufficient voice or power to represent themselves.

Corporate tax rates are set by sovereign governments, often with an eye to competitive levels to attract investment. International attention to tax minimisation since the financial crisis has led to work by the OECD to coordinate comparisons and try to stop egregious 'tax shopping', notably by offshore financial centres, but there is still work to do. Here too politicians need to understand how important this is to their constituents if change is to occur.

On both of these issues, concerned individuals can engage by raising a concerted voice on the importance of these issues to their elected officials and through non-governmental organisations. In order to do that, individuals need to consider what they believe to be in the common good, and whether that common good is defined as local, national or international.

For example, narrow, selfish agendas of global pharmaceutical companies have pushed tougher patent rules, while banks have lobbied for unfettered access to foreign markets. It is not clear that in either of these areas the corporations have a greater regard for public interest than the protectionists do.[3] Both as companies and individuals, we need to look beyond our narrow self-interest to what we want the world we live in to look like, how we want to treat our fellow citizens on the planet and how our actions affect others.

At the micro level: The fact that the macro is a collection of micro decisions is why the behaviour of the individual is so important in determining the future of globalisation. As we have all seen in recent years, our ability to make our voices heard has been amplified by the magic of social media. The Bangladeshi Primark subcontractor factory collapse in 2013 created serious reputational damage for Primark and changed the buying habits of many of their young customers. The garment industry has changed for the better as a result, but consumers and investors cannot afford to be complacent. Individuals as consumers, investors and employers need to vote with their wallets to make their voices heard.

Consumers have never had so much choice nor have they ever had so much product information at their fingertips. We can choose to buy Fairtrade goods if that is important to us. We can choose to avoid imported, non-seasonal produce or flowers that take away precious water from subsistence farmers. Consumers can choose to support local production or companies with low carbon footprints if that matters to them. We need to learn that every choice about consumption is also a moral choice about the sourcing of the inputs and the labour. At the very least we can choose to buy from companies that share our values, in whom we have confidence that they will check the treatment of subcontracted workers and the quality of their supply chain.

More of us are investors than we realise. Anyone with a private pension is an investor. As investors, we need to consider not just the short-term return of our investments but how the companies we invest in operate, their values and their social purpose. Anyone with a private pension can voice their views on these subjects to the trustees of the plan or the manager of the investments. Increasingly there are funds that take ethical considerations into account, which range from the type of products sold to environmental issues and increasingly labour issues. While in its early stages, some companies are beginning to use triple-bottom-line reporting. This refers to a how a corporation deals with and reports on its impact and behaviour with respect to people, planet and profit. The intention of such reporting is to improve transparency and accountability in public disclosure regarding environmental, social and economic dimensions of corporate performance. To ask these questions before investing helps

‘More of us are investors than we realise’

ensure that your money is working in a way that is consistent with your values.

Regarding labour, for those of us who employ people, wherever in the world they might be, we need to consider whether we treat them as we would wish to be treated. We need to think of them as human beings, not just 'human resources'. Do we pay our employees a wage that permits them to live, or are they required to take a second job to make ends meet? The employment contract should benefit both employers and employees. Employers should develop staff to move up within the business rather than using them up until they are worn out.

Not everyone will be in a position to drive change as readily as others, but each of us can have an impact by using both our money and our voice in accordance with our values. It is often difficult to see the impact of such small movements, but they encourage others to consider their own behaviours. It does not take a majority to create change; a significant and vocal minority can often provide the tipping point for action. The impact of many small voices on child labour, sourcing and environmental issues is becoming significant, as it is also in investment policies and ethical investment funds.

Many businesses anxious to retain the best talent who understand their customers' demands have already embraced a value proposition for their company that considers 'What is the right thing to do?' and the reputational cost of not doing it. It is important to beware, however, of companies that talk a good line but whose actions may not be aligned with their purported policies. Caution is warranted to ensure that fine words are consistent with a company's actions.

Conclusion

Dani Rodrik suggested 20 years ago that 'too much globalisation would deepen societal cleavages, exacerbate distributional problems and undermine domestic social bargains.' He also suggested that economists had a lot to answer for by not being clearer about the costs as well as benefits of free trade.[4] Insofar as it is difficult for any single consumer or investor to have much power to effect change, he was correct. However, as with most things, trade and globalisation are neither all good nor all bad. The arguments are far more nuanced than people with vested interests on either side of the debate want you to believe.

Companies and consumers would be well served to consider the common good in their own decision-making and not just their own self-interest. The Archbishop of Canterbury's new book recommends dethroning Mammon.[5] This may take some time. Nonetheless, positive engagement would go a long way to redressing the balance of negotiating power in the global marketplace. After all, businesses know just how important consumers are to their success. Look at how much money they spend trying to influence our decisions and desires through marketing and advertising. The consumer needs to learn how to use that influence effectively.

'Companies and consumers would be well served to consider the common good'

Notes

1. Mark Carney, 'The Spectre of Monetarism', Roscoe Lecture, Liverpool John Moores University, 5 December 2016, www.bankofengland.co.uk/publications/Documents/speeches/2016/speech946.pdf.

2. Numerous product developments originating in NASA grants, or technology developments that grew out of the Defense Department in the USA, are often cited as indirect innovation investment by government.

3. Dani Rodrik, 'Straight Talk on Trade', Project Syndicate, 15 November 2016, www.project-syndicate.org/commentary/trump-win-economists-responsible-by-dani-rodrik-2016-11.

4. Rodrik, 'Straight Talk on Trade'.

5. Justin Welby, *Dethroning Mammon: Making Money Serve Grace*, London: Bloomsbury, 2016.