

PRINCIPLES OF CORPORATE REDESIGN

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Part of the bargain, the social contract which allows companies to be as large as they are, is that they become engaged in the challenges the world faces, rather than dismissing them as someone else's problem.

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Contemporary global corporations face two realities that in large measure explain the distrust in which the public regards such enterprises. It is a situation that troubles business leaders and society alike. It also is one that must be reconciled in the decades ahead if large corporations are to rebuild the trust of society that has been steadily eroding during the last decade.

The first reality is that global corporations arguably are unmatched in the resources they command—financial assets, capacity to innovate, and ability to both respond to and shape the markets for goods and services. Half of the largest economic entities in the world today are corporations. Annual turnover of US \$300 billion and market capitalization of US \$400 billion, unimaginable a decade ago, is now surpassed by several companies. Total cash assets and their equivalents held by the S&P 500 exceeds US \$2.5 trillion. Workforces comprise hundreds of thousands and span scores of countries, not to speak of additional thousands employed in supply chains. In the early years of the 21st century, global corporations exercise unprecedented influence on the lives of hundreds of millions of people, leading some to ask whether “corporate government” has become a permanent feature in the global economy.

The second reality is that trends in many of the world’s vital signs—ecological, economic and social metrics—are moving in the wrong direction. This situation was captured in recent data, for example, from the Index for Sustainable Economic Welfare, the 2005 UN Development Programme’s Human Development report and the Millennium Ecosystem Assessment. The divergence between income growth and quality of life, the income disparities between the world’s rich and poor, the degradation and unsustainable use of 60 percent of the world’s ecosystems and other similar trends point to development that fails the test of both equity and sustainability.

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The juxtaposition of corporate power with persistent inequity and unsustainability raises profound questions about whether corporations are upholding their end of the social contract or, indeed, whether the social contract itself needs to be rewritten. Of course, all of the world's urgent problems are not the responsibility of business. Government and consumers, for example, play powerful roles in fueling both social and ecological deterioration, for example, through public subsidies that drive overuse of natural resources and over-consumption of goods and services that exert pressure on global ecosystems. Nonetheless, in the public mind, the coexistence of corporate power and the alarming drift of the world's vital signs raises fundamental questions as to whether the business community is contributing to the public interest at a level commensurate with its capacity to do so.

If the answer to this query is “yes,” then the prescription for business-society relations is business-as-usual. That is, expect no more of business than the current notion of corporate responsibility that characterizes contemporary discourse pertaining to business-society relations. If, on the other hand, the answer to this query is “no,” then rethinking the fundamentals of business-society relations is necessary. In that case, conventional notions of corporate responsibility would be viewed as falling well short in terms of meeting societal needs and expectations; and, deeper, structural solutions must be pursued to close the gap between corporate contributions and societal needs. This, in turn, would shift the focus from the “what” and “how” of the production of goods and services to the nature of the corporation itself—specifically, its purpose and architecture.

The difference between the first and second of these prescriptions is the difference between gradual, incremental shifts in business conduct versus systemic, discontinuous shifts. At this juncture, with the evidence of intensifying signs of ecological, social and economic distress, it is the second course of action that seems closer to addressing the reality of the early years of the 21st century.

Sources of Disquiet

These are turbulent times for corporations. The promise of a truly global economy is tempered by weariness toward the disparities globalization has fueled between rich and poor within and across nations. Against this backdrop, three conditions emerge that color the public anxiety toward the growing power of corporations:

Scale. Unbridled growth continues to push the frontiers of corporate power at the same time that it heightens the anxiety of those who experience its effects—workers, communities, suppliers, and the environment, among others. For the business community, growth is viewed as not only a right, but an imperative. Waves of mergers and acquisitions have contributed to gradual consolidation of whole sectors—petroleum, media, automobiles, banking, and retail—into fewer and fewer global players. But in contrast to the perspective of financial markets, such trends evoke more anxiety than admiration among those stakeholders without a voice in the M&A process. Does the concentration of such economic power serve the long-term public interest? Are anti-

trust and competition regulations up to the task of harnessing growth in a way that the public interest is protected? For many, the evidence is unconvincing and the results disempowering.

Transience. The pace of change in the global economy is characterized by fleeting ownership enabled by new investment instruments, dislocation associated with continuous restructuring of production systems and, tellingly, historically high rates of change in CEO leadership occasioned in part by compensation structures dependent on stock options. Certain segments of the shareholder population are immune to the repercussions of these rapidly shifting tides and, in fact, benefit from the volatility of the transaction-driven capital markets. But for workers and communities, this same volatility is, at minimum, unsettling and, at worst, ruinous. For shareholders, transience is simply the contemporary manifestation of “creative destruction,” enabling the market to relentlessly drive near-term shareholder returns in the name of efficiency and competitiveness. For workers and communities, however, transience is the embodiment of the amorality of markets, bowing to pressures of short-term returns at the expense of broader long-term, stakeholder interests.

Disparities. Equity has never been viewed as the responsibility, much less the outcome, of free markets. Nor has employment opportunity, protection of indigenous peoples or poverty alleviation. Corporations have never functioned as agents of justice in terms of equitably distributing society’s wealth. It is neither their legal obligation nor their custom to incorporate equity into their decision-making. The results speak for themselves in terms of macro-level income disparities within and across nations; micro-level disparities in the form of the ratio of executive pay to average wages; historically high profits juxtaposed with stagnating or declining real wages of workers; and imbalances between how corporations are governed and the effects of these governance structures. Disparities are also manifested in profit players such as investment banking firms, resulting from what Philip Augar, former CEO of Schroders Securities describes as “enormous pressure on our clients to transact [resulting in] a heads we win, tails you lose strategy” that is immune to swings in overall market performance.

Scale, transience and disparities – these are among the leading conditions that conspire to foster distrust in large corporations. The sense that the business-society social contract is unraveling is widespread, and confidence that the conventional corporate responsibility movement is capable of reversing such trends is weakening.

Corporate Redesign as an Antidote

Without a shift in attention to the systemic aspects of business-society relations, the tensions surrounding corporate power will intensify and public trust will continue to diminish. The sheer scale, resources, and influence of the modern global corporation make this inevitable. The conventional definition of the corporation as a “private” entity only loosely connected to the social milieu in which it operates is increasingly disconnected from the real world of corporate operations.

What might such a system look like? Imagine that in the coming decade, selected business leaders forge an improbable coalition with civil society and labor. The group collectively steps forward and says: “We recognize that business-as-usual is not an adequate response to expectations, risks and opportunities for business in the 21st century. We therefore are advocating a change in the rules governing corporations. We need not just a level playing field; we need a different playing field.”

The contours of this new playing field take shape.² A general recognition emerges that the incremental, piecemeal progress in human rights, labor and environmental performance of corporations that lies at the heart of the CSR movement are simply inadequate in the face of intensifying ecological stresses and social inequalities. The notion of “shareholder value,” discredited for its short-termism and social vacuity, is replaced by “wealth creation” and “stakeholder governance” as the underpinnings of next generation business organizations. These concepts are rooted in the core premise that all company stakeholders — employees, communities, suppliers, and the environment—are “resource providers” that deserve to participate in the company’s governance and benefit from its surplus. Shareholder-centric law and practice has run its course and is replaced by a new definition of corporate purpose, one that broadens the purview of accountability from a singular focus on shareholders to include a multiplicity of stakeholders.

A focus on corporate purpose has moved into the political arena, challenging “shareholderism” as incongruent with 21st century needs and expectations of business. But unlike earlier incremental and fragmented corporate reform efforts, this movement is attracting broad support among progressive members of the corporate community itself. Disillusionment with short-term motivation is broad and deep, and the concept of companies as “team production” entities, dependent on the joint investment of employees, communities, customers, shareholders and other stakeholders has captured the public imagination. The property-centric definition of the corporation is fading, and in its place is an emergent view that the corporation is a community of individuals and a living system that cannot simply be owned, managed and marketed like an automobile, house or other inanimate object.

New Purpose, New Principles

The beacon of this movement is embodied in a new set of six “design principles” that preserve the innovation and competitive capacity of the corporation while elevating the public interest as its preeminent purpose.³

1. The purpose of the corporation is to harness private interests to serve the public interest.

Why does society create laws that allow corporations to exist? To serve the public interest, which is the core purpose of all democratic law. The license to operate is not an

² Allen L. White, “*Fade, Integrate or Transform: The Future of CSR*,” Business for Social Responsibility Issue Paper, August 2005.

³ www.corporation2020.org

entitlement; it is a privilege with conditionalities. This principle recognizes and reinforces the unique capacity of the corporation to generate wealth. At the same time, it insists that in the process of wealth creation, the corporation must act in a manner consistent with the public interest. Where private and public interests conflict, the public interest must prevail. Principle 1 rejects the characterization of the corporation as an insular entity freely marketable without constraints and detached from the broader societal context in which it operates. Instead it positions the corporation as inseparable from and accountable to the public interest.

2. Corporations shall accrue fair profits for shareholders, but not at the expense of the legitimate interests of other stakeholders.

Principle 2 begins by acknowledging that profit and investment are vital to a well-managed corporation. Yet corporations may not pursue profit for shareholders by undermining the legitimate interests of other stakeholders. The word “legitimate” is critical because rightful claims should vary according to the depth of the stake of various stakeholders. The notion of offloading external effects, or “externalities,” onto society is fundamentally unacceptable. Enriching shareholders at the expense of other stakeholders by depressing wages, deferring maintenance essential to a safe workplace and postponing promising R&D endeavors that promise to advance the public interest does not meet the test of “fair returns.” The legitimacy of stakeholders’ claims derives from their role as providers of human, natural, social, and financial capital to the corporation. Issues linked to this principle include, for example, how each corporation deals with consumer safety, workplace conditions, livable wages, pollution control, and localized social impacts.

3. Corporations shall operate sustainably to meet the needs of the present generation without compromising the ability of future generations to meet their needs.

Vital to the public interest – and vital to all life – is the stewardship of the biosphere through the preservation of natural resources and protection of common assets such as clean air, water, and the earth’s climate. This principle states unequivocally that corporations have intergenerational responsibilities, making managing for the short-term a violation of these duties. As stewards, corporations must not abdicate their long-term public responsibility in pursuit of short-term private gain. Climate change is the most compelling example. Operating sustainably in the future, consistent with Principle 3, implies for many corporations dramatic change in the nature and production of goods and services so as not to compromise the well-being of future generations. Issues linked to this principle include, for example, privatizing the world’s gene pool, reducing the carbon intensity of goods and services, and enriching the stock of human capital.

4. Corporations shall distribute their wealth equitably among those who contribute to its creation.

This principle positions equitable wealth distribution as an explicit, though certainly not exclusive, responsibility of business. It rejects prevailing norms of corporate governance

and fiduciary duty that make shareholder wealth paramount and the wealth of all other recipients subordinate. Gains to other stakeholders – wages for employees, payments to suppliers, and taxes to local and national governments – are currently handled as costs (to be minimized) under generally accepted accounting rules. In contrast, a corporation designed consistent with Principle 4 recognizes its obligation to distribute wealth equitably among parties who contribute to its creation. Issues linked to this principle include, for example, fair wages, employee ownership, profit sharing, fair trade and procurement policies, and community trust funds endowed with shares of corporations with local operations.

5. Corporations shall be governed in a manner that is participatory, transparent, ethical, and accountable.

Participatory governance empowers stakeholders at all levels of corporate decision-making. Through decision-making processes that are transparent, ethical, and accountable, affected parties are informed, heard, and influential. This type of “stakeholder governance” is a precondition for implementing all other principles. Issues linked to this principle include: broadening the composition and competencies of corporate boards; democratizing elections and removal of corporate directors; creating stakeholder councils with real influence on major corporate decisions such as mergers and acquisitions; and mandatory public reporting on the financial, economic, environmental, social and governance performance of the corporation.

6. Corporations shall not infringe on the right of natural persons to govern themselves, nor infringe on other universal human rights.

This principle speaks to how the corporation intersects with the broader political rights of citizens. It sets a boundary that corporations must not transgress, namely, the rights of natural persons to govern themselves. Corporations must not exceed their proper role in democratic political processes, and must respect norms that limit their influence in lawmaking when such influence dilutes or depresses the voice of the citizenry. Issues linked to this principle include corporate due process, freedom of speech and other constitutional rights, lobbying practices, ownership of the media, and campaign finance.

In the scenario depicted here, the principles catalyze a wave of experimentation and innovation in law and in practice.

- Self-declaration in corporate charters of how a corporation serves the public interest and the metrics it uses to assess its performance against its definition of the public interest;
- Periodic review of corporate charters by citizen and expert panels authorized by chartering authorities;
- Credentialing board members through formal training programs to strengthen their knowledge of social and environmental issues;

- Major innovations in internal incentives, rewards and recognition within corporations for environmental, social and governance performance;
- Expansion of the definition of the legal fiduciary duty to include non-shareholder interests;
- Changes in fiscal policy to heavily penalize short-term, speculative behavior in capital markets;
- Establishment of new corporate forms, including ownership structures, to broaden the scope of options available to socially-minded entrepreneurs;
- Vast expansion of non-financial information in the market via a major upscaling of non-financial business reporting using the Global Reporting Initiative (GRI)⁴ framework coupled with the emergence of research and rating groups to analyze such information;
- Upscaling to new governance structures adapted to specific socio-political conditions in emerging and poor countries.

How plausible is a scenario of this nature? For many observers, it stretches the imagination. But for others, the scope of discontent with the direction of corporate power is broad and deep enough that transformational change is no longer viewed as implausible.

Executives themselves are victims of the unrelenting pressure to maximize shareholder value. The stresses imposed by “impatient capital” arise because the vast majority of executives recognize their moral and ethical obligations but are effectively precluded from responding to them because of capital demands they confront every day. The pronouncements of a few business leaders, though still uncommon, suggest a growing number of dismissed and disgruntled that form the nucleus of a movement toward new business norms of the type described above.

This suggests that most well-compensated executives would, if given the opportunity, prefer an operating environment in which shareholder and non-shareholder interests are brought into balance, where managing for long-term wealth creation supplants managing for quarterly returns, and where alignment between personal moral norms and day-to-day business decisions becomes a reality. It is a hypothesis rooted in the premise that business leaders gain no pleasure or gratification in constantly bowing to capital pressures and, if given the choice, would embrace a more satisfying approach to measuring their own success and the success of the organizations they lead. While greed will not disappear tomorrow, it is not unreasonable to assume that most of those who lead

⁴ Disclosure: the author is co-founder and former CEO of GRI.

corporations would prefer a business environment in which the most anti-social propensities are tightly contained and a higher social calling is allowed to flourish.

As John Bogle, co-founder and former CEO of Vanguard mutual funds, observes: “The momentary precision of the price of a corporation’s stock [has come] to overwhelm the eternal verity of the intrinsic value of the corporation itself, however difficult to measure.”

Reflections

Without transformational change in the purpose of corporations, tensions created by the divergence of societal expectations and the single-minded pursuit of shareholder value will only intensify in the coming years. The power of the modern global corporation makes this inevitable. A continuation of the insular, atomistic view of the corporation’s societal role will exacerbate the distrust that currently pervades business-society interactions. Incremental, piecemeal efforts to reshape corporate practices and image have not proven adequate for addressing the great sustainability challenges that lie ahead. To establish enduring leadership in reversing the alarming trends in the world’s vital signs, a new vision of the corporation must take shape. It must be a vision built on a platform of long-term wealth creation and service to the public interest.

For the cynics that dismiss such a transformation as the idea of naïve optimists and dreamers, we respond that enough nascent signs of change are discernable: recent company law reform in the UK that opens the door to broader interpretations of fiduciary duty; innovative ownership structures that direct resources to the public interest, as in the case of GrupoNueva, IKEA, John Lewis Partnership, and Tata Industries; actions such as the Principles of Responsible Investing in the financial community and set asides by pension funds to steer capital in the direction of socially desirable ends; and cessation of quarterly earnings expectations by firms such as Pfizer, Citigroup, Coca-Cola, GM, Ford, Intel and Motorola. Taken individually, none of these will fundamentally shift corporate purpose or architecture. But taken as a whole, they portend a critical juncture—a tipping point—for what can occur in the not-too-distant future in the form of a broad-based movement for transformational change in corporations.

All major social movements—environmentalism, civil rights, feminism, anti-apartheid—were galvanized by some combination of broad-based grievance, visionary leadership, and propitious timing. Such markings, though diffuse and unsteady, are discernible. They provide the basis for optimism that a new corporate architecture is within reach.