# The Future of the Corporation:

# A Blueprint for Reform

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This is a draft working paper summarising the findings of the British Academy Future of the Corporation programme and provided solely for the purposes of discussion by the Supreme Court of New South Wales Annual Corporate and Commercial Law Conference to be held in Sydney, Australia on 29th October 2019.

This paper is for discussion only and not for circulation or citation. A final version of the paper will be published by the British Academy in November 2019. Anyone interested in receiving the final version should email fotc@britishacademy.ac.uk or add their email address to the mailing list at: https://www.thebritishacademy.ac.uk/fotc

The British Academy programme is the largest and most ambitious on the Future of the Corporation to date. It is also the largest programme of research that the British Academy - the national academy of the humanities and social sciences - has undertaken. The reason why the British Academy is doing this is that the Future of the Corporation is one of the most important and pressing topics of our time. It lies at the heart of the future of capitalism and the future of humanity.

This is the second report of the programme. The first, published in November 2018 set out the case for urgent reform of business to address the social, political and environmental challenges it faces and to take advantage of the remarkable technological and scientific advances in progress. It was based on research papers produced by academics across the humanities and social sciences from around the world guided by the advice of prominent business leaders.

The first report received considerable attention from academics, business, institutional investors and policy makers. Since its publication the world has moved significantly in the direction of its recommendations to reform business around its purposes, trustworthiness, values and commitments. This report takes over where the first left off and identifies how change can and should be achieved.

This report sets out a series of principles to guide formulation of policies and practice to reform business in any jurisdiction around the world. It is based on extensive research and evidence described in four compendium research reports on the four key areas of reform described in this report: law and regulation of business; ownership and governance of firms; measurement and performance; and finance and investment.

The significance of the recommendations stems not only from the comprehensiveness and evidence base of the proposals but also from the nature of the people involved in their production. The British Academy is one of the few institutions in the world with the independence and standing to convene the finest minds to address one of the most important issues of our time. This report has been guided by a Deliberation Group of nine people from a diverse set of backgrounds and experiences and roundtables of more than 100 people from business, academia, institutional investors, government and think tanks.

The principles have been presented in forums, conferences and policy discussions around the world and they were the subject of a public lecture series organized by the British Academy in eight cities across the UK. Together, the two phases of the British Academy programme represent the most substantial assessment of the Future of the Corporation to date. It has been made possible by the generous support of its sponsors for which we are most grateful, and the many people who have devoted substantial time and effort to organizing the programme and commenting on previous drafts of this report.

## Contents

## Executive Summary

### Purpose Before Profit

- Business is one of the most important institutions in our lives. It has been the source of remarkable economic prosperity and the growth of nations around the world.
- But it is failing to address the environmental, social and economic challenges of this age and to establish trust in its intention to do so.
- It is increasingly dependent on and has impacts on assets it does not own – human, natural and social assets,
- And some corporations are growing to the size of nation states, putting them outside the reach of national competition and regulatory bodies.
- Technological advances are intensifying social risks as well as offering significant benefits and the lag of regulation behind corporate innovations is increasing.
- The success of markets in delivering positive societal benefits is dependent on the integrity of the organizations participating in them.
- The purpose of business is key to this. Purpose is not purely about producing profits.
- Instead, the purpose of business is to produce profitable solutions for the problems of people and planet, and not profit from producing problems for people or planet.

### The Reforms

- Policy and practice reforms follow naturally from this notion of purpose.
- They relate to law and regulation; ownership and governance; measurement and performance; and finance and investment.
- *Corporate law* should place purpose at the heart of the corporation and require directors to state their purposes and demonstrate commitment to them.
- *Regulation* should expect particularly high duties of loyalty and care of companies to public interests where they perform important public functions.
- *Ownership* should recognize obligations of owners to support corporate purposes as well as their rights to derive financial benefit.
- *Corporate governance* should align managerial interests with companies' purposes and establish accountability to those parties most affected by the firm's activities.
- *Measurement* should recognize investment by companies in their workers, societies and natural assets both within and outside the firm.

- *Performance* should be measured against fulfilment of corporate purposes and profits measured net of the costs of achieving them.
- *Corporate financing* should be of a form and duration that allows companies to fund investment of their purposes.
- *Corporate investment* should be made in partnership with private, public and not-for-profit organizations that assist with fulfilling corporate purposes.

**Implications for Business**

- The proposals in this report promote companies that:
    - Specify their purposes;
    - Identify supportive shareholders;
    - Establish appropriate board governance arrangements;
    - Ensure consistent values and culture;
    - Create accountability to other parties affected by their activities;
    - Make investments in human, natural and social, as well as physical, assets;
    - Measure performance against fulfilment of corporate purposes;
    - Restate profits net of costs of remedying failures to fulfil their purposes;
    - Source long-term equity risk capital; and
    - Invest in partnerships with other organizations, including the public sector.

**Implications for Economies and Societies**

- The proposals in this report:
    - Provide credible resolutions to individual, social and environmental problems;
    - Offer meaningful, fulfilling employment and a sense of dignity and pride;
    - Increase investor wellbeing as well as wealth;
    - Improve individuals' capability of achieving their purposes;
    - Enhance the functioning of markets;
    - Promote diversity and variety in corporate activities;
    - Stimulate competition in and commitments to corporate purposes;
    - Create competitive advantage for purposeful companies and economies;
    - Protect against future adverse consequences of technological innovations.

**Part One – Purpose Before Profit**

In November 2018, the British Academy published a first stage report on the Future of the Corporation. It set out the case for urgent reform of the corporate sector to address the social, political and environmental challenges it faces and to take advantage of the technological and scientific advances in progress to further the wellbeing of humanity.

Since then there has been remarkable progress in the direction of the report's recommendations. It reflects a groundswell of support from investors, business leaders and prominent commentators about why business exists, why it is created, what it is there to do and what it aspires to become - namely the purpose of business.

In January 2019, Larry Fink, the CEO and President of Blackrock, the largest investment management business in the world, said that "every business needs a purpose, not a strapline or marketing campaign but a fundamental statement of its reasoning for being. Purpose is not the sole pursuit of profits but the animating force for achieving them." The leaders of other large investment management firms have made similar statements.

In August 2019, the Business Roundtable put out a statement on the Purpose of a Corporation. In an accompanying letter, the Chairman of the Business Roundtable and the Chairman of the Business Roundtable Corporate Governance Committee said: "Since 1978, Business Roundtable has periodically issued Principles of Corporate Governance that include language on the purpose of a corporation. Each version of that document issued since 1997 has stated that corporations exist principally to serve their shareholders. It has become clear that this language on corporate purpose does not accurately describe the ways in which we and our fellow CEOs endeavour every day to create value for all our stakeholders, whose long-term interests are inseparable."

"We therefore provide the following Statement on the Purpose of a Corporation, which supersedes previous Business Roundtable statements and more accurately reflects our commitment to a free market economy that serves all Americans. This statement represents only one element of Business Roundtable's work to ensure more inclusive prosperity, and we are continuing to challenge ourselves to do more." The statement said that corporate purpose was to deliver value to customers, invest in employees, deal fairly and ethically with suppliers, support communities, sustain the environment, and create long-term value for shareholders.

In September 2019, the editor of the Financial Times, Lionel Barber, announced a major campaign entitled "Capitalism: Time for a Reset" and said: "We at the Financial Times believe in free enterprise capitalism. It is the foundation for the creation of wealth which provides more jobs, more money and more taxes. The liberal capitalist model has delivered peace, prosperity and technological progress for the past 50 years, dramatically reducing poverty and raising living standards throughout the world. But in the decade since the global financial crisis, the model has come under strain, particularly the focus on maximising profits and shareholder value. These principles of good business are necessary but not sufficient. The long-term health of free enterprise capitalism will depend on delivering profit with purpose. Companies will come to understand that this combination serves their self-interest as well as their customers and employees. Without change, the prescription risks being far more painful."

These are statements by some of the most significant investors, business leaders and business commentators around one concept – the purpose of business. They are all saying one thing – that business is not and should not be about just making profits. Its purpose is much larger and more significant than that. It is to contribute to the wellbeing of humanity, society and the environment, and to do so in a way that delivers returns to its investors over the long-term.

However, there is a counterview, which was, for example, expressed by the Council of Institutional investors on the same day that the Business Roundtable made its statement about corporate purpose – that business is and should be about making money. It should not stray into the realms of public policy, government and philanthropy. It should not confuse its objectives by introducing a plethora of others for which there is no clear rationale or measures to quantify them with the same precision or confidence as profit. It should not be accountable to anyone other than its shareholders because they have property rights that derive from the money they have invested and unique exposure to the risk of failure of a business. The rights of shareholders are more than those of providers of finance – they are rights of owners, whereas "accountability to everyone is accountability to no one".

In this context, the purpose movement is a fundamental assault on the liberty of the individual to earn their rewards of effort, initiative, investment and risk taking. It is an attempt by management to seize control of companies and promote their own interests at the expense of shareholders, of labour to increase their share of income and wealth at the expense of shareholders, of a plethora of civil society and social interest groups to interfere in business, and of communists, Marxists and socialists to undermine the operation of our capitalist system. It is therefore a threat to our present and future well-being and prosperity which the existing system has so successfully created over such a long period of time.

This critique is based on a well-reasoned coherent notion of capitalism in which governments, regulators and the judiciary establish and enforce rules by which companies compete for the profits of their shareholders. Profit and competition together drive efficiency in production, resource allocation, investment and innovation. To the extent that there are failures of capitalism to reflect the interests of society those should be addressed through tougher regulation, competition policy, taxation and stronger enforcement.

We therefore face either progressively tougher more intrusive regulation and state intervention in shareholder centric corporations or the formation of purpose driven businesses with intrinsic not externally imposed interests in others. The Future of the Corporation programme is not suggesting that the former is wrong, but merely that there is an alternative equally coherent and compelling concept of the firm that could enhance its performance and address its defects. But, since the road to hell is paved with good intentions, this proposal is presented with modesty, humility and caution as a set of hypotheses and ideas that are worthy of serious consideration, testing and exploration. This paper seeks to describe a coherent vision of an alternative, why it might address the failings of the existing system and how it could be implemented through principles to guide reform.

What is corporate purpose if it is not just about making money? The answer that lies at the heart of the British Academy programme is that it is about helping to find solutions to the problems that we as humans, societies and the natural world face, and to do so in ways that are not just extraneous or philanthropic but core to the business, financially viable, and sustainable over the long-term. It is about **producing profitable solutions to the problems of people and planet, and not profiting from producing problems for people or planet.**

Corporate purpose in this context is neither purely aspirational in "saving the world" nor descriptive in simply describing what the firm does. It is about determining precisely whose problems a firm is seeking to address, what problems it is solving, how it does it, with whom and over what period in a form that is financially viable and profitable. It is a different way of viewing business that is inspiring not just mundane, practical not just academic, and valuable financially and fundamentally for our global wellbeing.

As employees, we all wish to do a good job, to have a sense of pride and dignity in what we do, and a feeling of motivation and inspiration in what we achieve. Business succeeds by working with humanity. As investors, we are all consumers, employees, communities and citizens of the world. We value returns on our investments, but we also value our health, welfare, relationships, descendants and survival. Investments succeed by enhancing not just our wealth but our wellbeing. Business therefore succeeds by working with humanity and investing in our future.

Business is one of the most important institutions in our lives. It clothes feeds and houses us, employs us and invests our savings. It is the source of economic prosperity and the growth of nations around the world. But it is also a cause of growing inequality, environmental degradation and mistrust to a point that threatens our economies, politics, societies, and survival.

There are powerful external forces at work. The first are political and regulatory threats arising from the failure of business to address the environmental, social and political challenges it faces. Trust in business and business leaders is low, regularly reported near the bottom of surveys of trust in society at large, in particular amongst the young.

The second force is the changing nature of business itself. Forty years ago, 85% of the assets of the S&P comprised tangible assets – buildings, plant and machinery. Today more than 85% are intangible assets – brands, patents and intellectual property. Increasingly, companies are dependent and have impact on human assets in their supply chains as well as within their legal boundaries – think Amazon and Uber; they are reliant on and affect the societies within which they operate – think Facebook and Google; and they draw on and adversely affect natural resources and the environment – think fossil fuel and airline companies.

The consequence of this is that, while traditionally firms comprised financial and physical assets financed by shareholders, today they affect and are affected by assets they do not own – their employees, societies and environment. This turns the property right justification for shareholder dominance of firms on its head. Instead of being shareholders' property, firms owe obligations and responsibilities to the other parties that affect and are affected by them. This calls into question the legitimacy of the legal basis on which public policy towards the firm has to date been based.

The third force at work is the most important and the basis for entitling this programme "the Future of the Corporation". Business is undergoing technological transformation. Of course, there is nothing unique about this and indeed the origins of the modern corporation are in one such transformation, namely the industrial revolution. But this one is different because it relates not just to business and society but to the future of humanity.

There are two particularly relevant technological advances in progress. The first is artificial intelligence and the second is genetic engineering. The effect of artificial intelligence that is receiving the most attention is in relation to the future of work, where there are serious concerns about the substitution of humans by machines. Important though this is, it is not probably the most significant influence. More enduring is its consequence for our minds rather than our bodies - its substitution for mental rather than manual labour.

As machine learning develops then the ability of artificial intelligence to replace human intelligence not just in processing vast amounts of information but in making decisions moves from the realms of science fiction to science fact. One area in which this is likely to be experienced is in the courtroom, with machines being able to outperform humans in processing information to reach judicial decisions. A second is in the boardroom, with machines not simply sitting beside but in place of directors in formulating board decisions.

Even this is not the end of the matter because of a further consideration – conflict and competition. Where there is human conflict then there is a real risk of restraints on machine learning being lifted to the point that humans lose control of its evolution. That risk is well appreciated in the context of armed conflict but there is another area where competition is welcomed and promoted and that is in relation to business and commerce. This raises profound questions of who is controlling the algorithms on which machine learning is based and for what purpose. If it is just for the commercial self-interest of "their owners" then we have good reason to be concerned.

Similar issues arise in relation to biotechnology and genetic engineering which again offer remarkable potential for enhancing human welfare through providing remedies to disease and ill-health but also threaten the future of our species as well as our minds. Together, artificial intelligence and genetic engineering have the capacity to alter evolution well beyond what we can currently conceive. We need at least to contemplate such developments and ensure that the systems and structures that we have in place are capable of managing them in such a way as to deliver outcomes that we as humanity desire.

That leads us to the heart of the matter and that is the purpose and the objective behind the technologies and the organizations we are constructing. What are we seeking to achieve from artificial intelligence and biotechnology? What type of world do we wish to create and how can we feel confident and assured that we can trust our organizations and institutions to deliver it? These are the questions that a programme on the future of the corporation should be seeking to answer and they are the ones that lie at the heart of this programme of research.

They are increasing in significance because our capacity to rectify the deficiencies of corporations and markets through regulation and competition policy is diminishing. Corporations are growing to a size where they are larger than nation states. Their global presence is placing them outside the reach of individual governments, their impact is increasingly on supply chains, societies and environment as well as consumers, and their intangible nature renders the application of traditional economic tools of competition policy and regulation largely irrelevant.

As technology accelerates, the ability of regulation to keep pace with innovation diminishes and the lag of regulators behind firms increases. Between market efficiency and regulatory effectiveness there is a void that is increasingly becoming a chasm as technology accelerates and business innovation leaves regulatory responses further behind. The capacity for public policy to correct the deficiencies of corporations and markets is therefore decreasing as the scale of their defects is intensifying. Instead of just relying on extraneous remedies, we should seek to modify the nature of business itself to align its interests with those of humanity more generally.

We should not simply presume that all will be for the best. We need to formulate a notion of what that means and what is required of our organizations and institutions to achieve it. Underpinning that is the purpose of business. Currently conceived, the purpose of business is straightforward: to promote the interests, wellbeing and wealth of their owners – their shareholders. The law tells us that and the law is important because the corporation is a product of the law and the law defines the corporation. The law makes reference to the need for corporations to reflect the interests of other parties and society at large, but in essence shareholder primacy is the way we have structured our businesses. In principle, when combined with competitive markets, this delivers desirable outcomes; but markets do not always work like that. The quality of markets is no better than that of the participants in those markets.

Our corporations are currently the autonomous vehicles of the 21st century programmed to reach the furthest destination in the shortest time, irrespective of where they arrive and who and what they destroy on the way. In the process of producing goods they often create bads. We should reprogramme them with a real notion of their destiny and sense of responsibility for their fellow passengers and pedestrians, and a recognition of the obligations on them to ensure that this is done. By stating their purposes and commitments to their delivery, competition in the production of solutions and the avoidance of problems is promoted.

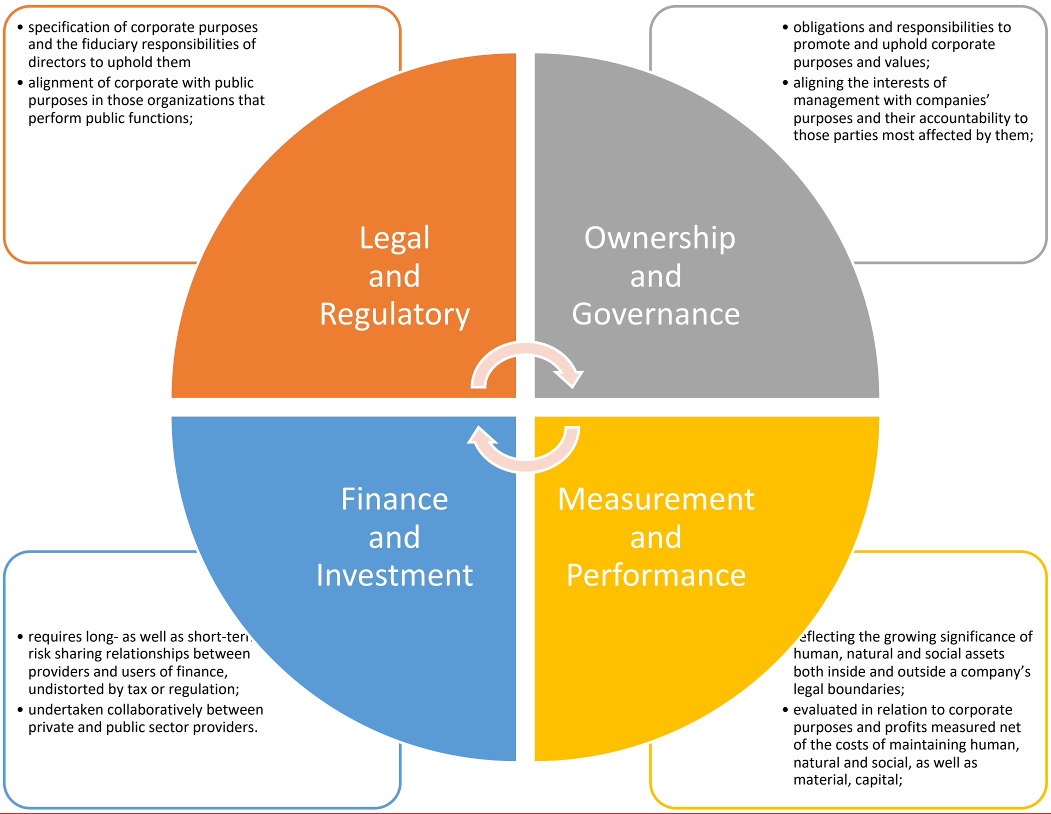
In so doing, we should seek to create an entity whose objectives are congruent with the societies it serves and the environments in which it operates, and whose internal organization and operations are compatible with their attainment. In other words, it should display an external consistency and internal coherence that gives integrity to the purposes to which it aspires. We should promote competition not just in products but in corporate purposes and encourage runs to the top in the creation of the most credible solutions to the most significant problems of humanity.

What is being sought is a shift from self-interested business moderated by the forces of competition and regulation to socially aware firms that **profit from producing solutions to the problems of people and planet and do not profit from producing problems for people or planet.** Once formulated in those terms both business practice and public policy to deliver corporate purpose follow naturally. Law, regulation, ownership, governance, standard setting, accounting, taxation and public investment should be structured in such a way as to complement and support the business practices that fulfil it. In other words, the role of lawmakers, regulators, standard setters and government should be to support and enable business and investors to achieve their purposes, and customers, employees, communities and societies to prosper from their benefits.

**Part Two – The Reforms**

There are four areas of public policy that are of particular significance to business and investors in realizing their objectives. The first is the legal and regulatory environment within which firms operate and defines the rules by which it operates. The second is the ownership and governance of the firm that dictate its control, values, culture and accountability. The third is the accounting and measurement of performance that relate to its internal incentives and external reporting. The fourth is the financing of business and the resourcing of investments required to deliver its purposes.

**Figure 1**




Shareholder primacy is currently coherently and consistently incorporated in the design of business – in corporate law and regulation, in notions of ownership and governance, in the way in which it accounts for its activities and measures its performance, and the form in which it funds its investments and deploys them.

- *Corporate law* privileges shareholders, while recognizing the importance of other parties to the firm in so doing;
- *Regulation* sets and enforces the rules of the game by which corporations pursue shareholder value.

- *Ownership* is concerned with the rights of shareholders;
- *Corporate governance* seeks to resolve the "agency problem" of aligning the interests of management with shareholders.

- *Measurement* records financial flows and investments in physical assets;
- *Performance* is measured by profits net of the costs of maintaining physical assets.

- *Corporate financing* is predominantly concerned with the interests of investors;
- *Corporate investments* are allocated to maximize shareholder value.

The reconceptualization of business set out here suggests an alternative formulation of each of the above that together also represents a coherent and consistent set of principles:

- *Corporate law* should place purpose at the heart of the corporation and require directors to state their purposes and demonstrate commitment to them;
- *Regulation* should expect particularly high duties of loyalty and care of companies to public interests where they perform important public functions.

- *Ownership* should recognize obligations of owners to support corporate purposes as well as their rights to derive financial benefit;
- *Corporate governance* should align managerial interests with companies' purposes and establish accountability to those parties most affected by the firm's activities.

- *Measurement* should recognize investment by companies in their workers, societies and natural assets both within and outside the firm;

- *Performance* should be measured against fulfilment of corporate purposes and profits measured net of the costs of achieving them.

- *Corporate financing* should be of a form and duration that allows companies to fund investment of their purposes;
- *Corporate investment* should be made in partnership with private, public and not-for-profit organizations that assist with fulfilling corporate purposes.

These four sets of principles will be developed in turn.

## Figure 2 to be updated

**Organising business principles around purpose**

| Success as increasing profit<br>Profit not accounting for externalities | | Success as delivering a purpose profitably<br>Purpose as profitable solutions for people and planet |
|---|---|---|
| privileges shareholders, while recognizing the importance of other parties to the firm in so doing; | CORPORATE LAW | about the specification of corporate purposes and the fiduciary responsibilities of directors to uphold them |
| sets and enforces the rules of the game by which corporations pursue shareholder value; | REGULATION | requires alignment of corporate with public purposes in those organizations that perform public functions; |
| concerned with the rights of shareholders; | OWNERSHIP | involves obligations and responsibilities to promote and uphold corporate purposes and values; |
| seeks to resolve the "agency problem" of aligning the interests of management with shareholders; | CORPORATE GOVERNANCE | is about aligning the interests of management with companies' purposes and their accountability to those parties most affected by them; |
| records financial flows and investments in physical assets; | MEASUREMENT | needs to reflect the growing significance of human, natural and social assets both inside and outside a company's legal boundaries; |
| measured by profits net of the costs of maintaining physical assets; | PERFORMANCE | evaluated in relation to corporate purposes and profits measured net of the costs of maintaining human, natural and social, as well as material, capital; |
| predominantly concerned with the interests of investors | CORPORATE FINANCING | requires long- as well as short-term, risk sharing relationships between providers and users of finance, undistorted by tax or regulation; |
| allocated to maximize shareholder value, | CORPORATE INVESTMENTS | should be undertaken collaboratively between private and public sector providers. |

**Principle 1: *Corporate law* should place purpose at the heart of the corporation and require directors to state their purposes and demonstrate commitment to them.**

At present corporate law is formulated in terms of shareholder interests. UK company law illustrates this. Sub-section (1) of s.172 of the UK Companies Act, 2006, states that: “a director of a company must act in the way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to the likely consequences of any decision in the long-term” and the interests of other stakeholders – employees, suppliers, customers, the community, and the environment.

According to UK company law, directors should therefore take account of the interests of stakeholders other than shareholders but only in so far as they further the interests of shareholders. The Act therefore enshrines what is sometimes termed “enlightened shareholder value”. It does not permit directors to further interests of stakeholders at the expense of shareholders and it does not provide protection to companies that promote purposes beyond shareholder value.

As described above, there are two components to a corporate purpose statement – the first is the positive benefit of “producing profitable solutions to the problems of people and planet”, and the second is avoidance of harm in “not profiting from producing problems for people or planet”. These require a reformulation of corporate law along the lines of: “directors of companies must establish their company purposes, act in a way they consider most likely to promote the fulfilment of their purposes, and have regard to the consequences of any decision on the interests of shareholders and stakeholders in the firm”.

This is precisely what sub-section (2) of s.172 of the UK Companies Act permits when it states that: “where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.” The provision therefore already exists within UK company law for companies to put purpose at their heart, only it is very rarely used because the notes to the Act make clear that it should only apply in exceptional circumstances in what are described as "altruistic" companies.  Far from being exceptions, purposeful companies should be regarded as the norm.

**Principle 2: *Regulation* should expect particularly high duties of loyalty and care of companies to public interests where they perform important public functions.**

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In general, there should not be an attempt to prescribe corporate purposes.  Diversity of purposes is a source of innovation and ingenuity.  However, where companies perform public functions that create a dependency of a segment of society on them by virtue of their product, market or function then there is a particularly strong obligation on firms to fulfil their roles. This is most clearly associated with regulated firms – utilities, banks, auditing firms, and public service providers – and regulators of these firms should oversee their statements and implementation of purpose.

This complements the role of regulation in prescribing and enforcing "rules of the game" in regulated entities, and the universal obligations that apply to all firms to abide by commercial, employment, environmental, human rights, investor protection, and public laws.  Its significance stems from the importance of aligning the interests and fiduciary responsibilities of directors of such companies with their public functions.  By incorporating public in corporate purposes, corporations mirror what are termed "public benefit corporations" in the US in which directors have duties to uphold their public as well as commercial objectives. Again therefore, there is a well-established precedent for the adoption of such corporate forms.

**Principle 3: *Ownership* should recognize obligations of owners to support corporate purposes as well as their rights to derive financial benefit.**

Ownership is currently conceived as being about the rights of shareholders over the assets of a firm.  Shareholders provide permanent risk capital for firms and, as residual claimants on their earnings, derive control rights over their assets.  But increasingly companies are dependent on and impact other parties to the firm that they do not own – workers, societies and natural assets in their supply chains, localities and environments as well as within their legal boundaries. This turns the traditional property right view of the firm on its head and suggests that ownership does not relate to the assets of a firm but to its purposes, and with the rights of ownership come obligations and responsibilities to respect the interests of other parties affected by its purposes.

Purpose comprises two components – problem solving and profit creation. While firms may utilize little external finance in comparison to the other assets they employ, they may nevertheless accumulate large amounts of financial capital in the form of ongoing streams of financial profit. Ownership of this financial capital provides strong incentives to its creation. However, it derives from the problem-solving nature of the firm and should not be earned at the expense of other parties. This means that alongside the rights of shareholders to streams of income are obligations to define and support the purposes of businesses on which they are based.

An illustration of this form of ownership is industrial foundations in Denmark and Germany, which account for some of the largest and most successful businesses in the world. These are companies that are owned by foundations which oversee the determination and implementation of their purposes and values but are not managed by the foundations. The companies have their own boards of directors that are accountable to the foundations.

**Principle 4: *Corporate governance* should align managerial interests with companies' purposes and establish accountability to those parties most affected by the firm's activities.**

Corporate governance is traditionally viewed in the context of solving the agency problem of aligning the interests of management with those of shareholders. However, there has been growing recognition that this is not the appropriate formulation of corporate governance.

The UK corporate governance code illustrates this. In July 2018, the Financial Reporting Council in the UK issued a revised corporate governance code which put corporate purpose at the heart of the code and emphasized the need for corporate governance to align managerial interests with the delivery of corporate purposes. Principles B and C of the Code state that: “the board should establish the company’s purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, lead by example and promote the desired culture”, and “the board should ensure that the necessary resources are in place for the company to meet its objectives and measure performance against them.”

These principles provide a clear statement of what corporate governance should achieve – an alignment of company’s strategy and culture with its purpose and values, led from the top and embedded throughout the organization from the board to the shop floor, together with appropriate resourcing and measurement of performance against the company’s purposes.

At present, the accountability of the board for good governance is primarily to its shareholders. `However, boards of directors can be accountable not just to shareholders and shareholder meetings but also to the other parties affected by the firm, as found, for example, in the two-tier board system of Austria and Germany.  Critical to the success of this form of governance is the provision of information on the performance of firms in relation to their purposes.

**Principle 5: *Measurement* should recognize investment by companies in their workers, societies and natural assets both within and outside the firm.**

At present corporate measurement systems and in particular corporate accounts relate predominantly to financial and material assets.  In contrast, companies are increasingly dependent on and affect other parties to the firm that they do not own.  There is therefore a growing mismatch between what companies manage and measure.  This is undermining the quality of information that management, investors, regulators, policymakers and stakeholders have available to them and leading to a misallocation of resources between what is conventionally measured and what is currently needed.

The last few years have witnessed a proliferation of providers of information on the non-financial performance of firms.  There is considerable confusion, inconsistency and cost associated with the variety of information being produced.  This reflects a lack of clarity about what precise questions the information provided is supposed to answer. There is a need for greater consensus, data assurance and standardization of available information.

In particular, there should be minimum standards that all companies nationally and internationally are expected to satisfy, and these standards should be verifiable and validated against common metrics. Laws and regulations set the socially accepted standards by which companies are expected to abide and standardized metrics should be established to determine their adherence to them, based for example on the UN Sustainable Development Goals (SDGs). In addition, the board of a company should determine the firm specific metrics against which fulfilment of purposes beyond minimum legal and regulatory standards can be evaluated. These metrics should translate into key performance indicators that drive behaviour in different parts of a business, and employees should be evaluated, rewarded and promoted against fulfilment of them.

**Principle 6: *Performance* should be measured against fulfilment of corporate purposes and profits measured net of the costs of achieving them.**

Corporate performance should be measured against achievement of both corporate purposes and financial performance. It is currently measured in relation to profits, net of the depreciation and maintenance costs of physical assets. Expenditures on workers, societies and natural assets which contribute to the delivery of corporate purposes should be recognized as investments that may yield benefits over extended periods of time. Those assets can lie outside as well as within the legal boundaries of firms in their supply chains, communities and environment. Companies should ensure that investments in these assets are sufficient to fulfil their corporate purposes.

Profit and loss statements should recognize expenditures on workers, societies and natural assets to deliver corporate purposes as investments and expense them over their relevant lives in an analogous fashion to physical assets. Likewise, companies that fail to deliver on their corporate purposes, and in particular profit from producing problems for people or planet, should make provisions for expenditures needed to rectify them, thereby reducing their distributable profits.

**Principle 7:** ***Corporate financing*** **should be of a form and duration that allows companies to fund investment of their purposes.**

Stock market listed companies in the UK and US are dominated by dispersed passive shareholders who do not provide the active engagement with companies that is associated with larger share blocks in other countries around the world. In particular, universal shareholders who hold the global portfolio of shares through index funds have risen to the fore in the $100 trillion of assets under management. To the extent that there are engaged investors, they take the form of short-term hedge fund activists who hold blocks of shares in companies for on average between 2 to 4 years.

What is for the most part missing in the UK and US is long-term, engaged, holders of blocks of shares who act as true owners of corporate purposes. Since one cannot have a relationship with the anonymous, the absence of identifiable holders of blocks of shares undermines the provision of long-term relationship forms of equity finance. The result is not only insufficient governance and stewardship by investors but also a deficiency of committed owners of corporate purposes.

At present, the corporate tax system discriminates in favour of debt over equity by allowing costs of servicing debt but not equity to be deductible from companies' taxable profits. Furthermore, investor protection rules relating to minority shareholders discourage holdings of significant concentrated blocks of shares, an example being mandatory bid and equal price rules in takeovers that allow minority investors to free ride on takeover premia in target firms. Both these policies discourage forms of funding that are increasingly needed by business. Instead, corporate taxation and investor protection should not discriminate between different sources of finance or forms in which businesses choose to structure their ownership and governance. Indeed, to the extent that taxation and regulation do bias finance, they should do so in the opposite direction of encouraging the provision of long-term equity finance.

**Principle 8: *Corporate investment* should be made in partnership with private, public and not-for-profit organizations that assist with fulfilling corporate purposes.**

Not only is corporate investment intangible in nature, it is increasingly external to the legal boundaries of the firm. To internalize the benefits from such investments, companies need to build close relations with partner organizations which confer reciprocal benefits through undertaking corresponding and complementary investments of their own.

These partnerships are particularly important in relation to large-scale, long-term investments in infrastructure programmes. Private capital markets are frequently unable to fund such programmes on their own because of their associated political risks. They are therefore undertaken either by the public sector or in conjunction with the public sector. To date, public-private partnerships, privatizations and private finance initiatives have been fraught with problems and failures. These reflect the inherent conflict that arises between the public sector interested in public benefit and the corporate sector in profit. Both parties are therefore exposed to exploitation by the other, in particular in relation to long-term programmes.

Resolution of this conflict requires private organizations to adopt the public interest in their corporate purposes. This is analogous to resolution of the conflict inherent in regulated entities discussed in principle 2 through inclusion of public interests in their corporate purposes.

**Implementation**

Business and institutional investors are already taking the initiative in adopting much of the above in the form of "enlightened shareholder capitalism". This aligns long-term value creation with the interests of stakeholders (principle 3), establishes appropriate governance arrangements (principle 4), designs systems of measuring stakeholder as well as financial interests (principles 5 and 6), encourages the provision of long-term risk capital (principle 7) and builds relations between the corporate and other sectors of the economy (principle 8).

Regulation and public procurement can then be used to align corporate and public purposes of regulated sectors, public service providers and infrastructure companies (principles 2 and 8). Institutional stewardship and corporate governance codes should be reformulated around the specification and attainment of corporate purpose rather than resolution of agency problems (principles 3 and 4). Minimum standardized metrics of performance beyond profits should be determined and systems of accounting for non-financial, non-material assets developed (principles 5 and 6). Investor protection regulation and taxation should be used to encourage the provision of long-term equity risk capital (principle 7).

While these changes are in progress, the extended process of reforming corporate law to enshrine corporate purpose in the fiduciary responsibilities of directors of all companies and institutions should be initiated (principle 1).

## Part Three – Implications of the Proposed Reforms

### Business

Purpose has moved centre stage into the boardrooms of companies around the world. This document represents a comprehensive consideration of what the adoption of corporate purpose means and how it can be brought about at micro (individual firm and institutional) as well as a macro (economy and nation state) levels. The reforms will produce profound changes in the nature of business, its performance, social contribution and avoidance of harm

First, the law will require companies to adopt and specify the purposes they are committed to achieving. Second, where they are regulated, then they will be required to adopt social licences to operate similar to the above as their purposes.

Third, they will identify shareholders supportive of their purposes who, through holding significant blocks of shares for extended periods of time, offer the stability of ownership required to fulfil their purposes. Fourth, they will establish board governance arrangements (board composition, training, diversity, committees) that promote the successful adoption and implementation of their purposes. They will determine a set of values consistent with their purposes and ensure that these are embedded in their companies' culture. They will be accountable to forums, councils and supervisory boards of representatives of relevant parties affected by and concerned about their activities (employees, customers, suppliers, communities, NGOs, governments and international agencies) for the nature and implementation of their purposes. Markets in corporate control will encourage their boards to compete to produce the most desirable and credible set of purposes.

Fifth, a standardized set of metrics will assess the extent to which companies adhere to common minimum standards of conduct in relation to human, natural and social assets. In addition, companies will determine the metrics that are most relevant to their specific corporate purposes and adopt key performance indicators to evaluate and reward employees against them. Sixth, they will restate their profits to make provisions for the costs of remedying failures to fulfil their purposes and the costs of maintaining their human, natural and social, as well as material, assets.

Seventh, their shareholders will provide the financial risk capital required by the nature, scale and duration of corporate investments. Eighth, they will establish partnerships with relevant organizations and demonstrate their commitments to them by making the investments required to support these partnerships.

What this does is to create a coherent, consistent approach to a defined direction of travel to which all their relevant parties are committed that addresses existing deficiencies and promotes the internalization of externalities that companies are currently creating.

**Economies and societies**

Authentic purpose is the means by which societal and environmental problems of business are addressed. It encourages credible resolutions to the world's most serious problems as a matter of priority by the organizations with the capability and resources to solve them.

Placing purpose at the heart of business and providing credible commitments to its fulfilment achieves a greater diversity of corporate activities than is possible where profit maximization alone prevails. It permits business to deliver outcomes that are simply not feasible, however desirable they may be, where shareholder value prevails as its sole objective. The traditional concept of the firm is impoverishing in relation to the richness that purpose driven companies can realize and the competitive advantage this creates for themselves and their economies.

Stating corporate purposes and demonstrating credible commitments to their fulfilment through adopting appropriate forms of ownership, governance, measurement and incentives enhances the functioning of markets and promotes competition in tackling the most challenging issues of the time. It encourages runs to the top not bottom in in delivering the greatest societal benefits in the most profitable way. It brings meaning and fulfilment, dignity and pride to employees, and it enhances the wellbeing as well as wealth of investors. It thereby enhances the capability of individuals to realize their own purposes.

But there is a still more important benefit of purpose over profit and that is the assurance it provides of the consequence of technological advancement. The fulfilment of purpose is a continuous requirement of firms throughout their lives. It imposes forward looking obligations on companies to consider the implications of their innovations and inventions over the foreseeable future, in regard to all conceivable occurrences. It demands that provision be made for the rectification of unanticipated damage through internal resources or insurance. It internalizes external consequences not just in the present but in the future in relation to possible outcomes of new technologies.

The demands of integrity are considerable but so they should be because the consequences of its failings are even greater. The rewards for success are immense but so too are the opportunities for concealing the risks. Companies need to realize their obligations not only for the periods of implementation and realization of new ideas but also through the revelation of their full implications. Integrity demands the inclusion of future as well as current generations in the parties to which firms owe duties of loyalty and care.

**Part Four – The Challenges**

Is this naively idealistic? No, it is realistic; it is the conventional belief in competition and regulation that has proven unrealistic.

Is it contrary to our naturally selfish instincts as rational individuals? No, it is consistent with our innate emotional desires to contribute to purposeful pursuits. We seek meaningful, fulfilling employment from which we derive pride, respect and dignity as well as a livelihood. The meaning of business is business with meaning.

Is it a confusion of business with government? No, on the contrary, the current lack of integrity of business in failing to internalize its impact on its environment and society is causing needless meddling of government in business.

Does it create a lack of accountability? Accountability to one body means nobody else counts. The principles set out above significantly strengthen accountability to those impacted by the firm, including but not exclusively to its shareholders. The problem to date has been a lack of engagement by shareholders to act as anything other than absentee landlords, collecting the rents, periodically evicting the tenants, and doing little to maintain the fabric of human, natural and social assets.

Does it make business more complex and confused? No, it is liberating. It focuses business on what it is there to do – to solve problems, to find innovative and profitable ways of doing that, and not to create problems in the process. Just as an honest person does not need to remember, so a purposeful company does not need to remedy. Both are inherently trustworthy.

Does it undermine the competitiveness of nations? No, the trust that purposeful companies engender is the source of competitiveness and the wealth of nations. As a consequence, instead of capital flight to shareholder primacy companies and economies, capital is attracted to the greater financial value of purposeful ones. To the extent that there are owners and investors who are willing to accept lower financial returns for greater societal impact then this puts their firms at a competitive advantage by reducing their costs of capital of furthering the interests of their customers, employees, suppliers and communities.

Does it impede adjustment and restructuring? No, it facilitates change by making all those impacted by it informed participants in it.

Does it require a change in the law? No, business and investors can promote the interests of other stakeholders in furthering the success of the company under existing UK, US and many other countries' current corporate legislation. In fact, they should do so to the extent that this promotes the success of the company for the benefit of its shareholders – "enlightened shareholder interest". Likewise, institutional investors should be concerned about detriments to stakeholders that pose material risks for their beneficiaries' interests. In other words, existing legislation is permissive in allowing companies to adopt the corporate forms that are most suited to their activities, and much progress can and should be made without enacting new legislation.

However, while legislation is permissive in furthering stakeholder interests, it is only so to the extent that it is for the benefit of shareholders. Even where it framed in terms of the success of the company rather than shareholders it does not permit of corporate purposes that prioritize stakeholder over shareholder interests or prevent harm to stakeholders that furthers the interests of the company and its shareholders. It still requires companies to pollute the environment, avoid paying taxes, and neglect the conditions of their workers to the extent that these enhance the success of the company for the benefit of its shareholders. Even more seriously, it does not require companies to demonstrate the furtherance of broader prosperity beyond enlightened self-interest and therefore offers no protection to those that promote prosperity from those that don't. There is therefore a limit to what firms can achieve without alignment of corporate function with legal form.

Ultimately if we are to address the scale of problems and challenges that we face we need intentionally to design organizations whose objective is to do exactly that. This is a system design not a retrofit problem and, since the corporation is an artefact of the law, it is the law that ultimately determines the nature of the system. The role of corporations in this context is to transform our individual self-interests into collective achievements of common purposes and for this to happen they need to be granted the legal authority and licence to do it.

Is purpose whitewash? Properly formulated a purpose statement is neither purely descriptive about what a company does nor aspirational in saving the planet or society. Instead, it identifies how companies assist individuals, organizations, nations and societies to address challenges they face while avoiding or minimizing the collateral damage they cause. Achieving that requires strong commitments and compelling means of attainment. It involves judgements about balancing the interests of different parties. It requires appropriate structures, systems, processes, financing, measurement and incentives.

Who should judge what is a good purpose? Is it not the job of elected governments, not unelected directors? The quality of a purpose should be judged by those affected by it. Consumers are one, but not the only such party. In the US, consumers seek remedies for defective products through class actions, but these are costly to initiate and ineffective in bankruptcy with limited liability (as the opioid tragedy has demonstrated). Other parties (supply chains, societies) rely on governments that are often conflicted, inadequately resourced and insufficiently motivated.

Does corporate purpose violate institutional investors duties to their investors? No, on the contrary, institutional investors have a fiduciary duty to promote stakeholder interests to enhance shareholder value, i.e. “enlightened shareholder value”. But those duties go beyond the relevance of stakeholder interests for the wealth of investors to their welfare. i.e. a recognition that shareholders are in their own right also consumers, employees, citizens of the world, and guardians of future generations.

Does it create problems of measurement? Yes, we have designed extensive systems of measurement around finance and financial performance, on the back of which we have established an efficient market for corporate control to maximize financial value. It is the combination of financial measurement and financially based markets for corporate control that, from the 1930’s in relation to accounting standards and the 1960’s in regard to markets for corporate control, intensified a laser sharp focus on shareholder value that exists today.

We do not possess equivalent means of either measuring performance or allocating control in relation to other objectives. As in the 1930's so in the 2020's, crisis reveals deficiencies of existing measures of performance that demand new standards of measurement, which in turn will allow new forms of governance beyond shareholder primacy to emerge.

Central to those new forms of governance are the allocation of rights of appointment, removal and remuneration of directors. At the moment, governance rights reside solely with shareholders and shareholder meetings. However, the impact of firms extends well beyond their shareholders to other parties affected by their purposes, most notably current and future generations of employees, customers, suppliers and communities. They too should have governance rights over the formulation and implementation of corporate purposes, in particular in regard to the outcome of corporate control contests. What this does is to shift the laser sharp focus of corporate boards on shareholder value to corporate purpose. It promotes equivalent markets in the formulation and implementation of corporate purposes to those that currently prevail in regard to shareholder value.

Is this an assault on individual freedom and liberty? No on the contrary, it is a means of enhancing both in two respects. First, owners and managers are granted rights to promote purposes beyond the confines of profit maximization to which they are conventionally restricted. Second, other parties enjoy the freedom and liberty that are conferred on them by their capability to realize their individual purposes. The principles that underpin the proposals in this paper are ones of pluralism, self-determination and relationships. Plurality and competition in purpose are promoted by diversity of ownership and governance.

However, the rights of individual to determine their own destiny stem not only from the choice that competition provides but also from their capacity to be able to exercise that choice. This derives from the capabilities that companies can confer on us through education, training, income and security as well as product variety and affordability. This in turn comes from the capacity of organizations to be able to transform our individual self-interests into collective problem-solving benefits through forming complex and extensive social inter-relationships between us.

Is this a revolution, socialism or anti-capitalism? No, on the contrary, it is a return to the original conception of the corporation and how it has operated for nearly all of its 2000-year history. It is only over the last sixty years since the emergence of markets for corporate control that the idea of profit being the sole purpose of business has emerged, coinciding precisely with a period during which the dependence and impact of firms on assets other than their financial and material has intensified. It is this mismatch between the nature and needs of corporate governance that has been the source of growing inequality, environmental degradation and mistrust in business.

How can the problem be rectified? The answer is predominantly by business and institutional investors themselves. Business and investors can and are bringing about much of the change without requiring reform of law or regulation. These changes relate to the role of shareholders as owners and investors in firms, and boards as leaders and directors of companies. However, as noted above, there are limits to what they can achieve without the support of public policy.

Some of the most difficult companies and sectors, namely the so-called "sin stocks" of alcohol, gambling, tobacco, arms manufacturers and fossil fuel producers, illustrate the power of problem solving purposes, the amount that companies and investors can achieve themselves, and the limitations on them to do so without accompanying reforms to law, governance and accounting standards. Consider, for example, the case of a tobacco company that seeks to create a "smokeless world" by weaning consumers off addictive cigarettes to less palatable and therefore addictive substitutes until eventually they stop smoking altogether. It remains profitable until the point at which it has achieved its objective and then either recognizes it has fulfilled its purpose and ceases operations or identifies alternative ways of satisfying its consumers' demand for products that provide equivalent forms of enjoyment, relaxation and socializing.

However, its attempts to do this are undermined by less purposeful competitors who perpetuate smoking by luring consumers to their cigarettes and enhancing their profits in the process. It is only if the requirement to "not profit from producing problems for people or planet" is imposed on all firms that such conduct is discouraged, and its negative externalities are internalized, by requiring them to account for the costs of remedying the health problems they create and diminishing their distributable profits accordingly.

**Part Five – Conclusions**

The principles set out here are straightforward. Companies need a purpose, to be trustworthy in upholding it, and to have the values and culture to support it. They need the ownership, governance, measurement, management, finance and investment to commit and deliver it. The law should enable it and regulation require it where necessary.

Corporations are not currently fully coherent, consistent and complete. They lack conviction and authenticity. They are driven by self- rather than other regarding interest and as such can be exploitative not supportive entities. They need to be made whole through integrating their consequences and effects within their corporate forms. They should internalize the externalities they create through embodying them in their ownership, governance, measurement and incentives systems. They should not rely on others to do this for them but instead recognize integrity as a corporate design objective.

The consequences are profound. Instead of being perceived as exploitative and manipulative entities promoting their own financial interests at the expense of others, they become organizations that exist to solve our problems and reward their founders and investors commensurately. They address inequality, environmental degradation and future of work issues. They ensure social benefits of technology and avoid its detriments. They enhance our capabilities to achieve our purposes by providing us with the goods, services, livelihoods and resources that allow us to do so. They bring meaning and fulfilment, dignity and pride not drudgery and routine to our working lives.

Companies want to do this. Business leaders aspire to achieve it. Workers seek to contribute to it and investors to resource it. But the system we have created prevents us from realizing it. Rectifying the problem is a systems design issue to which there is a ready solution. This report has sought to identify the solution and demonstrate how in practice it can and should be implemented.