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Excerpt
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INTRODUCTION

There is one and only one social responsibility of business – to . . . increase its profits.

Milton Friedman, Nobel Laureate in Economics

We share a fundamental commitment to *all* of our stakeholders. We commit to delivering value to our customers . . . investing in our employees . . . dealing fairly and ethically with our suppliers . . . [and] supporting the communities in which we work.

Business Roundtable Statement on the Purpose of a Corporation

The most effective way to improve board performance is to increase the power of shareholders.

Lucian Bebchuk, Harvard Law School

Shareholder primacy was ill-conceived in the first place and has utterly failed to provide for the needs of all stakeholders.

Martin Lipton, Founding Partner of Wachtell, Lipton, Rosen & Katz

Since 1978, CEO compensation has risen 940%, while the average American has seen a raise of just 12%. It's wrong . . . It's time we reward work, not just wealth.

Joe Biden, 46th President of the USA

Air France will disappear if it does not make the necessary efforts to be competitive . . . I call on everyone to be responsible: crew, ground staff, and pilots who are asking for unjustified pay hikes.

Bruno Le Maire, French Economy Minister

Capitalism is in crisis.

The consensus among politicians, citizens and even executives themselves – on both sides of the political spectrum and throughout the world – is that business just isn't working for ordinary people.

The 2007 financial crisis cost 9 million Americans their jobs and 10 million their homes. Although the economy recovered, the gains largely went to bosses and shareholders, while worker wages stagnated. In 2019, the world's 22 richest men enjoyed more wealth than all the women in Africa. This inequality will only increase due to the coronavirus pandemic. While 100 million people are being plunged into extreme poverty, the wealth of tech billionaires is skyrocketing.

Corporations aren't just passive beneficiaries from global trends – they actively contribute to them. To squeeze out every last dollar of profit, many pay their employees as little as possible and work them to the bone, flouting health and safety regulations. Every day, 7,500 citizens around the world die from work-related diseases and accidents. A company's impact is so far-reaching that it can harm people who aren't even its customers or employees. In June 2020, US power supplier PG&E pled guilty to 84 manslaughter charges stemming from California wildfires caused by its faulty equipment.

The damage isn't just to people, but to the planet too. In 2010, the explosion of BP's Deepwater Horizon drilling rig saw 4.9 million barrels of oil spill into the sea, threatening eight US national parks, endangering 400 species and spoiling 1,000 miles of coastline. Five years later, Volkswagen admitted installing a 'defeat device' in its cars, which cheated emissions tests and contributed to 1,200 deaths in Europe alone. In May 2020, mining company Rio Tinto detonated Juukan Gorge in Australia, a sacred site for the indigenous Puutu Kunti Kurrama and Pinikura people, which had been continuously occupied by humans for 46,000 years. Over and above these individual cases, the environmental costs created by business are estimated at $4.7 trillion per year.

Citizens are fighting back. On 15 April 2019, the activist group Extinction Rebellion organised demonstrations in 80 cities across 33 countries, blockading roads, bridges and buildings in protest at climate change. Myriad other responses include Occupy movements, Brexit, the election of populist leaders, restrictions on trade and immigration and revolts on CEO pay. But while the precise reaction varies, the sentiment's the same. 'They' are benefiting at the expense of 'us'.

In turn, companies are responding – or at least are appearing to. Stakeholder capitalism – the idea that business should serve wider society – has become the corporate buzzword of the day. It was the theme of the 2020 World Economic Forum in Davos. In August 2019, the Business Roundtable, a group of influential US CEOs, radically redefined its statement of the 'purpose of a corporation' to include stakeholders, rather than just shareholders.

But it wasn't clear whether these leaders genuinely meant what they said. Critics argue that Davos is more about appearing to do good than actually doing good. Sceptics claim that the Business Roundtable statement was a public relations exercise to stave off regulation. Indeed, several signatories shed thousands of workers in the coronavirus pandemic, at the same time as paying huge dividends to investors.

So we have companies exploiting society, citizens fighting back and companies responding with alleged publicity stunts that dupe regulators, but allow the exploitation to continue. And this cycle has been going on for centuries. In the mid-19th century, Karl Marx wrote about the struggle between capital and labour. Since then, we've seen a pendulum swing back and forth between executives and shareholders on the one hand, and workers and customers on the other. Think of the late-19th-century robber barons who created giant monopolies such as Standard Oil; policymakers responded by breaking some up. Or the peak of trade unions in the 1970s, followed by legislation that caused their decline. Or the rise of big banks in the early 20th century, which culminated in the

1929 financial crisis and their regulation by the Glass-Steagall Act – itself partially reversed since the 1980s, contributing to another crisis in 2007. Unless we can come up with another way, this movie will keep on being replayed.

But the good news is that there is another way.

By applying a radically different approach to business, enterprises can create *both* profit for investors and value for society. So in the face of all these conflicts, this is a fundamentally optimistic book. Yet this optimism is not based on blind hope, but on rigorous evidence that this approach to business works – across industries and for all stakeholders – and an actionable framework to turn it into reality.

The heart of this new approach is a shift in thinking. Conflict arises from what this book calls the *pie-splitting mentality*. The value that a company creates is seen as a fixed pie. Then, the only way to get a larger slice of the pie for 'us' is to reduce the slice given to 'them': business is a zero-sum game. To maximise profits, a CEO takes from society by hiking prices or cutting wages. Conversely, to ensure that business works for society, we must crack down on profits.

While a fair split of the pie is important, reforming business can't just be about redistributing the pie, because doing so reduces profits. This leads to two problems. First, if reform makes their company less profitable, many CEOs won't pursue it voluntarily – they might sign statements, but not put them into practice. Pie-splitting then has to be forced on businesses through regulation, but regulation only leads to compliance, not commitment. A company can meet minimum wage laws without providing meaningful work or skills development.

Second, reducing profits is bad for shareholders. Many business critics don't care – investors are often portrayed as nameless, faceless capitalists. But investors are not 'them'; they are 'us'. They include parents saving for their children's education, pension schemes investing for their retirees and insurance companies funding future claims. And investors are needed to finance companies in the first place, which they'll only do if there's the prospect of a return. So any reform of business must deliver profits as well as social value.

That's what this book is about. The *pie-growing mentality* stresses that the pie is not fixed. By investing in stakeholders, a company doesn't reduce investors' slice of the pie – it grows the pie, ultimately benefiting investors. A company may improve working conditions out of genuine concern for its employees, yet these employees become more motivated and productive. A company may develop a new drug to alleviate a pandemic, without considering whether those affected are able to pay for it, yet end up successfully commercialising it. A company may reduce its emissions far beyond the level that would lead to a fine, due to its sense of responsibility to the environment, yet benefit because customers, employees and investors are attracted to a firm with such values.

Crucially, the pie represents social value, not profits – profits are only one slice of the pie. A pie-growing company's primary objective is social value, and it views profits as a by-product. Surprisingly, this approach typically ends up *more* profitable than if profits were the end goal. That's because it enables many investments to be made that end up delivering substantial long-term pay-offs. But since these pay-offs couldn't have been forecast from the outset, the projects would have never been approved if profits were the only criterion. A 'maximise shareholder value' rule is theoretically appealing, but practically unworkable, because it's very difficult to calculate – even roughly – how many important decisions will affect long-term profits. The power of the pie-growing mentality is that it replaces *calculations* with *principles*, providing practical guidance for decision-making under uncertainty.

Summing up, a responsible business *creates profits only through creating value for society*. This positive effect on profits addresses both of the above problems. It means that investors benefit as well as stakeholders. And it means that it's in a company's own interest to transform the way they do business and take very seriously their impact on society. In fact, it's urgent that they do. Serving society isn't a luxury or optional extra, but fundamental to an enterprise's long-term success.

That the pie can be grown means not only that purpose isn't at the expense of profit, as some executives and investors believe, but also that profit needn't be at the expense of purpose, as some business critics argue. The implications are profound. High profits – and even high CEO pay – aren't automatically a reason to 'name and shame' a company, if earned in the right way. Profits are often the by-product of taking some things and making them better, the root of human progress across the ages. Investors shouldn't always be suppressed; they're allies in reforming capitalism to a more purposeful and more sustainable form. Business and society aren't adversaries, but play for the same team. When all members of an organisation work together, bound by a common purpose and focused on the long term, they create shared value in a way that enlarges the slices of everyone – shareholders, workers, customers, suppliers, the environment, communities and taxpayers. So it needn't be a question of either-or – serving either investors or stakeholders. It's both-and.

This win-win thinking is the heart of this book. We'll start in Part I with the *why* – why businesses exist and why they should focus on creating social value, not just profit. It explains the pie-growing mentality and how it differs from not only pie-splitting, but also broader views of business such as 'enlightened shareholder value'. Part I also addresses potential objections to the pie-growing mentality and nuances in its implementation. Growing the pie doesn't mean ignoring profits, nor carefree investment with scant attention to the cost – it's focused and disciplined. Indeed, I'll provide a set of principles to guide whether to turn down a project and how to deal with uncomfortable trade-offs, which can be applied even in the face of uncertainty. Importantly, investors can assess whether a leader is following these principles, alleviating concerns that departing from shareholder value calculations makes her unaccountable. Principles combine the practicality of judgment with the accountability of calculation.

I then present evidence that generating profit as a result of serving society is not a too-good-to-be-true pipedream, but realistic and achievable. It *is* possible for investors and society to simultaneously benefit. So creating value for stakeholders isn't just a worthy ideal – it's good business sense. When I speak to practitioners on the importance of purpose, I'm introduced as a Professor of Finance and the audience thinks they've misheard. Finance folks are often the enemy of mission-led initiatives, believing they're simply a distraction from creating profits. This might be true in the short term, where trade-offs particularly bite. But the long-term evidence shows that any finance department with this mindset is failing at its job.

Part II discusses *what* grows the pie. It shows that many common reform proposals don't actually work, because they're based on splitting a fixed pie. We'll turn conventional views on some of the most controversial aspects of business on their head, by looking at them through a pie-growing rather than a pie-splitting lens. We'll see that executive pay, shareholder activism and share repurchases – often thought to serve CEOs and investors at the expense of stakeholders – can grow the pie for all. But the important word is 'can'. As currently practised, they're often failing to do so, and I'll discuss how to improve them.

Part III turns to the practical question of *how* to grow the pie. It highlights the power of purpose – an enterprise's reason for being and the role it plays in the world. Purpose answers the question 'How is the world a better place by your company being here?' But when the rubber hits the road and a CEO faces short-term profit targets, how can she put purpose into practice? This part highlights the ability and responsibility of companies, investors, regulators and citizens – individually and working together – to achieve this.

The pie-splitting mentality is widespread, and doesn't just apply to the relationship between business and society. The tale

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of Robin Hood, who robbed from the rich to give to the poor, is much more celebrated than the Elves and the Shoemaker, where the elves help the cobbler make shoes without taking from anyone else. We'll end in Part IV by discussing how the idea of pie-growing can be applied to wider contexts, such as interpersonal dynamics, serving others and personal leadership.

What underpins this shift in mentality? It's a careful study of the *evidence* for what drives long-term value creation within enterprise. This evidence-based approach contradicts common views on business. Some views are based on case studies or stories. Stories are vivid, bring a topic to life and get retold. So they've been used successfully in business schools, books and TED talks. But as explained in my own TED talk, 'What to Trust in a Post-Truth World', stories tell you little, because you can always hand-pick a story to support any viewpoint – and have the incentive to choose the most extreme one that makes the point most starkly. Supporters of an exclusive focus on profit might use the story of GE under Jack Welch to show it can succeed. Opponents might use the story of Enron to show it can fail. Indeed, both GE and Enron are major business school case studies, but neither story tells us whether running a company for profit works in general.

When I started my academic career as a green PhD student at MIT Sloan, the world was grey to me. I was lucky to attend a private school in London on financial aid, yet some of my comments were so left wing that my Economics teacher, the wonderfully named Mr Toy, would sing the Labour Party anthem 'The Red Flag' after I expressed them. Outside of school, I was First Division Young Football Journalist of the Year and wrote forcefully against the commercialisation of football and players' excessive wages, yet ended up working for investment bank Morgan Stanley after university. But the silver lining to my confusion was that I formed my views based on the strength of the evidence, rather than whether it supported a preconceived opinion. Doing so taught me that there are two sides to almost any debate and highlighted the importance of considering the whole pie together, not just one slice. It was through exploring the evidence that the idea of this book – growing the pie – was born.

In contrast to stories, evidence draws insights from thousands of companies, across dozens of industries, over decades. It tries to distinguish correlation from causation and address alternative explanations. Just as diagnosis precedes treatment in medicine, it's critical to accurately assess the problems with capitalism before proposing reform.

But there's substantial variation in the quality of evidence. One of the most dangerous phrases is 'research shows that . . .', because research can be hand-picked to show nearly anything you'd like it to show. In the UK House of Commons' 2016 inquiry into corporate governance, the witness before me quoted evidence which 'found that firm productivity is negatively correlated with pay disparity between top executive and lower level employees', referencing a January 2010 work-in-progress draft. The finished version had actually been published three years prior to the inquiry. Having gone through peer review and tightened its methodology, it found the opposite result:

- 'We do not find a negative relation between relative pay and employee productivity.'
- 'We find that firm value and operating performance both increase with relative pay.'

The danger of hand-picking studies is especially severe given confirmation bias – the temptation to accept any evidence that supports your pre-existing view on business, regardless of its quality. So an evidence-based view gleans particularly from studies published in the most stringent peer-reviewed journals. These journals reject up to 95% of papers, such is the toughness of their standards. The above example shows that the rigour of a study isn't just an 'academic' issue, but can fully reverse its implications for real-world practice.

The evidence in this book will uncover many surprising results which contradict common myths about business, and suggest different solutions from those frequently advocated. We'll see how reducing the jaw-dropping levels of CEO salaries isn't actually the most effective way to reform pay to benefit society. We'll understand how an investor selling his shares in the short term can encourage businesses to act more long term. We'll learn how a company using cash to buy back shares rather than investing it may create long-run value, not just for its shareholders, but also the economy as a whole.

Now an evidence-based approach doesn't mean that there's only one right answer. Even if we agree on the facts, different people might have different opinions on those facts. Even if high pay ratios are linked to better productivity, some citizens may view them as undesirable because they see inequality as more important than productivity. The role of evidence is to put the facts on the table so that policymakers, practitioners and voters can make informed decisions, fully aware of any trade-offs. So I expect you to disagree with some of my stances. In fact, I hope you'll disagree, because I'd like this book to provide fresh – and potentially controversial – perspectives, rather than being an echo chamber that simply reinforces what you already think.

Critically, I'll present evidence *against* the book's key propositions – thus exploring the interesting, complex and nuanced shades of grey in issues often portrayed as black and white. I'll acknowledge that the average responsible investing fund underperforms, and how 'sin' industries such as tobacco and alcohol have been highly profitable. I'll take seriously common concerns about responsible business and arguments for shareholder value maximisation, and recognise that the latter is far more nuanced than commonly caricatured. I'll stress that, even in the long run, there are externalities that affect society, but don't feed back into a company's profits.

This balance is critical. The World Economic Forum's 2020 report on 'Measuring Stakeholder Capitalism' claimed