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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

The public expectations of your company have never been greater. Society is demanding that companies . . . serve a social purpose.

Larry Fink, CEO of BlackRock

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

Lucian Bebchuk, Harvard Law School

Shareholder activists . . . are more like terrorists who manage through fear and strip the company of its underlying crucial assets . . . extracting cash out of everything that would otherwise generate long-term value.

Peter Georgescu, author

There's something wrong when the average American CEO makes 300 times more than the typical American worker.

Hillary Clinton, 2016 US Presidential Candidate

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. Even though the economy has recovered since then, the gains have largely gone to bosses and shareholders, while worker wages have stagnated. In 2018, just twenty-six tycoons owned the same wealth as the 3.8 billion poorest citizens in the world. Corporations impact not only people's livelihoods, but also their lives. In a single year, fourteen Chinese workers were allegedly driven to suicide by unbearable working practices at the Foxconn City industrial park, where they made electronics for US giants.

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 cut emissions by up to forty times when it detected a test was being conducted. As a result, citizens were exposed to far higher pollution than Volkswagen claimed, causing approximately 1,200 deaths in Europe alone. Over and above these individual cases, the environmental costs created by business are estimated at $4.7 trillion per year.

Citizens, and the politicians that represent them, are fighting back. On 15 April 2019, the activist group Extinction Rebellion organised demonstrations in eighty cities across thirty-three countries, blockading roads, bridges and buildings in protest at climate change. US Presidential Candidate Elizabeth Warren has pledged, if elected, to break up tech giants Facebook, Google and Amazon, and to impose a wealth tax on the elites. 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'.

Even though the conflict between business and society is now at a peak, it's been around for centuries. In the mid-nineteenth 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-nineteenth-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 twentieth 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 pie for 'us' is to reduce the slice given to 'them'. Business is seen as a zero-sum game. If a company serves society, this is at the expense of profits; if it pays its CEO more, this takes from worker wages. As a result, business and society are enemies. Some businesses view citizens as a sitting duck, to be exploited by hiking prices or cutting wages; some citizens seek to straitjacket business through regulation. When the pie is fixed, executives and policymakers face a dilemma: Should companies serve shareholders or society?

This book advocates a new approach: Companies can serve both. The *pie-growing mentality* stresses that the pie is not fixed. 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. Evidence suggests that visionary leaders can transform a company, growing the pie for the benefit of all. Engaged shareholders can intervene in a failing firm, growing the pie for the benefit of all. A motivated workforce can innovate from the bottom up, growing the pie for the benefit of all.

Crucially, the pie represents social value, not profits – profits are only one slice of the pie. Thus, under the pie-growing mentality, a company's primary objective is social value rather than profits. 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 under a traditional shareholder value framework.

This positive effect on profits is critical. While other advocates of business reform correctly stress the importance of serving society, they often encourage the pie-splitting mentality – viewing investors as the enemy and profits as extracting value. Yet without profits, shareholders wouldn't finance companies, companies couldn't finance investments and investments couldn't finance shareholders' needs (citizens' retirements, insurance companies' claims or pension funds' liabilities). Thus, ideas to reform business that ignore profits' crucial role in society are unlikely to be implemented – enterprises aren't charities. The positive effect on profits also means that it's in companies' own interests to transform the way they do business and take very seriously their impact on society. In fact, it's urgent that they do. Otherwise, the promised regulations will be passed, and customers and workers will switch to competitors whose values they share.

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 need not 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. Companies, investors and citizens aren't adversaries; they can play for the same team. Because it needn't be a question of either-or – serving either investors or society. It's both-and.

This win-win thinking is what the book is about. We'll start in Part I with the *why* – why businesses exist and why they should focus on creating social value rather than 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 an actionable framework to guide when to turn down a project and how to deal with uncomfortable trade-offs.

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I then present evidence that generating profit as a result of serving society is not a too-good-to-be-true pipe dream, 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 often thinks they've misheard. A company's finance department is frequently the enemy of mission-led initiatives, believing that 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 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 international trade, 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 quotes. But when giving a quote, you have the incentive to make it as one-sided as possible. To become famous for arguing that business needs to be reformed, you might portray companies as evil and call activists 'terrorists', like the Georgescu quote earlier. To become famous for supporting a profit focus, you might claim that extracting profits is the only socially responsible activity a business can do, like the Friedman quote earlier. An extreme quote reduces the need to back it up with evidence, by giving the impression that the point is so obvious that no proof is needed. And an extreme quote is more likely to be tweeted, shared and cited by others since it makes the strongest possible case. Because one-sided quotes advocate for only one slice of the pie – 'us', but not 'them' – they fuel the pie-splitting mentality.

Other views on business 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. 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.

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

Now 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. For example, in the UK House of Commons' 2016 inquiry into corporate governance, the witness before me quoted research 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 up 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 one's 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 for the benefit of society. We'll understand how an investor selling his shares in the short term can actually encourage businesses to act more for the 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. So I expect you to disagree with some of my stances in this book. 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. Even if we all agree on the price and characteristics of a range of cars, different people will buy different cars depending on how important they view price versus emissions, safety and performance. Similarly, even if high pay ratios are linked to better productivity, citizens might argue they're still 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 – just as accurate information on car characteristics allows customers to make informed purchasing decisions, even though they won't all make the same choice.

Critically, we'll present evidence *against* the book's key propositions. We'll acknowledge that the average socially responsible investing fund underperforms, and how 'sin' industries such as tobacco and alcohol have been highly profitable. We'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. We'll emphasise that, even in the long run, there are externalities that affect society, but don't feed back into a company's profits.

When I started my academic career as a green PhD student at MIT Sloan, I had no clear views. 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. I started the PhD not only confused, but also ignorant. My first week showed me how far behind my classmates I was academically, and caused me to hastily enrol in a remedial maths course.

The silver lining to knowing almost nothing 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 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 addition to balancing the need to serve both investors and society, this book will also balance academic and practitioner insights. As a professor at London Business School and Wharton, and as a PhD student at MIT, I've spent nearly two decades studying what catalyses and constrains long-term value creation by companies. The book will draw from not only my own studies, but also those by many other researchers, while employing the stringent standards for rigour I've learned while running a leading academic journal. Even though this vast body of knowledge contains many profound insights for practitioners, it often remains buried in academia. My goal is to share this collective wisdom with a wider audience. I hope to show that, even though the statistical tools that researchers use to nail a result may be complex, the insights themselves are simple.

These large-scale academic studies will be complemented by practical examples from forward-thinking companies and investors, across different industries and countries. And we'll learn from failures as well as successes. These examples are carefully selected to be representative of the large-scale evidence and bring it to life, so that no general conclusion is drawn from an individual case without it also being supported by the data.

I'll also glean from my experience working with and learning from directors, executives, investors, policymakers and stakeholders on embedding purpose into business. This experience has taught me the many practical obstacles in doing so. But these difficulties don't arise because the concepts themselves are difficult. In fact – just like the insights from academic research – they're surprisingly simple. Instead, complexity often has its roots in the pie-splitting mentality. The misguided belief that the sole purpose of business is to generate profits can lead to the need to justify every major investment by a giant spreadsheet calculating its profit impact. We'll see that a pie-growing approach to business is best implemented through judgment than calculation. Yet this judgment isn't arbitrary or a licence that anything goes, but one that's underpinned by rigorous principles.

Indeed, the combination of academic and practitioner insights aims to make the book not only rigorous, but also implementable. Many great academic ideas are truly 'academic' and difficult to put into practice. Serving society might seem a nice ideal, but too nebulous to implement compared to the frameworks currently used to maximise profits. This book shows that a pie-growing approach to business can be just as actionable, operational and concrete as one based on maximising profits – and ultimately lead to more profit in the long run.

By presenting this case for both purpose *and* profit, the intended audience is varied. It includes readers who view profit as important even if not the only goal, such as investors and executives, as well as those who emphasise the need to serve society, such as trade unions or stakeholder representatives. The ideas can be put into practice not only by senior executives, but also middle managers who can instill a social orientation into their teams, and employees who can spark ideas and manage upwards. It's also intended for readers outside business, who wish to learn both sides of the controversy surrounding business – the good and the bad – and understand the interesting, complex and nuanced shades of grey in issues often portrayed as black and white.

Before we start, a brief discussion on terminology. The words that are used to describe businesses can already convey a preconception that they don't or don't need to contribute to society.

- A writer suggesting that companies are exploitative monopolies may use the word *corporation*. We sometimes use the word *enterprise* to highlight how companies, both old and young, can grow the pie by being enterprising – come up with new products, services and ways to engage their employees.
- A company's managers are often referred to as *executives* who passively execute routine activities. It's little wonder that the public objects to CEO pay if millions are given to managers who simply execute. We sometimes use the word *leaders* to highlight how they can pursue new strategic directions and inspire their workforce.
- Executives receive *compensation*. They're assumed to have no intrinsic motivation to serve society by working hard; instead, they demand to be compensated for doing so. You get compensation for an injury, for something unpleasant. Leaders receive *reward*. Reward is earned for something intrinsically desirable, like finding a missing person.
- *Employees* suggest that workers are at the behest of the employer, employed as factors of production on a contractual basis. *Colleagues* are partners in the enterprise, contributing to its growth and sharing in its success.
- *Consumers* imply a one-time transaction: once you've consumed a good, it disappears. *Customers* provide an enterprise with their custom over the long term.
- *Shareholders* imply passive holding of an enterprise's stock. *Investors* highlight their responsibility to invest in the long-term success of a firm through active monitoring or engagement.

Enterprise, leaders, reward, colleagues, customers and investors. These words all emphasise the humanity of business and the relationships that underpin it, which we'll see are crucial in growing the pie to benefit all of society.