Are companies right to abandon the shareholder-first mantra?

Two experts debate the Business Roundtable's decision to rethink corporate purpose

Geoff Owen - AUGUST 27, 2019

No — Straying too far from focusing on profits would be a serious mistake The pronouncement by the Business Roundtable, a group that represents CEOs, that companies should downgrade the interests of shareholders in favour of employees, local communities and society at large reflects a significant shift in thinking, writes Geoffrey Owen. Not surprisingly, the statement was promptly criticised by the Council of Institutional Investors on the grounds that it "undercuts notions of managerial accountability to shareholders". But how has this shift come about? The business community is understandably concerned by the low esteem in which companies, especially big companies, are now held. This is in part a consequence of the 2008 financial crisis, which provoked justifiable anger at the behaviour of banks. But there is also a wider perception that many of the world's ills — rising inequality, stagnant or falling wages, and environmental pollution, among others — are due to the activities of profit-maximising corporations, and that these ills can only be corrected by radical changes in the way businesses are run. There are things that companies can do to improve their image. But in doing so they should be careful not to concede too much. They would do well to take note of remarks made some years ago by David Henderson, the late British economist. His critique of a growing enthusiasm for what was then called corporate social responsibility equally applies to today's view that companies should focus on "purpose" as well as profits. In Misguided Virtue, Henderson argued that the case for CSR rested on a mistaken view of how a market economy works. Advocates, he wrote, wrongly assumed there was a disjunction between profitability and the interests of society. If we want to measure the contribution that a business makes to the general welfare, there is an obvious solution. Henderson wrote that we should put a value on the benefits that arise from its operations, and then subtract the associated costs. In his view, "the benefits to people in general are indicated — not precisely measured but clearly indicated — by what they are prepared to pay for what it produces and sells — that is, by the revenues accruing to the business". The business's costs, meanwhile, can be defined as the value of what could have been produced if the resources that the business used had been deployed elsewhere. In this view, "profits are the difference between the two flows, revenues minus costs. Hence they are a prima facie measure of the good that a business is doing for people in general." When businesses concern themselves directly and predominantly with profits, they are not showing excessive regard for owners as distinct from stakeholders. Nor are they slighting other worthy objectives or allowing greed to govern its actions. Prioritising profits means focusing on the most obvious value to society. The idea that a company's main contribution to society comes from other aspects of its activities not directly related to profitability derives from a fundamental misunderstanding of what business does. Of course, this is not the whole story. There are various reasons why profits may be a dubious or unreliable measure of a company's contribution to the general welfare — distortions in the tax system, a lack of competition in the relevant market, lax regulation that allows businesses to offload some of their costs on to others. There are also situations in which companies should "do the right thing", even though there is no legal obligation to do so and the decision may lead to reduced profits. Companies should always behave responsibly, and should be seen to do so. But Henderson's arguments about profits are a useful corrective to some fashionable ideas about what companies are for. It would be a serious mistake to assume that the contribution that a business directly makes to the welfare of society is largely independent of its profitability. It is equally wrong to conclude that society has conferred on businesses certain privileges in return for which they must do good works that are not related to profitability.

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